

**DEPARTMENT OF CONSUMER AND REGULATORY AFFAIRS
INSURANCE ADMINISTRATION**

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In the Matter of: National Council X
 on Compensation Insurance 1992 X
 Rate Filing X
XXXXXXXXXXXXXXXXXXXXXXXXXXXX

Order 92-8A

BEFORE: Robert M. Willis, Superintendent of Insurance

INTRODUCTION

This hearing arises under the authority of the District of Columbia Insurance Administration pursuant to Section 35-1704 of the D.C. Code, 1981 Edition, (as amended), to review, investigate, and adjust insurance premium rates filed by insurance companies or licensed rating bureaus under Section 35-1703 of the D.C. Code, 1981 Edition, (as amended), and the District of Columbia Administrative Procedures, Section 1-1502 et. seq., of the D.C. Code, 1981 Edition (as amended).

The NCCI is a licensed insurance rating bureau pursuant to D.C. Code, Section 35-1706, 1981 Edition (as amended). As an insurance rating bureau, NCCI gathers statistics from all insurance companies writing workers compensation insurance in the District of Columbia. NCCI also periodically files rates or loss costs with the Insurance Administration on behalf of its member companies.

On December 31, 1991, NCCI filed with the Insurance Administration, its proposed rates, rules and loss costs for workers compensation insurance.

The NCCI filing consisted of two rate requests. The first filing requested a loss cost level change on voluntary market rates of +2.5 percent for industrial classifications and +3.8 percent for "F" classifications. The second filing requested an overall rate level increase in the residual market premium rates of +26.2 percent for industrial classifications and +24.7 percent for "F" classifications.

In prior rate filings it had been NCCI's procedure to submit for approval the full workers compensation premium rates to be used by insurance companies doing business in the District of Columbia in both the voluntary and the residual markets. As to the voluntary market, this 1992 filing is the first time NCCI has requested approval of only the loss cost component of the rate instead of the full premium rate.

NCCI adequately justified the increase in the loss cost component proposed in the voluntary filing. The Insurance Administration has not challenged any of the components submitted by NCCI in the voluntary market filing.

The residual market filing requested a substantial increase in the overall premium rates. The Insurance Administration has raised some questions about the components of this filing which constituted the basis of the March 19, 1992 hearing.

NCCI's rate making approach in determining the residual market rate level adequacy was to first combine voluntary and residual market data to determine an overall statewide need. The second step was to examine the residual and voluntary market experience over a longer period of time. (t.p. 52)

The cost per workers compensation case in the District of Columbia is higher compared to Maryland and Virginia. Also, indemnity costs are higher. (t.p. 23,24). One of the primary reasons is that the statutory benefits available to injured workers in the District is larger than those provided injured workers in Maryland and Virginia.

On March 6, 1991, the District of Columbia amended the Workers Compensation Act to generally increase the benefits available to injured workers. According to NCCI, the estimated affect of these changes is an increase in benefits of approximately +6.2. percent. (D.C. Law 8-198; t.p. 28-30).

On March 4, 1992, Mr. Clark Simcock, Manager of the Property and Casualty Division of the Insurance Administration, notified Ms. Marie R. Kinietz, Director of the National Council on Compensation Insurance (NCCI) that a review and investigation of NCCI's December 31, 1991 program and rate filing had been conducted. Mr. Simcock further stated his intention to recommend that the Superintendent of Insurance order an adjustment to the 1992 program and filed rates, on the basis that the proposed rates, rules and loss cost had not been shown to comply with Section 35-1703(b) and (c) of the District of Columbia Code. The recommended adjustments would have required the previously approved NCCI rates to remain in effect.

In response to Mr. Simcock's letter, NCCI requested a hearing. On March 19, 1992, I, Robert M. Willis, the Superintendent of Insurance, conducted a public hearing of this matter.

DEFINITIONS

In this Order the following terms shall have the meaning indicated unless a different context requires otherwise:

- (1) "Rate" means rate, rule, loss cost, or premium charge.
- (2) "ARAP" means the Assigned Risk Adjustment Program.
- (3) "ARRP" means the Assigned Risk Retrospective Program.

- (4) "NCCI" means the National Council on Compensation Insurance.
- (5) "t.p. Number X" means Page number X in the official transcript of the March 19, 1992 hearing.
- (6) "The 1990 Management Summary" means the 1990 Management Summary - The Workers Compensation Reinsurance Pools".
- (7) "IEE" means the Insurance Expense Exhibit, a financial exhibit required of all insurance companies, updated annually.
- (8) "NAIC" means the National Association of Insurance Commissioners, a voluntary association of 55 insurance commissioners which performs independent evaluations of insurance company's data, among other activities.
- (9) "DOL" means the U.S. Department of Labor.
- (10) "DOES" means the District of Columbia Employment Services.
- (11) "Voluntary Market" means those insurance companies who voluntarily choose to write workers compensation insurance for employers who meet specific underwriting guidelines and criteria.
- (12) "Residual Market or Assigned Risk Market" means the market available to those employers who seek workers compensation insurance but are unable to find coverage through the voluntary market. Both terms are interchangeably in this opinion.
- (13) "Servicing Carriers" means the seven insurance carriers who service the residual market by collecting the premiums and paying the claims. For those service, these carriers are paid a "servicing carrier allowance".
- (14) "Experience Rating Plan" is a workers compensation insurance market pricing mechanism which emphasizes the frequency of claims.
- (15) "Revised Experience Rating Plan" means the plan approved by the Insurance Administration in December 1991 and scheduled to go into effect in August, 1992.
- (16) "R.F." means NCCI's 1992 rate filing.
- (17) "App" means Appendix.

