

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
NCCI PROPOSED WORKERS COMPENSATION
ADVISORY LOSS COSTS
EFFECTIVE 8/1/17

Prepared for: State of Rhode Island and Providence Plantations
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I. BACKGROUND

On 11/18/16, the National Council on Compensation Insurance, Inc. (“NCCI”) filed for a revision to its Rhode Island workers compensation advisory loss costs to be effective 8/1/17. NCCI proposed an overall change in loss costs of -2.6% for the industrial classes and -1.1% for the Federal (“F”) classifications. For the U.S. Longshore and Harbor Workers (“USL&HW”) compensation percentage that adjusts for differences in benefits and loss-based expenses, NCCI proposed no change from the current percentage of 60%.

The Department of Business Regulation (“the Department”) has retained Milliman, Inc. (“Milliman”) to perform an independent actuarial review of the filing.

The Department of the Attorney General (“AG”) has also performed an independent actuarial review of the filing.

II. SUMMARY OF MILLIMAN FINDINGS

Table 1 summarizes the proposed changes of NCCI, Milliman, and the AG.

Table 1 Rhode Island NCCI Loss Cost Filing Summary of Proposed Changes by Party Effective 8/1/17			
	NCCI	Milliman	AG
Industrial Classes	-2.6%	-4.5%	-12.3%
"F" Classifications	-1.1%	-3.0%	-10.0%
USL&HW %	0.0%	0.0%	0.0%

The following is a summary of the major findings of Milliman's independent actuarial review of the filing.

- **Industrial Classes:** With the exception of the indemnity loss trend and LAE provision, we generally find NCCI's methodology to be within a range of reasonableness and its assumptions to be reasonably supported. Based on our review of the data and information presented in the filing, we recommend lowering the indemnity trend factor from -0.5% to -1.0%. We also recommend lowering the LAE provision from 18.9% to 18.4%. We estimate the overall revised indication to be -4.5% for the industrial classes. Please see Section VII for details.
- **"F" Classifications:** With the exception of the indemnity loss trend and LAE provision, we generally find NCCI's methodology to be within a range of reasonableness and its assumptions to be reasonably supported. We recommend the same changes as noted above for the industrial classes. We estimate the overall revised indication to be -3.0% for the "F" classifications.

- **USL&HW:** NCCI's methodology is reasonable and its assumptions are reasonably supported at this time.

III. SCOPE AND INTENDED PURPOSE

The Department has retained Milliman to review NCCI's Rhode Island loss cost filing, effective 8/1/17, including the underlying assumptions, actuarial methodology, and reasonableness of the selections.

IV. DISCLOSURES AND LIMITATIONS

A. Disclosures

1. Terminology

Case Reserves and IBNR Reserves. Total loss reserves consist of case reserves (claims administrator's estimates of future payments on individual reported claims) and incurred but not reported ("IBNR") reserves. As used in this report, the terms "IBNR reserves" and "unreported losses" refer to the difference between ultimate losses and case incurred losses as of the evaluation date. As such, they are a provision for unreported claims, changes in incurred values on open claims, and future payments on reopened claims.

Loss Adjustment Expenses ("LAE"). LAE are classified as allocated loss adjustment expenses ("ALAE") and unallocated loss adjustment expenses ("ULAE"). Generally, ALAE include claims settlement costs directly assigned to specific claims, such as legal fees, and ULAE includes other claims administration expenses. The National Association of Insurance Commissioners ("NAIC") categorizes LAE in the Annual Statement as DCCE and AOE. Generally, DCCE includes all defense and litigation-related expenses, whether internal or external to a company, while AOE includes all claims adjusting expenses, whether internal or external to a company.

2. Acknowledgment of Qualifications

John Herzfeld is a Principal of Milliman, a Fellow of the Casualty Actuarial Society, and a Member of the American Academy of Actuaries. Mary Ann McMahon is a Consulting Actuary of Milliman, a Fellow of the Casualty Actuarial Society, and a Member of the American Academy of Actuaries. John and Mary Ann each meet the qualification standards of the American Academy of Actuaries to provide the estimates in this report.

