

# **Workers' Compensation Insurance Rating Bureau of California**

Report on Operational Examination  
To the California Department of Insurance

Rector & Associates, Inc.

August 10, 2011

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# WCIRB Report on Operational Examination

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Exhibit A: 2009 Recommendations Matrix

Exhibit B: Comprehensive List of Exam Recommendations

August 10, 2011

Honorable Dave Jones  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner Jones:

Pursuant to your instructions, Rector & Associates, Inc. ("R&A") performed a follow-up Operational Examination of the Workers' Compensation Insurance Rating Bureau of California ("WCIRB"), 525 Market Street, Suite 800, San Francisco, California 94105-2767.

## **I. INTRODUCTION**

In 2008, R&A was appointed as a Special Examiner to assist in an examination (the "2009 Examination") of the affairs of the WCIRB pursuant to California Insurance Code ("CIC") Sections 733 and 11752. The California Department of Insurance ("CDI") began the examination in response to the Commissioner's May 29, 2007 decision regarding the WCIRB's July 1, 2007 pure premium rate filing (File No. REG-2007-00015). Among other things, that decision highlighted concerns regarding the WCIRB's standards and procedures pertaining to data collection, the WCIRB's process for developing loss cost projections, and the system pursuant to which the WCIRB is governed.

On April 22, 2009, R&A submitted an Operational Report (the "2009 Report"), detailing its findings and recommendations. The 2009 Report found, among other things, that the effectiveness of the WCIRB's pure premium rate recommendations hinges on two key things—(1) the quality of the data received and used by the WCIRB, and (2) the actuarial projection of that data into pure premium rate indications—and that improvements were needed in both areas. Based on these findings, the 2009 Report made a total of fifteen (15) recommendations (the "2009 Recommendations").

In July, 2010, you requested that R&A perform a follow-up examination of the WCIRB. This Report contains our findings and recommendations with respect to the follow-up examination.

## **II. OBJECTIVES, SCOPE, AND APPROACH**

The objectives of the follow-up examination were (1) to provide information that will assist the CDI in determining whether the WCIRB has implemented the 2009 Recommendations and whether the WCIRB is properly carrying out its functions with respect to public access and the rate making process; and (2) to provide recommendations regarding further implementation of our 2009 Recommendations and how the WCIRB's policies and practices with respect to public access and the rate making process can be improved.

To accomplish those objectives, the scope of the follow-up examination consisted of a review and evaluation of the following three items:

1. The status of the WCIRB's implementation of the 2009 Recommendations;
2. The WCIRB's practices with respect to participation in committee meetings and public access to data it collects or produces; and
3. The role of the WCIRB in the rate making process and whether it is properly carrying out its function, particularly with regard to its pure premium rate filings.

### **Implementation of the 2009 Recommendations**

To assess the status of the WCIRB's implementation of the 2009 Recommendations, we performed various tasks, including:

- Reviewing the WCIRB's response letter to the 2009 Report, dated May 22, 2009;
- Reviewing the WCIRB's Preliminary Plan of Implementation dated June 18, 2010 and the WCIRB's October 27, 2009, December 17, 2009, and June 14, 2010 Implementation Plan Updates;
- Reviewing the WCIRB's January 1, 2010 and January 1, 2011 pure premium rate filings<sup>1</sup>;
- Reviewing the WCIRB's July 1, 2010 informational filing;
- Reviewing the WCIRB's implementation plan with respect to transactional level data;
- Reviewing changes to the WCIRB Program for the Submission of California Aggregate Data (SCAD);
- Reviewing the WCIRB's March 28, 2010 plan pertaining to enhancing communication between the WCIRB and SCIF;
- Reviewing selected Executive Committee and Actuarial Committee meeting minutes; and
- Interviewing WCIRB senior staff.

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<sup>1</sup> Throughout this Report, when we refer to the date of a WCIRB rate filing, we mean the date as of which the WCIRB has requested that its pure premium rate indications be adopted by the Commissioner, not the date on which WCIRB made the filing.

### **Committee Meeting Participation and Public Access to Data**

To assess the WCIRB's practices with respect to committee meeting participation and public access to data, we performed various tasks, including:

- Reviewing the July 13, 2004 Memorandum of Understanding regarding Committee Openness Proposal between the WCIRB and the CDI;
- Reviewing selected provisions of the California Insurance Code regarding WCIRB governance and operations;
- Reviewing the WCIRB's Constitution and Bylaws;
- Reviewing agendas and minutes for selected executive sessions of the Governing Committee and the Actuarial Committee;
- Reviewing the WCIRB's website;
- Interviewing WCIRB senior staff; and
- Evaluating the WCIRB's rationale for its policies and procedures with respect to public access to data and committee meeting participation.