FINDINGS OF FACTS

After due consideration of the documents comprising the official record, the evidence and testimony presented at the public hearing, the following Findings of Fact are made:

BACKGROUND AND GENERAL CONSIDERATIONS

- The NCCI is a licensed insurance rating bureau pursuant to D.C. Code, Section 35-1706, 1981 Edition (as amended). As an insurance rating bureau, NCCI gathers statistics from all insurance companies writing workers compensation insurance in the District of Columbia. NCCI also periodically files rates or loss costs with the Insurance Administration on behalf of its member companies.
- On December 31, 1991, NCCI filed with the Insurance Administration, its proposed rates, rules and loss costs for workers compensation insurance.
- The NCCI filing consisted of two rate requests. The first filing requested a loss cost level change on voluntary market rates of +2.5 percent for industrial classifications and +3.8 percent for "F" classifications. The second filing requested an overall rate level increase in the residual market premium rates of +26.2 percent for industrial classifications and +24.7 percent for "F" classifications.
- In prior rate filings it had been NCCI's procedure to submit for approval the full workers compensation premium rates to be used by insurance companies doing business in the District of Columbia in both the voluntary and the residual markets. As to the voluntary market, this 1992 filing is the first time NCCI has requested approval of only the loss cost component of the rate instead of the full premium rate.
- NCCI adequately justified the increase in the loss cost component proposed in the voluntary filing. The Insurance Administration has not challenged any of the components submitted by NCCI in the voluntary market filing.
- The residual market filing requested a substantial increase in the overall premium rates. The Insurance Administration has raised some questions about the components of this filing which constituted the basis of this hearing.
- NCCI's rate making approach in determining the residual market rate level adequacy was to first combine voluntary and residual market data to determine an overall statewide need. The second step was to examine the residual and voluntary market experience over a longer period of time. (t.p. 52)

- The cost per workers compensation case in the District of Columbia is higher compared to Maryland and Virginia. Also, indemnity costs are higher. (t.p. 23,24). One of the primary reasons is that the statutory benefits available to injured workers in the District is larger than those provided injured workers in Maryland and Virginia.
- On March 6, 1991, the District of Columbia amended the Workers Compensation Act to generally increase the benefits available to injured workers. According to NCCI, the estimated affect of these changes is an increase in benefits of approximately +6.2. percent. (D.C. Law 8-198; t.p. 28-30).

RESIDUAL VS. VOLUNTARY MARKET DIFFERENTIAL

- The indicated residual market differential measures the degree of adequacy of the residual market rate level versus the voluntary market rate level. According to NCCI, the average indicated differential for the years 1985 to 1989 was 65.5 percent. Accepting and applying this measure, residual market rates level would have to be 65.5 percent above the voluntary market rate level in order to be fully self-supporting. (R.F. App., C-VIII).
- The actual differential is a percentage amount incorporated into the residual market rates to reduce the residual market loss ratios. The current actual differential is 12.0 percent. The NCCI filing proposes to increase the actual differential to 20.0 percent, which represents a +7.1 percent change: $1.20/1.12 = 1.071$. (id).
- According to Mr. Davis, NCCI's expert witness, it would be inappropriate to try to make fully stand-alone residual market rates because of the significant variations from year to year. The results would be wide fluctuations in the residual market rates. (t.p. 53).
- On a nationwide basis, the actual differential is usually lower than the indicated differential. The only clear exceptions are a few states whose laws require residual market losses be entirely adequate. Thus, to some extent, the voluntary market generally subsidizes the residual market. (t.p. 80).
- NCCI calculated the 65.5 percent average residual market differential by first developing the total statewide residual and voluntary market experience to ultimate. The next step was to develop residual market experience to ultimate based on quarterly submissions by the servicing carriers doing business in the District of Columbia. The final step was to develop the voluntary market experience by subtracting the residual market experience from the statewide combined experiences. (t.p. 86-87; R.F., App., A-VII)

- The loss ratios of the assigned risk market are volatile, whereas the loss ratios of the voluntary market are more stable. According to Mr. Davis, this is to be expected because the voluntary market represents a larger volume of insureds than the assigned risk market. (t.p. 88-90).
- According to the Tillinghast Report, the development of the indicated residual market differential would be more credible, if the relativity factors are obtained by developing voluntary market losses, and then, deriving ultimate residual market losses and pure premium by subtraction. Mr. Davis agreed that this would be a reasonable approach. (Tillinghast, p.7; t.p. 95-97).
- According to the data presented by NCCI, there has been a consistent downward trend of the indicated differential in the District from 105 percent in 1985 to 37 percent in 1989. NCCI, apparently, did not consider or evaluate the basis for this downward trend. (R.F. App., A-VII; t.p. 99).
- In response to a data request, an exhibit originally submitted by NCCI indicating the residual market differential was recalculated using the method suggested in the Tillinghast Report. The results demonstrated an even more pronounced downward trend. (Data Request, Q #1).