B. Limitations on Distribution and Use of Name

Milliman's work is prepared solely for the use and benefit of the Department in accordance with its statutory and regulatory requirements. Milliman recognizes that materials it delivers to the Department may become public records subject to disclosure to third parties, however, Milliman does not intend to benefit and assumes no duty or liability to any third parties who receive Milliman's work and may include disclaimer language on its work product so stating. To the extent that Milliman's work is not subject to disclosure under applicable public records laws, the Department agrees that it shall not disclose Milliman's work product to third parties without Milliman's prior written consent; provided, however, that the Department may distribute Milliman's work to (i) its professional service providers who are subject to a duty of confidentiality and who agree to not use Milliman's work product for any purpose other than to provide services to the Department, or (ii) any other applicable regulatory or governmental agency, as required.

Any reader of this report agrees not to use Milliman's name, trademarks or service marks, or to refer to Milliman directly or indirectly in any third party communication without Milliman's prior written consent for each such use or release, which consent shall be given in Milliman's sole discretion.

C. General Limitations

1. Reliance on Data

In performing this analysis, we relied on data and other information provided by NCCI and the AG. We have not audited or verified this data and information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete. In that event, the results of our analysis may not be suitable for the intended purpose.

We performed a limited review of the data used directly in our analysis for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

2. Uncertainty

Actuarial estimates are subject to uncertainty from various sources, including changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, and economic conditions.

In estimating the amount of loss cost change required, it is necessary to project future loss and LAE payments. Actual future losses and LAE will not develop exactly as projected and may, in fact, vary significantly from NCCI's projections. Further, the projections make no provision for future emergence of new classes or types of losses not sufficiently represented in NCCI's historical database or that are not yet quantifiable.

3. Variability of Results

NCCI's estimates are based on long term averages. Actual loss experience in any given year may differ from what is suggested by these averages.

V. SUMMARY OF NCCI FILING

A. Industrial Classes

Table 2 summarizes NCCI's proposed changes to its Rhode Island workers compensation advisory loss costs for the industrial classes to be effective 8/1/17.

Table 2 Rhode Island NCCI Loss Cost Filing Proposed Changes - Industrial Classes Effective 8/1/17	
<u>Component</u>	<u>Indication</u>
Change in Experience, Trend, and Benefits	-3.4%
<u>Change in Loss Adjustment Expenses</u>	<u>+0.8%</u>
Proposed Change in Loss Costs	-2.6%

NCCI proposed an overall change of -2.6% in loss costs of the industrial classes. This is derived from a change in experience, trend, and benefits of -3.4% and a change in the LAE provision of +0.8%.

B. "F" Classifications / USL&HW

Table 3 summarizes NCCI's proposed changes to its "F" classifications and the USL&HW percentage to be effective 8/1/17.

Table 3 Rhode Island NCCI Loss Cost Filing Proposed Changes - Other Effective 8/1/17	
<u>Component</u>	<u>Indication</u>
"F" Classifications	-1.1%
USL&HW %	0.0%

For the "F" classifications, NCCI proposed a loss cost change of -1.1%.

For USL&HW, NCCI proposed no change to the current 60% adjustment factor for differences in benefits and loss-based expenses.

C. Industry Group Loss Cost Level Changes

Table 4 below summarizes the distribution of the overall loss cost level change to each industry group as filed by NCCI. The overall change across all classes is designed to balance to the overall aggregate indication.

Table 4 Rhode Island NCCI Loss Cost Filing Proposed Changes - Industry Groups Effective 8/1/17	
<u>Industry Group</u>	<u>Average Change</u>
Manufacturing	-0.9%
Contracting	-7.0%
Office and Clerical	-5.2%
Goods and Services	-2.0%
<u>Miscellaneous</u>	<u>+0.7%</u>
Overall	-2.6%

D. Experience Rating Plan Split Point

In experience rating, the split point separates losses into primary and excess components. For the twenty years prior to 2013, the split point had been \$5,000. According to NCCI, experience indicates that the split point should be increased to \$15,000 and the experience rating plan becomes less responsive if the split point is not indexed for claims cost inflation. Any future changes in the split point will be based on countrywide severity changes.