### **Role of WCIRB in Rate Making Process**

To assess the role of the WCIRB in the Rate Making Process, we performed various tasks, including:

- Reviewing the WCIRB's January 1, 2010 and January 1, 2011 pure premium rate filings;
- Reviewing the WCIRB's July 1, 2010 informational filing;
- Reviewing the August 10, 2010 letter from Governor Schwarzenegger to Insurance Commissioner Poizner regarding workers' compensation rates;
- Reviewing selected media (including WCIRB press releases) regarding WCIRB pure premium rate filings;
- Reviewing selected individual insurance company workers' compensation rate filings;
- Reviewing selected information regarding workers' compensation insurance rates available on the CDI website;

- Reviewing selected provisions of the California Insurance Code;
- Reviewing the transcript of the WCIRB rate hearing held by the CDI on October 12, 2010;
- Interviewing WCIRB senior staff; and
- Evaluating the purposes and objectives of the WCIRB pure premium rate filing and the regulatory process that surrounds it.

### **III. EXECUTIVE SUMMARY**

As we noted in our 2009 Report, the WCIRB staff and the members of its various Committees perform the tasks given the WCIRB pursuant to the California Insurance Code and the WCIRB's governing documents and do a number of those tasks well. However, as detailed below, some areas require improvement.

#### **A. Implementation of 2009 Recommendations**

The 2009 Report contained a number of recommendations pertaining to (a) the quality of the data received and used by the WCIRB, and (b) the actuarial projection of that data into pure premium rate indications. As part of this examination, we reviewed the status of the WCIRB's implementation of the 2009 Recommendations.

In most respects, implementation of the 2009 Recommendations is either complete or substantially underway.

In Section IV of this Report, we make a series of recommendations designed to ensure that the objectives of the 2009 Recommendations are satisfied on an on-going basis. Among our recommendations, the WCIRB needs to do the following:

- Assess, on an on-going basis, the level of communication by the public members and the public actuary to the CDI, and the actions by the WCIRB to facilitate that communication;
- Report to the CDI on a quarterly basis regarding the status of (a) its medical transactional data system and (b) its data processing system for policy submissions until each system becomes operational;
- Report to the CDI in the 1<sup>st</sup> quarter of 2012 with respect to its use of its new enforcement powers, and with respect to whether the timeliness, completeness and accuracy of data calls improved during 2011;
- Report to the CDI on an annual basis whether there were any instances in the preceding calendar year in which an insurer failed to obtain a "clean" audit

opinion regarding its data report, and if so, what if any disciplinary action was taken by the Governing Committee; and

- Report to the CDI on an annual basis on the steps that it took in the preceding calendar year to work with SCIF regarding SCIF's data collection and reporting system.

## **B. Committee Meeting Participation and Public Access to Data**

During this examination, we reviewed and evaluated the WCIRB's policies and practices with respect to participation in committee meetings and public access to data collected or produced by the WCIRB. Our goal was to evaluate whether the WCIRB's policies and practices sufficiently promote good corporate governance and optimize the ability of committee members to do their jobs well.

This issue raises an important regulatory concern because the WCIRB occupies a unique position as the CDI's designated workers' compensation statistical agent and the sole workers' compensation rating organization in the State of California. Although the WCIRB is a private corporation, its activities potentially affect every workers' compensation insurer and every employer (and indirectly, every employee) in the State of California. Its activities also influence legislative and regulatory actions regarding workers' compensation rates in California.

The WCIRB attempts to operate in an open and transparent way, consistent with its prior commitments to the CDI and with a view toward public education and public input. However, there exist restrictions on public participation and access that frustrate the regulatory goals of transparency and openness unnecessarily. Further, some restrictions on committee member participation and access fail to promote good corporate governance and to optimize the ability of committee members to do their jobs well.

Most significantly, all standing committees of the WCIRB, including the Governing Committee, are treated as "co-equal" with one another. As a result, no WCIRB governing body (akin to a traditional Board of Directors) is responsible for the general oversight over all corporate operations.

