STATE OF TENNESSEE
DEPARTMENT OF COMMERCE AND INSURANCE
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JULIE MIX McPEAK
COMMISSIONER

July 9, 2012

Honorable David Lillard, Jr., Chair
Tennessee Workers' Compensation Advisory Council
Treasurer, State of Tennessee
State Capitol, First Floor
Nashville, TN 37243-0225

Dear Chairman Lillard:

Tenn. Code Ann. §50-6-402(d) requires that the Commissioner of Commerce and Insurance report to the Workers' Compensation Advisory Council regarding all workers' compensation filings made by the designated rate service organization and received by this Department.

Attached to this letter, please find a summary of all NCCI filings made in Tennessee for the period April 1, 2012 through June 30, 2012. This Department appreciates the role that the Workers' Compensation Advisory Council provides in the area of workers' compensation regulation.

Should you or any member have questions or comments concerning this report, please do not hesitate in contacting me or a member of my staff.

Sincerely,

Julie Mix McPeak

Julie Mix McPeak
Commissioner

JMM/ms

NCCI Filing Activity Report:

Summary as of June 30, 2012

<u>(includes filings received April 1, 2012 and later)</u>

1. **R-1404 2012 Update to Retrospective Rating Plan Parameters – Excess Loss Factors**

   Filed: May 8, 2012

   Effective Date: March 1, 2013 applicable to new voluntary policies only

   Status: Approved May 14, 2012

PURPOSE
This item updates the Excess Loss Factors in NCCI's 2009 Edition of the ***Retrospective Rating Plan Manual for Workers' Compensation and Employers Liability Insurance***.

BACKGROUND
Retrospective rating adjusts premium based upon losses occurring during the policy period.

An optional provision of the plan allows for individual losses to be capped -- referred to as an individual loss limitation – for the calculation of retrospective premium adjustments. A premium charge called the Excess Premium Factor (ELF) is made to compensate for the individual loss limitation.

There is a variation of ELFs depending on the loss limitation and the hazard group, reflecting the varying degrees of severity exposure to occupational hazards inherent to operations of each of the classifications. There are a couple of reasons that require the ELFs to be updated annually.

1. ELFs are developed from excess ratios. These ratios reflect the expected percentage of losses in excess of the loss limit. Since the limits are fixed, inflation increases the percentage of losses above such limit. Accordingly, excess ratios and ELFs are updated periodically in order to accurately reflect the impact of inflation on the losses.
2. Overall excess ratios are calculated on the basis of weighted averaging injury-type excess ratios. As such, excess ratios and ELFs must be updated periodically for changes in the injury type mix.

Proposed ELFs are based upon data underlying current approved NCCI loss costs, trending factors forward to the effective date of the next projected loss cost filing. Finally, filed ELFs were computed in the same manner as the currently approved ELFs.

PROPOSED

This filing proposed to update the ELFs that are used with the optional loss limitation in the Retrospective Rating Plan.

IMPACT

Proposed ELFs reflect the updated mix of injury types. NCCI does not anticipate these changes having any impact in the overall premium levels.

2. R-1405 -- 2012 Update to Retrospective Rating Plan Parameters – Expected Loss Ranges and State Hazard Group Differentials

Filed: June 1, 2012

Effective Date: January 1, 2013 applicable to new voluntary policies only

Status: Approved June 26, 2012

PURPOSE

The Table of Expected Loss Ranges and the Hazard Group Differentials (Appendix A), also referred to as Relativities, is being updated in the 2009 Edition of NCCI's **Retrospective Rating Plan Manual for Workers Compensation and Employers Liability Insurance (Retrospective Rating Plan Manual).**

BACKGROUND

Retrospective rating adjusts premium based upon losses occurring during the policy period, using the following formula: R = (b +cL) * T, where:

R	**=**	**Retrospective premium (subject to minimum and maximum amounts)**
b	=	Basic Premium
c	=	Loss conversion factor (as a general rule, reflects loss adjustment expense)
L	=	Actual incurred loss during the applicable policy period
T	=	Tax multiplier

Not until the policy expires and the losses are completely developed is the retrospective premium is known. The carrier's expenses are represented by the "basic charge". Included in the basic premium is the net insurance charge, resulting from the maximum and minimum limits on the retro premium. The net insurance charge compensates for the possibility that the retrospective premium will exceed the maximum premium. On the other hand, it reflects the savings resulting from the possibility that the retrospective premium will be below the minimum premium amount. The final insurance charge is developed from the difference between the "Maximum" premium charge and the savings from the minimum premium charge.

Expected Loss Ranges

The table of Insurance Charges (Table B) includes the excess ratios needed to quantify the insurance charge and savings described previously. The "entry ratio" or the ratio of the loss limit to expected losses is used to locate the values in the Table of Insurance Charges. In addition to the size of the insured, the charges depend on the maximum and minimum subject losses. This is due to the fact that the expected variation in losses is lower for larger employers.

According to NCCI:

> [a]s inflation increases claim size, there is an apparent growth in the size of the insured, measured in expected losses, but no real growth in the size of the insured, measured in the expected number of claims. To correct for the impact of loss size inflation, NCCI [proposed] that Appendix A—Table of Expected Loss Ranges be updated for the trend in average size of loss. The last time such an update was made was in 2011 (Item R-1403). The current Table of Expected Loss Ranges is based on a projected annual increase in average loss size of 5.5% from March 5, 2008 to January 1, 2013. NCCI has observed an actual annualized growth in average loss size of 7.7% from March 5, 2008 to March 22, 2009, and projects an annual growth in average loss size of 5.5% from March 22, 2009 to January 1, 2014. The new table incorporates both of these observed and projected changes in severity.[1]

Hazard Group Differentials

Actuarially, loss ratio variations for employers in the lower hazard groups generally should be smaller than the variation for employers in the higher hazard groups.

> The Hazard Group Differential factors adjust for this difference by placing lower hazard group employers in a higher Expected Loss Range and higher hazard group employers in a lower Expected Loss Range than would otherwise be the case. This adjustment affects the column selection in Appendix B—Table of Insurance Charges, which then impacts the basic premium portion of the retrospective policy premium. The Hazard Group Differentials should be updated regularly to reflect changes in the circumstances (e.g., state statutory benefit levels, inflation, etc.) underlying each state's severity.[2]

PROPOSED

The filing proposed that these changes to Appendix A—Table of Expected Loss Ranges and the Hazard Group Differentials/Relativities be effective at 12:01 a.m. on January 1, 2013, applicable to new and renewal voluntary policies only.

IMPACT

Expected Loss Ranges

Proposed changes to the Expected Loss Ranges are essential to maintain the aggregate expected balance between the guaranteed cost premiums and retrospectively rated premiums. If updates in the ranges were not made, there would be a normal slippage caused by claims inflation over time because risks would have an apparent growth in size

[1] Item R-1405 NCCI Filing Memorandum
[2] Item R-1405 NCCI Filing Memorandum

(due to increasing expected losses) but no actual growth in size as observed by their expected number of claims. The impact of this filing is expected to be revenue-neutral.