<u>Policy Year</u>	<u>Original Indicated Differential</u>	<u>Recalculated Indicated Differential</u>
1985	2.056	1.983
1986	1.880	1.813
1987	1.838	1.624
1988	1.304	1.399
1989	<u>1.379</u>	<u>1.342</u>
Weighted Averages	1.655	1.599

- Prior to 1989, the actual residual market differential in the District was 1 percent. In 1989, 1990 and 1991 the actual differential was increased to 6.0 percent, 9.0 percent and 12.0 percent, respectively.
- The residual market in the District is very small, representing approximately 13 percent of the total market and could be materially impacted by the presence or absence of large losses. NCCI did not consider this fact when calculating the indicated differential (t.p. 260, 261).

ARAP

- **ARAP is a residual market pricing mechanism applied to employers eligible for experience rating. Both ARAP and the Experience Rating Plan are structured to be sensitive to the frequency of losses of an individual insured. However, the ARAP program goes beyond frequency and factors in the severity of total losses of an individual insured. (t.p. 56-57).**
- **The Experience Rating Plan is designed to improve equity within a class by tailoring an insured's final premium to actual past experience, and to provide an incentive for loss control which is absent in the manual rate. An experience modification factor is developed from the latest three years of claims experience. This factor is expressed in terms of 1.00 (unity). An employer with a factor of 1.00 pays the manual rate. Those employers with a factor of 1.10 pay 10 percent more than the manual rate. Employers with a factor of 0.95 pay 5 percent below the manual rate. (t.p. 118)**
- **According to Mr. Davis, after significant testing of countrywide data, the Experience Rating Plan approach produces rates which are adequate and not excessive and is an excellent means of predicting an insured's future loss experience. (t.p. 119)**
- **In December 1991, the Insurance Administration approved a major revision to the Experience Rating Plan, which goes into effect in August, 1992. The Revised Experience Rating Plan is intended to be more responsive to the experience of smaller employers and less responsive to larger employers. The potentially disparate affect of the revised plan was not considered in the NCCI filing.**
- **ARAP is an adjunct to the Experience Rating Plan. If an employer's experience modification factor is greater than 1.00, ARAP applies a surcharge to this factor. For instance, a factor of 1.10 might be surcharged to become 1.15. The ARAP surcharge is in addition to the increased manual premium the insured may be required to pay under the Experience Rating Plan. (t.p. 119-20).**
- **ARRP is a program which bases an insured's premium on the actual claims incurred, plus an administrative fee to cover the insurer's expenses.**
- **According to the Tillinghast Report to the Superintendent of Insurance, the combination of the ARRP and ARAP programs could result in an insured being surcharged twice for worse than average experience. The report noted "If ARAP is designed to compensate for a perceived lack of responsiveness in the Experience Rating Plan, we question why adjustments to the experience rating plan are not proposed in place of ARAP".**

- According to NCCI, ARAP was created in order to achieve the following purposes:
 1. Reduce the residual market differential;
 2. Reduce the residual market burden;
 3. Provide better loss control incentives; and
 4. Depopulate the residual market.

- NCCI did not introduce any evidence or data indicating that ARAP had achieved any of the four stated purposes. (t.p. 149-50).

- The 1990 Management Summary indicates that the size of the D.C. residual market in 1990 was 13.2 percent. This result is well below the multistate average of 24.1 percent. In fact, only four states had a smaller residual market percentage. (t.p. 18).

- The Management Summary also indicates that the District of Columbia residual market burden for the years 1985 to 1990 was one of the lowest in the country. There has been a consistent downward trend in the residual market from -4.6 percent in 1985 to -1.7 percent in 1990. (t.p. 21-25).

- The residual market burden is a function of the loss ratio in the residual market and the adequacy of rates. The residual market burden is but another measure of the relative adequacy of residual market rates.

- According to Mr. Davis, the overall adequacy of the workers compensation rates in the District has been fairly good. (t.p. 153).

- It has not been substantiated that surcharging premiums is necessarily an effective tool to provide better loss control incentives among employers, as intended by ARAP. Moreover, it is not necessarily true that all insureds in the residual market are there because of poor claims experience. Therefore, ARAP may not succeed in depopulating the residual market. (t.p. 146, 255).

- ARAP and the Experience Rating Plan approach only apply to employers with annual premiums over \$5,000. Employers with annual premiums of less than \$5,000 are not subject to either rating program. (t.p. 161).

- NCCI's data for the residual market, by size of insured, appears to indicate that insureds subject to ARAP have relatively better loss ratios than smaller insureds who constitute the majority of the assigned risk market and are not subject to ARAP. (t.ps. 141-145).