In Section V of this Report, we make a series of recommendations that, if implemented, will improve transparency, promote good corporate governance, and optimize the ability of committee members to do their jobs well. The WCIRB needs to do the following:

- Expand the role of the Governing Committee to mirror the role of a traditional Board of Directors;
- Post the meeting schedules and a list of agenda items for each meeting of its standing committees on its public website along with a statement that these meetings are open to the public;

- Review its practices regarding matters discussed in executive sessions of the Governing Committee and the Actuary Committee, with a view to limiting executive sessions to only those matters that are privileged, proprietary or confidential;
- Permit members of the Actuarial Committee to attend meetings of the Claims Subcommittee, and members of the C&R Committee to attend meetings of the Manuals Subcommittee;
- Give Governing Committee members unfettered access to all committee, subcommittee, special committee and task force meetings conducted by the WCIRB; and
- Eliminate its “blanket ban” on public participation in all meetings of the Claims Subcommittee, the Manuals Subcommittee, special committees and task forces.

### **C. Role of the WCIRB in the Rate Making Process**

During this examination, we reviewed and evaluated the role of the WCIRB in the rate making process and considered whether it is properly fulfilling this role, particularly with regard to its pure premium rate filings. To do this, we took a fresh look at the California workers’ compensation rate making process by asking a number of questions, including: Does the public understand the purpose of the WCIRB rate filings? How much of the current content of the WCIRB rate filings is an accident of history, and how much actually makes sense in light of existing realities? Without new legislation, is there a way to transform the WCIRB rate filings, and the regulatory process that surrounds them, to better serve the needs of the Commissioner, policy makers, insurers, employers, and the general public?

As described more fully in the body of this report, what we found, at a threshold level, is a great deal of confusion. The public perception of how workers’ compensation rates are made, how much control the Commissioner has over those rates, and the meaning and purpose of the WCIRB “pure premium” rate filings, is inaccurate.

We further found that many aspects of the WCIRB’s filings (including the terminology used, the focus on a number that represents the “average” loss costs for approximately 500 classification codes, and the presentation of that number as a comparison to prior Commissioner decisions rather than as a comparison to rates actually charged by workers’ compensation insurers) feed into the confusion.

Because of this confusion, the public debate regarding the WCIRB filings is largely disconnected from the reality of the rates actually being charged to businesses in California. As described more fully in the body of this report, aspects of this disconnect include the following:

- The WCIRB rate filings are not “rate” filings at all—they are merely the WCIRB’s predictions of whether workers’ compensation insurers’ loss costs, on average, will rise or fall in the next year.
- The WCIRB describes its predictions of whether loss costs will rise or fall using a percentage figure that bears little relationship to what it believes will happen to rates charged in the marketplace during the next year.
- Pursuant to California law, insurers writing workers’ compensation insurance are free to charge essentially whatever rates they want, including that they have the freedom to accept or reject the WCIRB’s predictions as they deem appropriate (and regardless of the Commissioner’s decisions regarding the WCIRB filings).
- The WCIRB filings are based on aggregate data from all workers’ compensation insurers (some of which presumably control costs well and some of which presumably do not), and as such only represent a mythical “average” insurer.
- The WCIRB filings emphasize a number that represents the weighted average loss costs for the aggregate of approximately 500 classification codes (some of which enjoy low loss costs and some of which experience high loss costs).

The WCIRB plays an essential role in the workers’ compensation rate making process by aggregating loss cost data and evaluating trends. However, the way in which it structures its filings, and the regulatory process surrounding those filings, hamper the ability of the WCIRB to fulfill this essential role in light of modern realities. For this reason, the WCIRB needs to transform its filings into something more useful to the Commissioner, insurers, policy makers, employers and the general public, with a view to retaining and enhancing what adds value and eliminating what does not.

In Section VI of this Report, we make a series of recommendations that will assist this transformation. Our recommendations fall into three broad categories:

- Public Education: The WCIRB needs to take steps to ensure that the public understands (a) that the Commissioner does not have the authority to hold down rate increases regardless of what he or she does relative to the WCIRB filing and (b) that there is no “one number” that can describe what will happen to actual workers’ compensation rates in the coming year.
- The WCIRB Filings: In addition to the WCIRB’s projections of future loss costs, the WCIRB needs to restructure its filings to contain an analysis of the actual pure premium rates currently being charged by California workers’ compensation insurers and use that as the method by which the change in pure premium rates is measured. The use of prior advisory pure premium rates does not accurately reflect the change needed to the current insurer filed pure premium rate level in

California's open rating system. Also, the WCIRB needs to take steps to clarify the extent of uncertainty in its projections and compare its projections to more relevant numbers, such as rates actually filed or charged by workers' compensation insurers. Doing so would focus public and policy maker attention on what is actually happening in the workers' compensation marketplace and away from whose predictions about the future is best.

