



STATE OF TENNESSEE
DEPARTMENT OF COMMERCE AND INSURANCE
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BILL HASLAM
GOVERNOR

JULIE MIX McPEAK
COMMISSIONER

September 26, 2012

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

Re: Assigned Risk Plan Loss Cost Multiplier

Dear Chairman Lillard:

In accordance with Tenn. Code Ann. § 50-6-402(c), please accept this letter as Notice to the Advisory Council of my intent to decrease the assigned risk plan loss cost multiplier (LCM) from 1.67 to 1.52 effective March 1, 2013.

In making this determination, I have considered the estimated cost of providing plan services and the level of multipliers in the voluntary market as provided for by Tenn. Code Ann. § 56-5-314(c)(6)(B). I have also reviewed both the financial condition of the plan as reported by the plan administrator, Aon Risk Services Central, Inc. ("Aon"), and the level of plan utilization compared to the voluntary market. The supporting rationale for decreasing the LCM is as follows:

- Aon recently published the enclosed actuarial forecast for the 2013 LCM. Aon actuaries' forecasted that the "baseline" LCM needed to be 1.57. A range of 1.52 to 1.61 was projected. Provisions for "adverse selection" previously included in LCM projections are no longer being accounted for, as will be explained below. The 1.57 is the targeted LCM based solely on carrier experience for plan years 2003 through 2009. The loss ratio has been leveled to 1.51, meaning that the actual LCM for each year was removed and replaced with a 1.51 LCM to eliminate the impact of fluctuating LCMs over time.

Year	Loss Ratio	Leveled LCM
2003	71.5%	1.51
2004	70.8%	1.51
2005	61.9%	1.51
2006	69.2%	1.51
2007	78.6%	1.51
2008	75.8%	1.51
2009	79.3%	1.51
Total	70.9%	1.51

- Plan premiums increased significantly in 2011, particularly near the end of the year. In the last quarter of 2011, for example, premiums rose 45% over the same period in 2010. In, the first six months of 2012, premiums were up 45% in the first quarter and 60% in the second, over comparable periods in 2011.

Year	Written Premium
1998	\$ 23,188,304
1999	\$ 20,441,815
2000	\$ 34,755,823
2001	\$ 68,615,355
2002	\$115,845,825
2003	\$131,882,587
2004	\$137,460,236
2005	\$115,340,080
2006	\$ 89,923,835
2007	\$ 62,780,728
2008	\$ 42,257,079
2009	\$ 34,525,193
2010	\$ 32,899,463
2011	\$ 39,140,180

- Based on discussions with Aon actuaries and an established premium trend, we believe that it is appropriate to discontinue factoring for adverse selection. Historically, when there has been a three year period where premiums were at their lowest, the plan has experienced adverse loss ratios. This is due to the fact that when the voluntary market selects the better business out of the plan, adverse experience occurs during the premium “trough”. We have clearly moved out of the low premium trough observed between 2009–2011.
- In order to maintain a significant differential between voluntary market pricing and the plan pricing, we modified the Tabular Surcharge program by reducing factors by 50% effective 9/1/12. After factoring for this change, the actuaries have adjusted the projected LCM need of 1.46 to 1.52, using the experience between 2003 and 2006. This period was chosen because it more closely represents the “high water mark” for premium writings during the seven year data

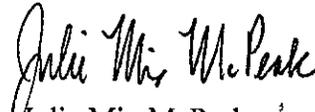
period. While we are not anticipating the premiums to peak in 2013, we do see the very significant growth trend continuing over the next few years.

- The weighted average LCM in the *voluntary* market saw a modest increase in 2012. The 1.52 projected assigned risk LCM is 13% above the *current* voluntary market weighted average LCM, at the low end of the range of historical differentials. Using 2011 premium data, 18% of the premium in the *voluntary* market has an LCM above a 1.52., compared to 7% at the current 1.67 LCM. If the market begins to firm up, as it should, and multipliers increase on average of three points, the difference would be 10%. Currently, there is a 24% variance between the assigned risk LCM and the weighted average voluntary LCM. Twelve point seven (12.7) percent is the historic 10 year low for the difference between the weighted average voluntary LCM and the assigned risk LCM. That was in a period in time when premiums were in a low ebb.

Year	Weighted Average Voluntary LCM
2004	1.49
2005	1.46
2006	1.43
2007	1.40
2008	1.37
2009	1.33
2010	1.34
2011	1.34
2012	1.35

This Notice satisfies the statutory responsibility of the Commissioner of Commerce and Insurance. The Advisory Council may, as you know, provide written comment and recommendation back to the Department related to this intended action within fifteen (15) days of receipt of this Notice. Should there be any questions, please feel free to contact Mike Shinnick at 741-0472.