PRODUCTION AND GENERAL EXPENSES

- When calculating the overall rate level indication in the residual market, NCCI reviewed countrywide expense data from the IEE. This report does not separately show voluntary and residual market data. All data are shown on an aggregate basis.

A. Production Expenses

Production Expenses refer to the cost incurred as a commission to agents and/or as other acquisition expenses related to marketing.

The NCCI filing requests an amount of 15.0 percent for production expenses. This number is a budgetary provision only partly based on informed judgement. It does not consider the residual market alone, but includes the voluntary market as well. (t.p. 70).

The commission component of the production expense is generally higher than the other acquisition expense components. (t.p. 180).

The residual market commission schedule varies from 2.0 percent to 8.0 percent based on the premium amount. The average commission is approximately 4.0 percent. (t.p. 176-177).

According to Mr. Davis, the residual market has a lower fixed commission scale than the voluntary market. (t.p. 70).

The production expenses of the residual market filing do not recognize the 2.0 percent to 8.0 percent lower commission scale. (t.p. 178).

In the voluntary market the commission component is approximately 10.0 percent. Therefore, the acquisition expense component is approximately 5.0 percent. (t.p. 202).

NCCI proffered a study done by Milliman and Robertson, an actuarial consulting firm, finding that production expenses in the New Mexico residual market were higher than in the New Mexico voluntary market. However, no other evidence was presented to indicate whether this finding was unique to New Mexico, common nationwide or at all true in the District of Columbia. (t.p. 178).

B. General Expenses

The general expense component in the NCCI filing is 6.7 percent. General expenses include all expenses other than production expenses, taxes, and profits. This figure does not distinguish residual market cost data alone. Both residual and voluntary market data are combined. (t.p. 184).

NCCI noted that some expenses are unique to the residual market, such as safety issues, loss controls and fraud units. However, NCCI did not provide any data to substantiate the amount or size of these expenses or demonstrate that these unique expenses were incurred in the District's residual market. (t.p. 185).

VI. SWING LIMITS

- NCCI calculates an overall rate level change and then allocates the change to individual classifications of employers. As fully as possible, classification changes consider the actual experience of the individual classification in the District of Columbia. NCCI follows a procedure of capping the classification rate changes within a maximum and minimum swing limit to lessen the effect of unusually large changes. The NCCI approach adds and subtracts 25.0 percent to the voluntary overall rate level change and makes several other adjustments when calculating the maximum and minimum swing limits.
- According to NCCI's facsimile transmission received on April 10, 1992, these swing limits are:

	<u>Minimum</u>	<u>Maximum</u>
Voluntary Market	-22.5%	+27.5%
Residual Market	-13.5%	+42.3%

- The consistent practice of the Insurance Administration has been to apply a cap of +15.0 percent to the maximum swing limit. No cap has been applied to the minimum swing limit. In this filing, the Insurance Administration's practice would result in the following limits:

	<u>Minimum</u>	<u>Maximum</u>
Voluntary Market	No cap	+18.8%
Residual Market	No cap	+24.3%

- NCCI's use of a 25.0 percent factor to develop maximum and minimum swing limits is an arbitrary number. The intent of the Insurance Administration's cap on the maximum swing limit is to reduce the effect of an unusually large rate changes while permitting the full benefit of good claims experience.

VII. DOL SPECIAL ASSESSMENT

- Prior to July 26, 1982, injured workers in the District of Columbia were covered by the Longshore and Harbor Workers

Compensation Act (LHWCA), which is administered by the U.S. Department of Labor's Employment Standards Administration (DOL). Individuals injured during the course of employment or who contracted an occupational disease related to employment are entitled to receive medical benefits, compensation for lost wages and rehabilitation services. Survivor benefits were also provided, if the work-related injury caused the employee's death. (t.p. 22).

- On July 26, 1982, the District of Columbia adopted its own Workers Compensation Act. However, workers injured prior to that date continued to receive benefits under LHWCA. The DOL continues to maintain legal responsibility for all claims occurring prior to July 26, 1982. (Memorandum dated March 25, 1992 by Luis Perez).
- LHWCA benefits were paid directly by authorized self-insured employers, through an authorized insurance carrier or in particular circumstances, by a Special Fund administered by DOL. (Id).
- The DOL Special Fund was established for the primary purpose of equitably distributing among all employers the liabilities associated with second injury claims. The Special Fund covered all private employees working in the District who incurred a work-related injury based upon an employment event occurring prior to July 26, 1982. (Id).
- Proceeds of the Special Funds are used for payments under Section 8(f) for second injury claims; Section 10(h) for initial and subsequent annual adjustments in compensation for permanent total disability or death from injuries which occurred prior to the 1972 amendments; Sections 39(c) and 8(g) for the procurement of medical and vocational rehabilitation services for permanently disabled employees and to provide a maintenance allowance to workers undergoing rehabilitation; Section 18(b) for compensation to injured workers in cases of employer default; and, Section 7(e) for the cost of certain medical examinations.
- The Special Fund is primarily supported by revenues obtained through annual assessments of insurance carriers and self-insured employers. (t. p. 224).
- NCCI's ratemaking approach to the assessment was developed as a means of assuring that those carriers, in the aggregate, who were being assessed by DOL are able to recoup their costs. (Correspondence dated March 24, 1992 by Frank Cummings).
- NCCI established the Special Fund assessment as a percentage of premium included in the rates charged by all servicing carriers in the

residual market. This surcharge is applied regardless of whether a particular servicing carrier was doing business in the District prior to 1982, or whether a servicing carriers would be assessed on its voluntary business. NCCI also applies an assessment surcharge to the premium charged by voluntary market carriers, irrespective of whether a particular carrier was doing business in the District prior to 1982. (Id).