NCCI increased the split point from \$5,000 to \$10,000 in the 2013 filing, to \$13,500 in the 2014 filing, and to \$16,000 in the 2016 filing. In the current filing, NCCI has increased the split point to \$16,500, which was based on the selected split point of \$15,000 and adjusted based on current countrywide severity changes. No party has contested these changes and we believe NCCI's implementation of incremental changes to the split point is reasonable.

VI. DISCUSSION OF ATTORNEY GENERAL RECOMMENDATIONS

In its review of the above filing, the AG disagrees with NCCI's proposed indication of -2.6% for the industrial classes and -1.1% for the "F" classes. Instead, the AG recommends alternative indications of -12.3% and -10.0%, respectively. The AG's recommendation is broken down into the following components:

A. Modification Factor

The AG disagrees with NCCI's selected average expected modification factor ("mod") of 0.963, and recommends a mod of 0.967. The AG argues that a lower selected mod will be proportional to a higher proposed change in loss costs, and "NCCI does not rely on any specific formula or methodology to determine Average Expected Mod. Instead, NCCI considers various data displayed in Filing Appendix A-I, Section J, and then makes a judgment selection." The AG then relies upon the judgment of its actuarial expert that the mod should not change from the prior filing. The estimated impact of the AG's proposed change would decrease the indication from -2.6% to -2.9% for the industrial classes. This assumes no change to any of NCCI's other assumptions.

NCCI counter argues that the average mod factor did change from the prior filing to the current one but it was not due to a judgmental selection. According to NCCI, "The average actual mod in each year may be different from the previous year for several reasons, including the use of a new year of experience in the mod calculations, the mix of intra- and interstate risks, and/or the distribution of experience rates versus non-rated risks. NCCI calculates the average mod factor using a weighted average of [these] three components."

NCCI provided a derivation of the average mod factor of 0.963 used in this year's filing and noted that (a) the intrastate mod of 0.960 was judgmentally selected and remains unchanged from last year, (b) the interstate mod is based on actual data and has

changed since last year, and (c) the actual percent of non-rated risks is based on actual data and has changed since last year. We agree with NCCI that the average mod factor may fluctuate each year based on the underlying data. We further note that NCCI's methodology has not changed since its prior filing. We do not believe that the AG has a convincing argument that NCCI is intentionally making unreasonable assumptions and is driving up the loss cost indications.

B. Medical Loss Development Factors

The AG finds NCCI's selected age-to-age paid medical loss development factors ("LDFs") to be reasonable but argues that the selected 19th-to-ultimate paid medical LDF of 1.035 is excessive and proposes a factor of 1.019. The AG recommends that NCCI adjust the medical tail factor by 50% to account for the impact of the 1992 reform on loss development. NCCI makes this adjustment for the indemnity tail factor and the AG believes that it is also necessary for medical losses. The AG further argues that NCCI's current approach to selecting the tail factors is based on historical data from insurers other than Beacon Mutual Insurance Company ("Beacon Mutual"). Since Beacon Mutual currently comprises the majority of the Rhode Island insurance market, the AG offers an alternative approach to calculating the tail factors. The estimated impact of this proposed change is a reduction in loss costs from -2.6% to -3.0%. This assumes no change to any of NCCI's other assumptions.

NCCI disagrees with the AG's argument that both indemnity and medical tail factors need to be adjusted by 50% to account for the impact of the 1992 reform on loss development. According to NCCI, "The reform did not include any provisions that would have been expected to directly affect medical costs, except for the implementation of a fee schedule." NCCI also states that the AG's analysis of alternative tail factors is based on inaccurate data triangles. Lastly, NCCI states that it relies on a long-term average to determine both indemnity and medical tail factors, and notes that Beacon

Mutual was created in 1992 and therefore has limited data available to contribute to the tail analysis.

We agree with NCCI that a 50% adjustment to the medical tail LDF is not necessary. The 1992 reform primarily impacted indemnity loss development. We further note that NCCI's methodology has not changed since its prior filing and we believe its methodology to be reasonable.