- Data Collection: The WCIRB needs to collect additional data from its member insurers to enhance the CDI's ability to make comparisons of workers' compensation insurers for solvency monitoring and consumer education purposes.

#### **IV. IMPLEMENTATION OF 2009 RECOMMENDATIONS**

##### **A. Findings Pertaining to the WCIRB's Implementation of 2009 Recommendations**

In our 2009 Report, we made a total of 15 recommendations that would improve the WCIRB's processes and procedures pertaining to governance, data collection, and loss cost projections. Each recommendation fell within one of the following categories of review:

- The WCIRB's Governing System;
- The WCIRB's Data Collection and Compilation Activities;
- The WCIRB's Activities Other than Data Collection and Compilation; and
- The Towers Report

In most respects, implementation of the 2009 Recommendations is either complete or substantially underway. A brief summary of each recommendation, steps that the WCIRB has taken to implement that recommendation, and our assessment as to the status of implementation for that recommendation, is set forth below. With respect to our assessment as to the status of implementation, we provide one of two designations for each recommendation: "Ongoing Monitoring Required" or "Completed." More detailed information is provided in Exhibit A.<sup>2</sup>

##### **1. 2009 Recommendations Pertaining to the WCIRB's Governing System (Recommendations #1 through #4)**

*2009 RECOMMENDATION #1: Procedures should be adopted whereby the views of public members of the Governing Committee and the actuary they retain be presented to the CDI on a routine basis.*

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<sup>2</sup> For ease of reference in this Report, we have sequentially numbered all 15 of the 2009 Recommendations. We note that this numbering differs from that used in the 2009 Report. A reference key to the recommendation numbering is provided in Exhibit A.

**Implementation:** The public members and their actuary have directly communicated their views to the CDI on several occasions since the date of the 2009 Report. Recent communications include providing testimony at the CDI's rate hearings with respect to the WCIRB's January 1, 2010 and January 1, 2011 pure premium rate filings; submitting letters detailing the actuarial differences between the public member pure premium rate recommendations and those presented by the WCIRB; and meeting with CDI staff to discuss ways in which the pure premium rate filing process might be improved. We also understand, anecdotally, that CDI representatives and public members often have the opportunity to discuss WCIRB-related matters before and after WCIRB Committee meetings, and that attendance by the public members at Governing Committee meetings has materially improved. Although direct communication by the public members and their actuary did occur prior to the issuance of the 2009 Report, the level of communication – both in terms of frequency and quality – appears to have improved.

While the increased level of communication is a positive development and satisfies the objective of our recommendation, it is important to note that the WCIRB has not adopted any "procedures" to ensure that public members/public actuary views be presented to the CDI "on a routine basis." The WCIRB views this recommendation as more of an "invitation" by the CDI to the public members and their actuary to exercise their statutory right to communicate directly with the CDI than a directive requiring proactive implementation by the WCIRB.

**Status Assessment:** Ongoing Monitoring Required. The WCIRB has not adopted a formalized process to ensure ongoing compliance with the issues that led to our original recommendation. We again recommend that the WCIRB adopt a formalized process (such as including a formal "minority report"—to be prepared by the public members and their actuary—with each rate filing) to ensure ongoing compliance.

***2009 RECOMMENDATION #2:*** *Committee meeting minutes should be expanded to better describe the various points of view expressed in the meetings.*

**Implementation:** Based on our review of selected post-recommendation and pre-recommendation committee meeting minutes, it appears that WCIRB committee meeting minutes are now drafted to reflect varying points of view to a greater extent than before.

**Status Assessment:** Completed.

***2009 RECOMMENDATION #3:*** *Steps should be taken to allow more time for the review of pure premium rate recommendations before "mid-year" rate filings are made.*

**Implementation:** In response to this recommendation, the WCIRB has adopted two "process enhancements" with respect to its mid-year pure premium rate

filings. First, the WCIRB will only make a mid-year filing if the pure premium rate to be recommended by the WCIRB is at least 5% different (plus or minus) than the pure premium rate reflected in its latest year-end filing. Second, the Actuarial Committee is now given more time to review and analyze the data on which the potential mid-year filing is based. Specifically, the Actuarial Committee's opportunity for review and analysis with respect to the potential 2010 mid-year filing lasted approximately 3 weeks and involved 2 meetings (compared to the mid-year 2009 process in which the Actuarial Committee's opportunity for review and analysis lasted approximately 1 week and involved 1 meeting).