- After the District of Columbia adopted its workers compensation laws on July 26, 1982, insurance companies entering the District's insurance market used the NCCI ratemaking approach allowing all carriers to receive a loading for the Special Fund Assessment in rates for workers compensation in the voluntary and residual markets. However, in the hearing of this matter, it was disclosed that not all carriers actually pay the DOL assessment. Some carriers receive the benefit by merely using NCCI's rate without actually being assessed by DOL.
- According to the legal opinion submitted by Mr. Frank Cummings, there is no law or regulation mandating that the NCCI surcharge be applied to servicing carriers not specifically assessed by DOL for the Special Fund. (Correspondence dated March 24, 1992, by Frank Cummings).
- Under the current NCCI cost recoupment approach, all insurers doing business in the District are reimbursed for the payment of DOL assessments through a premium surcharge loading and not in proportion to their actual share of the DOL assessment payment.
- The premiums generated by the residual market for DOL assessment payments are reimbursed to the servicing carriers only and not to all insurance carriers making DOL assessment payments. The servicing carriers receive, as a fee, a portion of these payments whether or not they are assessed by DOL.
- Servicing carriers collect premiums from the residual market and remit such payment to a pool. In addition, the servicing carriers pay claims and submit bills to the pool for reimbursement of the claims paid. Servicing carriers receive fees from the pool for these activities which include a percentage of the DOL assessment surcharge of the residual market premium.
- There was conflicting testimony as to the quality controls DOL uses in reviewing the active claim files. At the hearing, it was disclosed that NCCI does not perform any independent analysis of the data it receives from DOL to confirm some level of credibility. The assessment information is processed and placed in NCCI's rates without being tested. (t.p. 234).
- NCCI is proposing a change in premium level of +1.3 percent which increases the combined DOES and DOL assessment from the current 13.2 percent of losses to 14.5 percent. (t.p. 60).

- In 1990, DOL the assessment for the Special Fund was estimated at \$10.4 million to pay injured worker claims in 1991. (t.p. 61).
- It is important to note that disputed workers compensation claims may take years to resolve. However, according to DOL, the number of claimants are reducing. Assessments have decreased in the prior two years from \$12.9 million in 1989 to 11.3 million in 1990. (t.p. 62)
- Beginning in 1991, NCCI changed the methodology used to compute the Special Fund assessment from a pre-funding to a recoupment basis. Under the pre-funding approach, the assessment rate was calculated based on paid losses. This assessment rate was applied to the expected loss component of the rates for the upcoming policy year. By developing the ratio based on paid losses and applying that ratio to the incurred component in the rate, insurers collected an amount that should have been sufficient to cover all future assessments. Under this approach, these future assessments would have been paid to the D.C. Special Fund as losses were actually paid. Thus, companies collected a year in advance for future loss payments. (Tillinghast Report, p. 3).
- Under the proposed recoupment approach, insurers would collect an assessment in each year equal to losses paid during the previous year. A significant portion of the losses paid during a particular year relate to policies issued in prior years. (Id, p.4).
- The pure recoupment approach, as outlined by the NCCI filing, will result in collecting some level assessment twice on losses from prior policy years. (Id, p.4).

OTHER ISSUES

- The NCCI voluntary loss cost filing assumes approval of two offsets related to the assigned risk filing; First, the proposed increase in the residual market differential of 0.9 percent. Second; the reduction of 1.3 percent for the ARAP program. According to NCCI, if either of the residual market programs are not approved, these offsets should not apply to the voluntary market loss cost filing. (t.ps. 47-49).
- According to NCCI, if both residual market programs are not approved, the voluntary loss cost would increase 4.7 percent instead of 2.5 percent. (t.p.49).
- The NCCI residual market filing includes a proposed profit and contingencies provision of 2.5 percent. (R.F.).

- The Actuarial Operations Branch of NCCI issued a February 24, 1992 memorandum entitled, "Result of National Council's Semiannual Calendar Call for Worker's Compensation Experience", which includes data for the 12 months ending June 30, 1991, a more recent time period than shown in this filing. This report shows a net loss ratio for the District of Columbia of 57.6 percent, which is the lowest such ratio of all forty-two states/jurisdictions illustrated. A low net loss ratio indicates favorable claims experience and that premium levels are relatively adequate.

Based on the foregoing Findings of Fact, I make the following Conclusions of Law.