C. Trend Factors

In this year's filing, NCCI selected annual trend factors of -0.5% for indemnity and -0.5% for medical. The indemnity trend factor is the same as the selection in the prior filing, while the medical trend factor is 1.0% less (i.e., a decrease from +0.5% to -0.5%) than the factor selected in last year's filing. The AG argues that NCCI's selected annual indemnity and medical trend factors have no historical basis and are excessive. The AG proposes lower annual trend factors of -1.5% for indemnity and -2.5% for medical. The estimated impact of the AG's proposed change would decrease the indication from -2.6% to -8.6% for the industrial classes. This assumes no change to any of NCCI's other assumptions.

Indemnity Trend

Regarding the selected indemnity trend factor, the AG recommends:

- Using a frequency trend of -1.5%, as recommended by its actuarial expert, and
- Using a severity trend of 0.0%, as recommended by its actuarial expert, noting that the severity trends based on the latest 5, 6, 7, and 8 years of NCCI Financial Data are 0.0% or lower.

NCCI agrees that the -1.5% frequency trend is reasonable, but believes a positive severity trend is more appropriate. NCCI notes that the AG's indemnity trend selection is the lowest historical loss ratio trend, is based on the shortest reasonable trend length in Rhode Island, and could be considered biased low.

Medical Trend

Regarding the selected medical trend factor, the AG recommends:

- Using a frequency trend of -1.5%, as recommended for indemnity, and
- Using a severity trend of -1.0%, as recommended by its actuarial expert.

NCCI counter argues that its selected annual medical loss ratio trend is within the range of reasonable trends, while the AG's medical trend selection is the lowest historical loss ratio trend and could be considered biased low.

Please see Section VII for Milliman's detailed recommendation on the selected indemnity and medical trend selections.

D. Large Loss Methodology

The AG proposes to eliminate NCCI's large loss methodology, and catastrophe & terrorism provisions. As in prior filings, the AG argues that these provisions are excessive. The estimated impact of the AG's proposed change would decrease the indication from -2.6% to -5.2% for the industrial classes. This assumes no change to any of NCCI's other assumptions.

NCCI counter argues that the AG's arguments have been fully vetted in prior Rhode Island filings.

We agree with NCCI and believe that NCCI's large loss methodology and catastrophe & terrorism provisions are reasonable at this time.

E. "F" Classes

The AG recommends that the indicated change for the "F" classes be revised to reflect the alternative provisions as presented in items A through D for the industrial classes. The estimated impact of the AG's proposed changes would decrease the indication from -1.1% to -10.0% for the "F" classes.

NCCI's counter arguments presented against items A through D above for the industrial classes apply here.

Please see Section VII for Milliman's recommendations.

F. Summary

Combining the AG's recommendations above results in a proposed indication of -12.3% for the industrial classes and results in a proposed indication of -10.0% for the "F" classes. Please see the next section, Section VII. Milliman Analysis and Comments on NCCI Filing, for Milliman's recommendations.

VII. MILLIMAN ANALYSIS AND COMMENTS ON NCCI FILING

A. Loss Cost Level Indication

With respect to the treatment of individual large losses, NCCI used the same ratemaking methodology as was used in recent filings of limiting individual large losses to a certain loss threshold (about \$3.8 million in this year's filing). The actual excess incurred loss amount greater than this amount is removed and replaced with an expected excess loss amount. This methodology is intended to stabilize the loss cost indications. According to NCCI, in the experience period used in this year's filing, there were no claims that exceeded the threshold on a paid basis. On a paid plus case basis, there was one claim that exceeded the threshold with a total of approximately \$6.4 million of paid plus case losses above the threshold.

Using this ratemaking methodology, NCCI calculated an indication of the estimated loss cost needed for the prospective year based on the loss experience of policy years 2012, 2013, and 2014 evaluated as of 12/31/15. The proposed indication was based on the following loss development methodology: 100% weight to developed paid losses using LDFs based on the average of the latest five years excluding the highest and lowest years.

We asked NCCI to calculate alternative loss cost level indications based on the same methodology as described above for the treatment of large losses, but using alternative scenarios. These alternative indications are listed below and compared in Table 5. Please note that these alternative indications reflect the overall impact of the proposed change, including the LAE provision.