**Status Assessment:** Completed.

***2009 RECOMMENDATION #4:*** *The WCIRB should collect the detailed, transaction-level data needed to perform more refined cost and trending analyses.*

**Implementation:** The WCIRB is in the process of developing a system to collect medical transactional data. The WCIRB's Governing Committee has approved an implementation plan pursuant to which insurers will be required to begin submitting medical transactional data by mid-2012 and the WCIRB will begin actuarial analyses of the data by the second quarter of 2013. In the interim, the WCIRB plans to continue relying on medical transactional data provided to it by the California Workers' Compensation Institute (CWCI).

**Status Assessment:** Ongoing Monitoring Required. We are satisfied that the WCIRB is working diligently to develop its medical transactional data system, and we understand that the process takes time. However, given the importance of this issue, ongoing monitoring to confirm that the project stays on schedule is necessary.

**2. 2009 Recommendations Pertaining to the WCIRB's Data Collection and Compilation Activities (Recommendations #5 through #10)**

***2009 RECOMMENDATION #5:*** *The WCIRB should require insurers to (a) submit their call reports via eSCAD and (b) resolve all data validation errors prior to submitting the information to the WCIRB.*

**Implementation:** With respect to part (a) (our recommendation that the WCIRB require insurers to submit their call reports via eSCAD), we note that the WCIRB has not, as recommended, made the use of eSCAD mandatory. Rather, the WCIRB has addressed this recommendation by amending the SCAD Program to impose, effective July 1, 2010, a processing charge (ranging from \$100 to \$250) for each data call which is available for reporting via eSCAD but is not submitted via eSCAD. According to the WCIRB staff, almost 100% of insurers are now submitting their data call reports electronically, and the WCIRB expects compliance to be at 100% in the near future.

The WCIRB has also addressed part (b) (our recommendation that insurers be required to resolve all data validation errors prior to submitting the information to the WCIRB), through amendments to the SCAD Program. Specifically, the WCIRB has increased, as of July 1, 2010, the maximum annual assessment for untimely, incomplete or inaccurate data calls (and/or failure to provide complete and timely responses to data call inquiries arising from “basic edit” or “actuarial edit” failures), to the greater of \$50,000 or 0.1% of the insurer’s written premium at the approved advisory pure premium rate level. Previously, the maximum annual assessment was the greater of \$10,000 or 0.1% of the insurer’s written premium at the approved advisory pure premium rate level.

Moreover, the WCIRB has implemented several changes to its data validation procedures in response to this recommendation, namely: (a) as a result of Unit Statistical Report Special Assessment Guidelines adopted by the Governing Committee on August 12, 2010, the WCIRB president is now authorized to levy a special assessment (in the minimum amount of \$10,000) whenever it is determined that a member insurer’s unit statistical report submissions are materially inaccurate due to a widespread systemic failure or deficiency that caused numerous experience modifications to be incorrect; (b) effective July 1, 2010, the SCAD Program now provides for an assessment of \$50,000 per affected rate filing whenever it is determined that an insurer’s inaccurate data submissions have significantly impacted a previous WCIRB pure premium rate filing (that is, that the pure premium rate indication would have differed by 0.5% or more if the inaccurate data were reported correctly); and (c) effective July 1, 2010, the SCAD Program now provides for a \$5,000 assessment for each sampled large unit statistical submission in which there is a significant misreporting of payroll or claims. “Significant misreporting” means, in the case of payroll, that the omitted or reported payroll represents 2% or more of the statewide average annual payroll for the classification. In the case of claims, “significant misreporting” means that 3 or more of the claims sampled by the WCIRB are misclassified.

**Status Assessment: Ongoing Monitoring Required.** It remains to be seen if the processing charges and increased maximum penalties are sufficient to resolve the insurer data reporting issues that led to this recommendation. The WCIRB should report 100% compliance by the end of 2011 and maintain 100% compliance thereafter. If it is unable to do so, it should provide a full explanation to the CDI in writing, and promptly take steps to make electronic filings mandatory (as originally recommended).

Further, we note that some of the WCIRB’s new enforcement options require the exercise of discretion on the part of the WCIRB staff (e.g., the terms “materially inaccurate,” “widespread systemic failure” and “numerous,” with respect to the WCIRB president’s special assessment power, are not quantitatively defined). To avoid a recurrence of the issues leading to our 2009 Recommendations, the

WCIRB should be aggressive in using these additional enforcement options in appropriate circumstances.