CONCLUSIONS OF LAW

I. Statutory Framework:

The statutory authority governing the formulation of rates, rules, and policy forms by Insurance Companies or Insurance Rating Organizations and the regulatory review of the proposed rates and rules for workers compensation insurance are Sections 35-1703 and 1704 of the D.C. Code, 1981 Edition, (as amended). The pertinent provisions of these Sections are as follows:

Section 35-1703:

(a) Rates for insurance within the scope of this chapter shall not be excessive, inadequate, or unfairly discriminatory.

(f)(1) Every classification plan fixed, established, and promulgated by the Superintendent shall be so structured as to produce rates or premium charges which are adequate, not excessive, and not unfairly discriminatory.

Section 35-1704:

(a) "On and after July 1, 1948, every company shall file with the Superintendent, either directly or through a licensed rating organization of which it is a member or subscriber ..., all rates and rating plans, rules and classifications which it uses or proposes to use in the District."

(b) Whenever it shall be made to appear to the Superintendent, either from his own information or from complaint of any party alleging to be aggrieved thereby, that there are reasonable grounds to believe that the rates on any or on all risks or classes of risks or kinds of insurance within the scope of this chapter are not in accordance with the terms of this chapter, it shall be his duty, and he shall have the full power and authority, to investigate the necessity for an adjustment of any or all such rates.

(c) After such an investigation of any such rates, the Superintendent shall, before ordering any appropriate adjustment thereof, hold a hearing upon not less than 10 days written notice specifying the matters to be considered at such hearing, to every company and rating organization which filed such rates, provided the Superintendent need not hold such hearing in the event he is advised by every such company and rating organization that they do not desire such hearing. If after such hearing the Superintendent determines that any or all such rates are excessive or inadequate, he shall order appropriate adjustment thereof. Pending such investigation and order of the Superintendent, rates shall be deemed to have been made in accordance with the terms of this chapter..."

(d) "In determining the necessity for an adjustment of rates, the Superintendent shall be bound by all of the provisions of Subsection 35-1703."

In accordance with the statutory framework noted above, insurance premium rates must be adequate, not excessive and not unfairly discriminatory. In *Geico vs Montgomery*, 465 A. 2d 813 (D.C. 1983), the court defined the burden to be met by the proponent of the rate increase. The court stated: "The insurer must bear the burden of demonstrating both the need and reasoning behind a rate increase request".

II. NCCI Rate Filings.

NCCI submitted two separate rate filings. The first filing requested a change in the loss cost component of the voluntary market rates of +2.5 percent for Industrial classifications and +3.8 percent for "F" classifications. This filing, as stated, was not challenged by the Insurance Administration.

The second filing requested an overall rate level increase in the residual market premium rates of +26.2 percent for industrial classifications and +24.7 percent for "F" classifications.

In terms of the components of the overall rate increase in the residual market rates, NCCI requested an increase in the residual market differential from the current 12 percent to 20 percent; the implementation of a new assigned risk adjustment program (ARAP); the approval of production and general expenses based on combined voluntary and residual market historical data without regard to the actual residual market expenses; an increase in swing limits from the current +15 percent to +25 percent on the upside and from unlimited to -25 percent on the downside; and the recoupment allocation in the residual market rates of assessments made by the Department of Labor for claims filed prior to July 26, 1982. Each of these components have been challenged by the Insurance Administration and will be considered individually in this opinion.

III. Increase in the Assigned Risk Differential from 12 to 20 Percent.

The Insurance Administration approves, as reasonable, NCCI's request to increase the actual assigned risk differential from 12 to 20 percent. However, the Insurance Administration strongly disagrees with NCCI's claim of a 65.5 percent indicated differential. The evidence in the record clearly demonstrates the indicated differential is much lower than asserted by NCCI.

According to an NCCI exhibit, the indicated residual market differential is 65.5 percent based on a five year average from 1985 to 1989 of the difference between the assigned risk and voluntary market loss ratios. (R.F., App., A-VII). While the exhibit indicates an average 65.5 percent differential, the results are questionable.

The Insurance Administration's examination of the same exhibit disclosed that there is a clear downward trend of the indicated differential from 105 percent in 1985 to 37 percent in 1989. NCCI did not provide any explanation for this trend or determine whether it is likely to continue. The consistency of this trend was further reinforced by another exhibit submitted later by NCCI. According to this recalculated exhibit, the indicated differential declined consistently from 98 percent in 1985 to 34 percent in 1989.

According to Mr. Davis, NCCI's actuarial expert, it would be inappropriate to establish fully stand-alone residual market rates because of the significant variations from year to year. The results would be wide fluctuations in the residual market rates. This is more evident in the District where the size of the residual market is small.

Therefore, the Insurance Administration's concludes that the current indicated residual market differential is substantially lower than 65.5 percent. The evidence in the record clearly demonstrates a downward trend in the indicated differential. On this basis, it is reasonable to assume the indicated differential will be lower than the indications for years 1988 and 1989. Allowance of the proposed 20 percent differential appears to be reasonable for this filing, but does not establish a precedent for future filings.