1. 100% weight to developed paid losses with LDFs based on the average of the latest five years (“Paid 5”)
2. 100% weight to developed paid losses with LDFs based on the average of the latest three years (“Paid 3”)
3. 100% weight to developed “paid plus case” losses with LDFs based on the average of the latest five years excluding the highest and lowest years (“Paid+Case 5 XHL”)
4. 100% weight to developed “paid plus case” losses with LDFs based on the average of the latest five years (“Paid+Case 5”)
5. 100% weight to developed “paid plus case” losses with LDFs based on the average of the latest three years (“Paid+Case 3”)
6. 50% weight to Paid 5 and 50% weight to Paid+Case 5
7. 50% weight to Paid 3 and 50% weight to Paid+Case 3
8. 50% weight to Paid 5 XHL and 50% weight to Paid+Case 5 XHL

Table 5		
Rhode Island NCCI Loss Cost Filing		
Industrial Classes		
Alternative Scenarios - Policy Year Basis		
<u>Scenario</u>	<u>Indication</u>	<u>Change</u>
Original	-2.6%	
Paid 5 Years	-1.4%	1.2%
Paid 3 Years	-1.4%	1.2%
Paid+Case 5 Years XHL	-11.8%	-9.2%
Paid+Case 5 Years	-11.4%	-8.8%
Paid+Case 3 Years	-11.7%	-9.1%
50% Paid and 50% Paid+Case 5 Years	-6.4%	-3.8%
50% Paid and 50% Paid+Case 3 Years	-6.6%	-4.0%
50% Paid and 50% Paid+Case 5 Years XHL	-7.2%	-4.6%

Table 5 summarizes NCCI’s original and alternative indications for the current filing. The table also shows the differential between the original and alternative indications.

NCCI's selected methodology (i.e., original indication) is in a similar range compared with the alternative indications. In other words, it is not an outlier, either high or low. In addition, NCCI's selected methodology is consistent with the approved methodology in last year's filing. Based on all of this information, we believe that NCCI's selected methodology is reasonable at this time.

We also asked NCCI to provide an alternative indication based on loss experience and premium for accident years 2013, 2014, and 2015, using the same loss development methodology used in the original filing. Table 6 summarizes this alternative indication. Please note that this alternative indication reflects the overall impact of the proposed change, including the LAE provision.

Table 6	
Rhode Island NCCI Loss Cost Filing	
Industrial Classes	
Alternative Scenarios - Accident Year Basis	
Accident Year	Indication
2013	0.0%
2014	-7.6%
2015	-0.6%
Total	-2.7%

In general, we believe that NCCI's selection based upon paid LDFs in the calculation of the loss cost indication is reasonable. Paid LDFs have been relied on for many years in Rhode Island and can be stable and reliable for workers compensation coverage, which typically makes periodic payments on claims.

Based on the data and information that we received from NCCI, we believe that NCCI's loss development methodology is reasonably supported.

B. Treatment of Large Losses

We believe that NCCI's ratemaking methodology with respect to the treatment of large losses is reasonable and appropriate for use in a small state like Rhode Island. It is a continuation of NCCI's program utilized in prior Rhode Island filings as well as similar to NCCI's program in other states. This methodology should help increase long-term stability in the loss cost level in Rhode Island. If one or more large losses occur in a policy year, it will not cause the loss cost level to increase as significantly in the years that follow. The large loss threshold is approximately \$3.8 million in this year's filing, compared to approximately \$3.6 million in the prior filing. The large loss threshold increases over time based on loss trend and development. We believe the current large loss threshold of approximately \$3.8 million is reasonable at this time.

C. Tail Factors

A "tail factor" is the final LDF that is applied to losses to develop them to an ultimate basis, and is selected for each of medical and indemnity losses. NCCI selects its tail factors based on historical loss information. NCCI's selected the following tail factors:

- Indemnity "paid plus case" of 1.005
- Indemnity paid of 1.013
- Medical "paid plus case" of 1.025
- Medical paid of 1.035

The indemnity "paid" tail factor is slightly higher than the prior filing, and all other tail factors are lower than the prior filing.