Sincerely,


Julie Mix McPeak
Commissioner

JMM/mrs

Aon Risk Solutions
Global Risk Consulting
Actuarial and Analytics

Tennessee Workers Compensation Insurance Plan

Loss Cost Multiplier effective March 1, 2013

Workers Compensation

Data Evaluated as of March 31, 2012

Issue Date – August 15, 2012

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I. Introduction

Purpose

Aon Global Risk Consulting ("AGRC") has performed this analysis at the request of Tennessee Workers Compensation Insurance Plan (hereinafter "TWCIP"). The purpose of this report is to estimate the appropriate loss cost multiplier (LCM) effective March 1, 2013 for TWCIP. The LCM reflects two main considerations:

- A. The expenses of the Plan which are not provided for in the advisory loss costs
- B. The differential in loss costs for the residual market versus the voluntary market.

Our estimate of the LCM takes item B. into account via analysis of the historical loss and expense experience of the Plan.

Scope

The general scope of the analysis is an estimation of an appropriate LCM effective March 1, 2013.

The ultimate loss estimates presented in this report are actuarial central estimates (i.e., expected values over a range of reasonably possible outcomes).

This analysis is not an actuarial estimate of unpaid losses and cannot be used to estimate loss liabilities.

We have not considered catastrophic events in our estimates of the ultimate losses.

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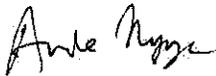
Andre Nguyen is a Fellow of the Casualty Actuarial Society, a member of the American Academy of Actuaries, and meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

We performed this analysis using generally accepted actuarial principles and in accordance with all relevant Actuarial Standards of Practice.

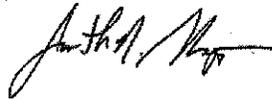
Please contact us if you have any questions regarding this report.

Respectfully submitted,

Aon Global Risk Consulting



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II. Conditions and Limitations

Inherent Uncertainty

Actuarial calculations produce estimates of inherently uncertain future contingent events. We believe that the estimates provided represent reasonable provisions based on the appropriate application of actuarial techniques to the available data. However, there is no guarantee that actual future payments will not differ from estimates included herein.

Extraordinary Future Emergence

Our projections make no provision for the extraordinary future emergence of losses or types of losses not sufficiently represented in the historical data or which are not yet quantifiable.

Data Reliance

In conducting this analysis, we relied upon the provided data without audit or independent verification; however, we reviewed it for reasonableness and consistency. Any inaccuracies in quantitative data or qualitative representations could have a significant effect on the results of our review and analysis.

Use and Distribution

Distribution by TWCIP is unrestricted. We recognize that this report may be distributed to auditors and appropriate governmental agencies. We request that Aon Global Risk Consulting be notified of further distribution of this report. The report should only be distributed in its entirety including all supporting exhibits. Use of this report is limited to TWCIP for the specific purpose described in the Introduction section. Other uses are prohibited without an executed release with Aon Global Risk Consulting.

III. Executive Summary

Summary of Results

We estimate a loss cost multiplier (LCM) of 1.57 based on a target expense ratio of 29.0% (see attached Exhibit 1). We derive the target expense ratio as the sum of the following:

1. 22.5% servicing carrier fee.
2. 3.4% provision for uncollected premium (derived in Exhibit 4).
3. 0.03% provision for federal income taxes (see Appendix - 1).
4. 3.1% provision for expenses (excluding servicing carrier fees and federal income taxes), based on 2005-2010 experience.

Note that we have not used the poor loss experience of the 2010 policy year to estimate the LCM because this policy year was very negatively impacted by the presence of a greater than \$5 million claim.

There is no provision for adverse deviation because of two reasons:

- 1) Premium for policy year 2013 is projected to be much higher than for policy years 2009-2011.
- 2) There exists TAIL Plan protection for accounts with over \$250,000 of standard premium.

Had we used the loss experience of the 2003-2010 policy years instead of the 2003-2009 policy years to estimate the LCM, we would have estimated an LCM of 1.61

Had we used the loss experience of the 2003-2006 policy years only instead of the 2003-2009 policy years to estimate the LCM, we would have estimated an LCM of 1.52

In summary, we estimate that low, midpoint, and high estimates of the LCM to be as follows:

Low: 1.52

Midpoint: 1.57

High: 1.61

Exhibit 1 shows, for policy years 1998-2010, various components of the provision for expenses as a percentage of written premiums. This exhibit also shows that an initial LCM of 1.51 is required to meet a 71.0% target loss ratio, based on the loss experience of the plan under direct assignment carriers and servicing carriers combined. Decreases in the Tabular surcharge equating to a 4% premium decrease will be implemented effective September 1, 2012. We derived a final LCM of 1.57 by dividing the initial LCM of 1.51 by (100%-4%) (i.e. an LCM of 1.57 combined with a 4% premium decrease is equivalent to an LCM of 1.51 without any premium decrease).

Exhibit 2 shows the plan's loss experience under direct assignment carriers for policy years 1998-2010.

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Exhibit 3 shows the ratios of uncollected premium to written premium for policy years 1998-2010 at various policy year ages. Based on these ratios, we estimate that the percentage of written premium that will ultimately remain uncollected will be 3.4% for policy year 2013.

Appendix – 1 details the derivation of the 0.0% provision for federal income taxes.