IV. ARAP.

For this filing, the Insurance Administration denies NCCI's request for the establishment of an Assigned Risk Adjustment Program. Based on the evidence submitted in the record, allowance of the ARAP approach would overlap the current Experience Rating Plan which has been demonstrated to be adequate and not excessive. Moreover, in light of the fact that the current Experience Rating Plan has been recently revised, it would be premature to initiate yet another new program without first testing the results of the revised plan. Finally, NCCI has not adequately demonstrated that ARAP is necessary in the District.

ARAP is an experience sensitive debit rating plan which results in a surcharge being applied to residual market insureds who generate poor loss experience. The ARAP program measures the same variables as the Experience Rating Plan. In combination, these plans could result in an insured being charged twice for worse than average experience. Therefore, there is potential overlap between the Experience Rating Plan and ARAP.

According to Mr. Davis, the Experience Rating Plan produces rates which are adequate and not excessive. He further stated that after a significant amount of testing countrywide, the Experience Rating Plan is the better predictor of an individual insured's future loss experience. Therefore, to the extent that a surcharge is applied in addition to the premium indicated by the experience modification factor, such additional premium is excessive without a clear demonstration that the Experience Rating Plan approach is not an adequate means to predict future losses. We concur with the Tillinghast opinion that, to the extent that ARAP is designed to compensate for a perceived lack of responsiveness in the Experience Rating Plan, NCCI should propose adjustments to the Experience Rating Plan instead of implementing ARAP.

Early this year, the Insurance Administration approved the Revised Experience Rating Plan submitted by NCCI. The revised plan will become effective in August, 1992. NCCI did not take into consideration the revised plan when submitting this filing. We believe that the approval of ARAP would be premature and inappropriate before testing and analyzing the affect of the Revised Experience Rating Plan.

Moreover, NCCI did not adequately demonstrate that ARAP is necessary in the District or that any of the intended objectives would be accomplished. According to NCCI, the ARAP Plan has four main objectives: 1- reduce the residual market burden; 2- provide better loss control objectives; 3- reduce the overall residual market differential; and 4- depopulate the residual market.

According to the evidence in the record, it appears ARAP is unnecessary in the District and that the stated objectives of the program would not be accomplished.

1. Reducing the residual market burden - the evidence on record established that the residual market burden in D.C. has consistently declined for the past five years. Presently, it is one of the lowest multistate experiences in the 1990 Management Summary.

2. Provide better loss control objectives - NCCI did not introduce sufficient evidence to demonstrate that the surcharge would be a deterrent to provide better loss control or that increasing premiums will necessarily provide better loss control incentives among employers. According to NCCI's own data, small employers, who comprise the largest share of the District's assigned risk market, have the worse loss experience. ARAP does not apply to these small employers.

3. Reduce the overall residual market differential - As stated in Section III of this opinion, the Insurance Administration approves the current differential from 12 to 20 percent, as adequate.

4. Depopulate the residual market - the District's residual market population is very stable and one of the lowest in the country. It is a small market which represents only 13 percent of the total market. The sole fact that the residual the market share increased by 3.2 percent in 1990 does not justify the implementation of a new remedial program without a clear demonstration of a need for corrective measures.

Finally, there was no evidence introduced to demonstrate that ARAP has been an effective tool in the jurisdictions in which it has been approved.

V. Production and General Expenses

The Insurance Administration approves the amount requested by NCCI for production and general residual market expenses. However, the Insurance Administration has some reservations about the manner in which these expenses were calculated and the potential for overstating actual residual market expenses.

NCCI used the nationwide combined data for voluntary and residual market expenses in calculating the total production and general expenses for the residual market only. The Insurance Administration believes that this methodology is not the most accurate measure because it allocates expenses that are not actually incurred in the residual market.

According to the evidence in the record, each market has its particular costs, but the expenses of each market can be substantially different. In general, the evidence strongly suggests the method used by NCCI may have overstated the expenses of the residual market. In future filings, NCCI must demonstrate a more precise allocation or show the actual expenses of the residual market.

VI. Swing limits.

NCCI's use of plus or minus 25 percent in the calculation of swing limits is its own historical practice. Nonetheless, it has been the consistent practice of the Insurance Administration to limit the maximum swing to 15 percent above the overall voluntary rate level change and no cap on the minimum swing.

The Insurance Administration's approach allows the benefit of good claims experience to be reflected in an insured's rate, while minimizing the effect of poor claims experience from unduly affecting an employer's classification. The Insurance Administration's procedure is particularly important since many District classifications do not have full credibility. Therefore, national claims experience is only useful to a greater or lesser degree.

The Insurance Administration concludes that it is reasonable to continue its consistent practice of no minimum swing and calculation of the maximum swing limit based on +15.0 percent.

VII. DOL Assessment

The Insurance Administration disallows the surcharge included in the residual market filing for DOL assessment payments. Based on the evidence in the record, there is no legal mandate requiring the NCCI approach. Moreover, the application of the NCCI recoupment approach, to distribute the liabilities associated with the second injury fund to compensate insurers for DOL assessment payments, produces rates which are excessive and unfairly discriminatory.