We asked NCCI to provide an alternative indication using the prior selected tail factors along with the other assumptions of the original filing. According to NCCI, the alternative indication in this scenario is -2.5%. Please note that these alternative indications reflect the overall impact of the proposed change, including the LAE provision.

Based on the data and information that we received from NCCI, we believe that both the medical and indemnity tail factors are reasonably supported.

D. Trend Factors

NCCI used trend factors to measure expected changes in benefit costs along with expected changes in wages. Trend was determined separately for indemnity and medical benefits. NCCI estimated that the indemnity portion of the total benefit costs would be 67% and the medical portion would be 33%.

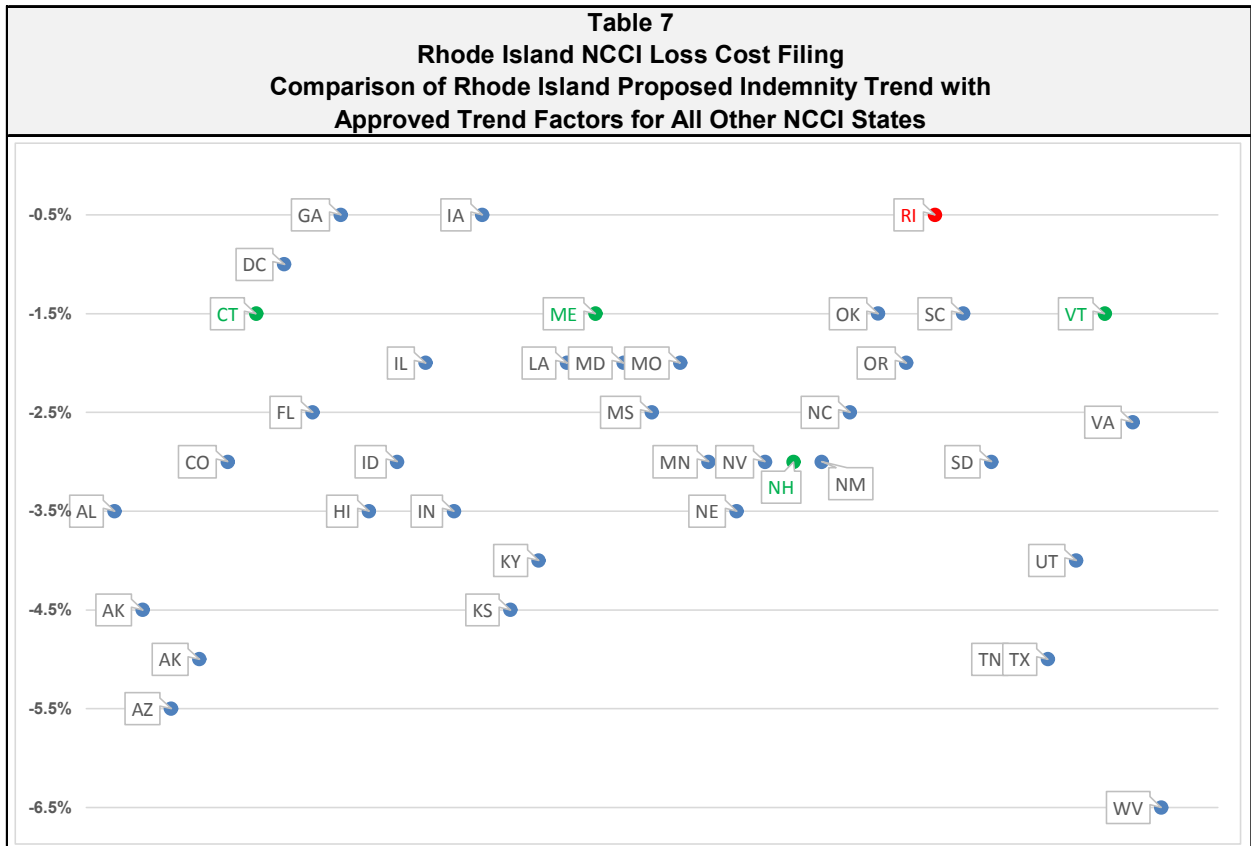
In the current filing, NCCI proposed no change to the indemnity trend factor of -0.5% and a decrease in the medical trend factor from +0.5% to -0.5%. NCCI's selections are based on an analysis of Rhode Island historical loss ratios as well as economic data.