IV. Exhibits



TWCIP Loss & Expense Analysis

EXHIBIT I

3/31/2012

Evaluation Date:

Serviceing Carriers Only

Year	Expense	Revenue	Loss Ratio	Expense	Revenue	Loss Ratio	Expense	Revenue	Loss Ratio
1998	1,248,884	0	17,496,308	17,276,303	17,496,308	1.3%	16,371,000	16,371,000	93.6%
1999	394,286	0	12,092,779	11,923,397	12,092,779	1.4%	11,008,000	11,008,000	91.0%
2000	617,035	0	24,197,896	23,466,488	24,197,896	3.0%	21,377,000	21,377,000	88.3%
2001	902,175	438,922	40,687,333	39,708,004	40,687,333	2.4%	26,456,000	26,456,000	65.0%
2002	1,066,687	701,306	67,292,261	65,458,368	67,292,261	2.7%	44,405,000	44,405,000	66.0%
2003	1,788,794	3,311,009	77,443,809	73,783,368	77,443,809	4.7%	45,306,000	45,306,000	58.5%
2004	1,590,365	4,136,997	72,291,049	69,523,532	72,291,049	3.8%	39,340,000	39,340,000	54.4%
2005	1,511,954	6,200,000	60,404,276	57,849,567	60,404,276	4.2%	29,946,000	29,946,000	49.6%
2006	1,399,088	3,173,045	49,232,560	47,343,738	49,232,560	3.8%	22,905,000	22,905,000	46.5%
2007	944,286	13,878	29,311,381	28,935,051	29,311,381	1.3%	15,977,000	15,977,000	54.5%
2008	800,524	0	21,538,474	20,439,824	21,538,474	5.1%	12,314,000	12,314,000	57.2%
2009	951,073	1,450,009	21,621,664	20,607,846	21,621,664	4.7%	16,345,000	16,345,000	75.6%
2010	727,092	0	22,666,050	21,279,767	22,666,050	6.1%	23,791,000	23,791,000	105.9%
Total	13,742,243	19,445,148	516,275,840	497,386,277	516,275,840	3.4%	325,541,000	325,541,000	63.1%

Target Plan Loss Ratio = 108% - 29.0% = 71.0%

Implied TWCIP 2013 LCM needed to hit 71.0% target loss ratio: 1.51

Serviceing Carriers and Direct Assignment Carriers Combined

Year	Expense	Revenue	Loss Ratio	Expense	Revenue	Loss Ratio	Expense	Revenue	Loss Ratio
2003	132,416,305	1.51	117,616,836	84,055,000	63.5%	71.5%	1.70		
2004	133,662,975	1.51	108,518,611	73,272,000	54.8%	70.8%	1.95		
2005	114,834,237	1.51	88,922,922	55,056,000	47.9%	61.9%	1.95		
2006	89,991,623	1.51	73,432,622	50,815,000	56.5%	69.2%	1.85		
2007	62,662,018	1.51	55,658,616	43,744,000	69.8%	78.6%	1.70		
2008	42,192,184	1.51	39,086,011	29,643,000	70.3%	75.8%	1.63		
2009	34,247,400	1.51	31,580,243	26,617,000	77.7%	79.3%	1.54		
Total	511,855,861	363,202,900				71.0%			

Tabular Surcharge Premium Decrease 4.0%

Final Target 2013 LCM 1.57

2013 Servicing Fee 22.5%

2013 Projected Total Expense Ratio* 29.0%

* Expense ratio includes allowance for bad debt
 ** Uncollected Premium Ratio is from Exhibit 4
 *** Fed. Income Taxes, see Appendix I
 **** Expense Ratio Excluding Servicing Fees and Taxes are based on 2005 - 2010 values
 Adjusted Premium = Earned Premium * Initial Target 2013 LCM / LCM
 Adjusted Loss Ratio = Selected Ult Losses / Adjusted Premium
 2013 Servicing Fee is an estimate for Servicing Carriers. We assume the same fee for Direct Assignment Carriers.
 Final Target 2013 LCM = Target 2013 LCM * (1 + Tabular Surcharge Premium Decrease)



Exhibit 2

TWCIP Loss & Expense Analysis

Evaluation Date:

3/31/2012

**Direct Assignment Carriers
Chartis, Liberty Mutual, and Travelers Combined**

Plan Year**	Earned Premium	Written Premium	Selected Ut. Losses	Loss Ratio
1998	4,956,221	4,956,221	4,406,000	88.9%
1999	7,349,700	7,349,700	7,510,000	102.2%
2000	10,557,897	10,557,897	7,907,000	74.9%
2001	27,885,841	27,885,841	23,121,000	82.9%
2002	48,798,485	48,798,485	32,559,000	66.7%
2003	54,972,496	54,972,496	38,749,000	70.5%
2004	61,391,926	61,391,926	33,932,000	55.3%
2005	54,429,961	54,429,961	25,110,000	46.1%
2006	40,759,063	40,759,063	27,910,000	68.5%
2007	33,350,637	33,350,637	27,767,000	83.3%
2008	20,653,710	20,653,710	17,329,000	83.9%
2009	12,625,736	12,625,736	10,272,000	81.4%
2010	11,969,668	11,969,668	10,938,000	91.4%
Total	389,701,341	389,701,341	267,510,000	68.6%

* Includes only Travelers information for Plan Years 1998, 1999, and 2010.