Prior to July 26, 1982, District of Columbia workers were insured for work related injuries under the LHWCA. At that time, premium rates were established which were determined to be adequate to pay for all future claims arising under such policies.

On July 26, 1982, the District of Columbia adopted a new workers compensation law. This new law was more restrictive in terms of benefits offered. DOL had always had a large backlog of unprocessed claims. After July 26, 1982, the number of claims filed with DOL may have escalated beyond what could reasonably have been projected at that time. This change of laws appears to have created an incentive to "discover" the cause of injury prior to July 26, 1982. The Insurance Administration recognizes that some insurers making DOL assessment payments may be bearing the load of this unexpected burden.

According to the evidence presented at the hearing, it has been NCCI rate making approach to allow insurers assessed by DOL for pre 1982 claims to recoup such losses. This recoupment has been implemented through a surcharge in the voluntary and residual market rates. However, it appears that some of these claims may correspond to payments which have already been accounted for through pre 1982 insurance premiums established to cover these risks. Based on NCCI's historical recoupment approach, the Insurance Administration concludes the rate surcharge applied by NCCI to the residual and voluntary market rates is inappropriate and produces rates which are excessive.

The record also discloses that the approach used by NCCI allows insurance carriers to recoup payments assessed by DOL in an unfairly discriminatory manner. Based on the evidence, we find there are three aspects of unfair discrimination as the NCCI approach is applied. First, the surcharge of rates allows insurance companies who are not assessed by DOL or paying any portion of the assessment to receive a windfall benefit through the use of NCCI's rate. The approach and results are unfairly discriminatory to those carriers who actually submit payments of these claims.

Second, the NCCI recoupment approach does not reimburse insurance carriers in proportion to the actual amounts being assessed by DOL. Insurance carriers are reimbursed through premium loading in accordance with their share of the market and not in accordance with their share of the pre 1982 losses upon which a DOL assessment is based.

Third, under the NCCI recoupment approach, a portion of the premium generated by the residual market rates attributed to the DOL assessment payments is reimbursed to the servicing carriers through the servicing fee. This practice is unfairly discriminatory to the insurance carriers in the voluntary market who are required to submit payments to DOL in the same proportions as the servicing carriers.

Finally, it was disclosed at the hearing that the quality control of claims is questionable. The lack of an active review of claim payments made by DOL may result in invalid awards.

The Insurance Administration understands that disallowance of NCCI's recoupment approach will require some adjustment in the manner in which NCCI clients will submit their rates. In order to meet the Insurance Administration's regulatory concerns, NCCI should submit a new plan for recouping the DOL assessment. However, the new plan must meet three criteria: only those carriers who pay the assessment should be permitted to recoup the DOL assessment; the only portion of an assessment which may be recouped is the amount exceeding any reserves previously established to pay claims related to the assessment; and only that portion of the assessment may be recouped which is not already being received in the servicing carrier allowance.

VIII. Other Issues.

NCCI has proposed a 2.5 profit and contingencies provision for the residual market. The Insurance Administration is not adjusting the profit provision assumed in this filing on the basis of reasonableness. However, we do not endorse the general concept of permitting a profit loading in the residual market. The Insurance Administration does not support this position and will exercise judgement in future filings to modify or eliminate the profit and contingency provision.

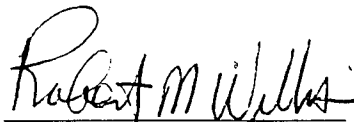
Finally, even though the voluntary market filing has been approved, NCCI effectively argued that the voluntary loss cost level change of that filing assumes two offsets related to the assigned risk filing. One of these assumptions is a reduction of 1.3 percent in the lost cost level change under the assumption that the ARAP program would be approved. Since we have not allowed the ARAP program, the additional 1.3 percent increase in the voluntary loss cost filing is approved.

ORDER

Based on the evidence presented at the March 19, 1992 public hearing, the documents contained in the official record of that proceeding and the above Findings of Fact and Conclusions of Law, it is the decision of the Superintendent of Insurance that:

1. The NCCI rates, loss costs, premium changes, as hereby approved, are adequate, not excessive, and not unfairly discriminatory.
2. The NCCI actual assigned risk differential is increased from 12 to 20 percent.
3. The NCCI proposal to establish an Assigned Risk Adjustment Program is denied.
4. The amounts as requested by NCCI for production and general expenses are hereby approved.
5. The NCCI voluntary and residual market swing limits are hereby adjusted to a maximum of 15 percent on top of the overall voluntary rate level change, with no cap on the minimum.
6. The NCCI surcharge included in the residual market filing for DOL assessment payments is hereby disallowed.
7. The NCCI profit provision of 2.5 percent is hereby approved.
8. The voluntary loss cost level change is increased from the requested 2.5 percent for Industrial classifications and 3.8 percent for "F" classifications to 3.8 percent for Industrial classifications and 5.6 percent for "F" classifications.

IN WITNESS WHERE OF, I have hereunto set my hand and affixed the seal of the Administration this 29th day of April, 1992.



Robert M. Willis
Superintendent of Insurance