For comparison purposes, we asked NCCI to calculate alternative overall indications for each of the following alternative scenarios: (a) -0.5% for the indemnity trend factor and +0.5% for the medical trend factor (i.e., no change to the currently approved trend selections); (b) 0.0% for the indemnity trend factor and -0.5% for the medical trend factor; and (c) -0.5% for the indemnity trend factor and 0.0% for the medical trend factor. The overall indications are -1.1% for scenario (a), -1.0% for scenario (b), and -1.8% for scenario (c). Please note that these alternative indications reflect the overall impact of the proposed change, including the LAE provision.

NCCI also provided the currently approved indemnity and medical trend factors in other NCCI states, and the exponential trend analyses that were reviewed for Rhode Island along with the goodness-of-fit statistics, or R-squared values.

Regarding NCCI's selected indemnity trend factor of -0.5%, we note that there are no filed and approved indemnity trend factors in any other state that are higher than -0.5% (see Table 7 below). The selected indemnity trend factors for the surrounding New

England states are -1.5% for CT, -1.5% for ME, -3.0% for NH, and -1.5% for VT. In addition, the countrywide unweighted average is -2.9%. Rhode Island has the highest indemnity trend factor at -0.5%. Both the AG and NCCI use goodness of fit statistics to support their selections, and they each present valid arguments. We believe that a small state like Rhode Island should not have an indemnity trend that is an outlier. We also believe that changes in the indemnity trend factor should be gradual. At this time, we believe that the data supports a small negative indemnity trend of -1.0%.



We reviewed similar data and information for the medical trend factor and we agree with NCCI's selection of -0.5%. The selected medical trend factors for the surrounding New England states are 0.0% for CT, -1.5% for ME, 0.0% for NH, and -0.5% for VT. In addition, the countrywide unweighted average is -1.2%. Rhode Island's selected medical trend factor of -0.5% is in line with that of the surrounding New England states

as well as the underlying data. We believe the AG's selected trend factor of -2.5% is too low at this time.

The estimated impact of this proposed change (i.e., an indemnity trend factor of -1.0% and a medical trend factor of -0.5%) would decrease the indication from -2.6% to -4.1% for the industrial classes and from -1.1% to -2.6% for the F classes. This assumes no changes to any of NCCI's other assumptions.

E. Loss Adjustment Expense Provision

NCCI is proposing an increase in the LAE provision from 17.9% to 18.9%, or an estimated impact of +0.8%.

NCCI's proposed LAE provision is determined in two steps:

1. Countrywide Provision

Using countrywide accident year data obtained from NCCI Call 19 for LAE, separate countrywide ratios for DCCE-to-loss and AOE-to-loss are developed to an ultimate basis based on selected development factors. NCCI selected separate loss, DCCE, and AOE development factors on both paid and incurred bases. NCCI selected a five year average for incurred loss, DCCE, and AOE development factors, which is consistent with its methodology used in the prior filing. According to NCCI, "longer-term averages are used because the incurred amounts include IBNR, which can be somewhat volatile." NCCI selected a two year average for paid DCCE, AOE, and LDFs, which is also consistent with its methodology used in the prior filing. According to NCCI, the reason for the shorter-term averages in its selection of paid factors is due to an observed historical decline in the estimated paid DCCE-to-loss ratios, which was generally attributable to a pattern of decreasing DCCE development factors and increasing LDFs.

After estimating separate ultimate DCCE-to-loss and AOE-to-loss ratios on both paid and incurred bases for each accident year, NCCI applied 50% weight to each of the paid and incurred methods. Finally, NCCI selected a three year average of the results as its selected ultimate DCCE-to-loss and AOE-to-loss ratios.

2. Rhode Island Provision

The countrywide DCCE ratio is converted to a state-specific DCCE ratio by comparing state-specific and countrywide calendar year paid DCCE-to-loss ratios and selecting a state relativity. The countrywide AOE ratio is added to the state-specific DCCE ratio to obtain the selected state-specific LAE allowance.

The selected Rhode Island DCCE relativity of 0.871 is based on a latest three-year average of Rhode Island-to-countrywide paid DCCE-to-loss ratios. We asked NCCI to provide the Rhode Island DCCE relativity based on a latest two-year average. According to NCCI, this relativity is 0.880, which would result in an indicated LAE provision of 19.0%.

Selecting the number of years to use for the average DCCE relativity involves a trade-off between responsiveness to new data and stability relative to the longer-term average. Based on our review of both the filing data and the supplemental information, we believe that the selected Rhode Island DCCE relativity, which is based on a latest three-year average, is reasonable at this time.

3. Recommendation

We recommend that the LAE provision be analyzed in each filing. We further recommend that the LAE provision remain relatively stable from one year to the next. There should not be large increases or decreases in the provision from one filing to the next. At this time, we believe an increase in the LAE provision from 17.9% to 18.9% is

too much of an increase in one year. We recommend a smaller increase from 17.9% to 18.4%, or an estimated impact of +0.4%.

The estimated impact of this proposed change would decrease the indication from -2.6% to -3.0% for the industrial classes, and from -1.1% to -1.5% for the “F” classes. This assumes no changes to any of NCCI’s other assumptions.

F. Summary

With respect to the following major areas of review, we believe that NCCI’s methodology in this year’s filing is reasonable at this time:

- weighting of standard actuarial loss development methodologies
- selection of LDFs
- treatment of large losses
- selection of medical trend factor

Please note that for convenience we use the term “reasonable” in this report as equivalent to our understanding of not excessive, inadequate or unfairly discriminatory as stated in Rhode Island law and regulations.

With respect to the following major areas of review, we recommend change to NCCI’s methodology:

- selection of indemnity trend factor
- selection of the LAE provision

As previously stated, we recommend that NCCI lower its selected indemnity trend factor from -0.5% to -1.0%. We also recommend that NCCI lower its LAE provision from 18.9% to 18.4%.

The estimated impact of these proposed changes would decrease the indication from -2.6% to -4.5% for the industrial classes, and from -1.1% to -3.0% for the “F” classes.

VIII. GLOSSARY OF INSURANCE TERMS

Adjusting and Other Expenses (“AOE”): the portion of loss adjustment expenses that covers all claims adjusting expenses, whether internal or external to an insurance company.

Case Reserves: claims administrator’s estimates of future payments on claims that have been reported to the insurance company for a particular period at a specific point in time.

Defense and Cost Containment Expenses (“DCCE”): the portion of loss adjustment expenses that covers all defense and litigation-related expenses, whether internal or external to an insurance company.

Incurred But Not Reported (“IBNR”) Reserves: the provision for unreported claims, changes in incurred values on open claims, and future payments on reopened claims.

Loss Adjustment Expenses (“LAE”): the sum of allocated loss adjustment expenses (“ALAE”) and unallocated loss adjustment expenses (“ULAE”); generally, ALAE includes claims settlement costs directly assigned to specific claims, such as legal fees, and ULAE includes other claims administration expenses.

Loss Cost: ultimate losses divided by payroll (in \$100 increments) and usually (but not always) includes LAE.

Loss Development Factors (“LDFs”): factors used to develop paid or “paid plus case” losses from their values at specific evaluation ages to their ultimate values; LDFs are estimated by reviewing historical experience.

Paid Losses: losses for a particular period that have been paid on all known claims.

“Paid Plus Case” Losses: the sum of all paid losses and case reserves for a particular period at a specific point in time; also called incurred losses or case incurred losses.

Premium On-Leveling: the process of estimating what historical premium levels would be, had the insurance been written today.

Tail Factor: a final LDF that is applied to losses to develop them to an ultimate basis, and is selected for each of medical and indemnity losses.

Trend Factors: factors used to adjust the losses and exposures for any underlying trends that are expected to produce changes over time (e.g., an indemnity trend factor accounts for expected growth in indemnity benefits as compared to wages, a medical trend factor accounts for expected growth in medical costs).

Ultimate Losses: the sum of paid losses, case reserves, and IBNR reserves for a particular period at a specific point in time; until all claims are closed, any calculation of ultimate losses is an estimate.