**2009 RECOMMENDATION #6:** *The WCIRB should determine the most efficient means for insurers to submit data electronically for those data elements not covered by eSCAD and prescribe a single, uniform method by which insurers should submit data elements not covered by eSCAD.*

**Implementation:** This recommendation has limited application, since most data calls are covered by eSCAD. This Recommendation appears to primarily relate to the Annual Call for Long-Term Loss Development Survey on California Workers' Compensation Claims, which is not covered by eSCAD but which may be submitted electronically. The WCIRB has addressed this recommendation through the following amendments to the SCAD Program (each of which is effective July 1, 2010): (a) a non-eSCAD submission will be considered "complete" only if it includes a completed transmission letter containing specified information and is in a prescribed format; and (b) a non-eSCAD submission that is not submitted electronically is subject to a \$100 processing fee.

**Status Assessment:** Ongoing Monitoring Required. The WCIRB should closely monitor compliance to ensure that the insurer data reporting issues that led to this recommendation do not reoccur.

**2009 RECOMMENDATION #7:** *The WCIRB should alert the CDI if it determines that there is a significant problem with the completeness, accuracy, or timeliness of aggregate financial data filed by insurer groups with significant market share.*

**Implementation:** The WCIRB has addressed this recommendation through the following amendments to the SCAD Program: Effective July 1, 2010, for insurers with 1% or more of the total California workers' compensation insurance market, the WCIRB will notify the CDI if (a) a complete data call submission is not received within 30 calendar days of the required submission date; or (b) a significant potential data inaccuracy has not been resolved within 30 days of the commencement of assessments relating thereto.

**Status Assessment:** Completed.

**2009 RECOMMENDATION #8:** *The WCIRB should take remedial action with respect to any insurer group not able to obtain a "clean" audit opinion regarding its data report.*

**Implementation:** The WCIRB has addressed this recommendation through the following amendments to the SCAD Program: Effective July 1, 2010, the Governing Committee is permitted to impose disciplinary action in the event an insurer group is not able to obtain a "clean" audit opinion regarding its data report. Disciplinary action may include reporting the insurer to CDI and/or requiring an onsite audit by an independent auditor.

**Status Assessment:** Ongoing Monitoring Required. The WCIRB now has additional enforcement options which, if used appropriately, should result in increased insurer compliance. However, use of these enforcement options is discretionary with the Governing Committee. To avoid a recurrence of the issues that led to our 2009 Recommendations, the Governing Committee needs to be aggressive in using these additional enforcement options in appropriate circumstances.

***2009 RECOMMENDATION #9:*** *The WCIRB should implement a program applicable to the largest insurers whereby the senior management and the controllers of the insurers attest to the effectiveness of the insurers' statistical and financial reporting systems.*

**Implementation:** Pursuant to amendments made to the SCAD Program, the WCIRB will require all insurers to annually submit a certification form, beginning with the aggregate financial data as of December 31, 2010 to be submitted by June, 2011. The certification form is modeled on the Financial Call Acknowledgement Form and the Self-Audit Form in use by the National Counsel on Compensation Insurance ("NCCI").

**Status Assessment:** Completed.

***2009 RECOMMENDATION #10:*** *The WCIRB should work closely with SCIF to assure that SCIF's data collection and reporting system is functioning effectively.*

**Implementation:** In the past year, (a) the WCIRB actuarial staff has met with SCIF data reporting staff to discuss a number of detailed data reporting issues; (b) the WCIRB has adopted a plan pertaining to enhancing communication between WCIRB actuarial staff and SCIF aggregate data reporting staff; and (c) the WCIRB submitted a letter to the CDI regarding SCIF experience with respect to the January 1, 2011 pure premium rate filing. Viewed collectively, these steps appear to demonstrate that the WCIRB is appropriately implementing this recommendation.

**Status Assessment:** Ongoing Monitoring Required. The WCIRB is actively working with SCIF at this time; however, given the importance of SCIF's data collection and reporting system to the WCIRB projections, it is critical that the WCIRB continue to do so.

### **3. Recommendations Pertaining to the WCIRB's Activities other than Data Collection and Compilation (Recommendation #11)**

***2009 RECOMMENDATION #11:*** *The WCIRB should move toward requiring insurers to file policy information in a standard filing medium, preferably electronically.*

**Implementation:** According to the WCIRB staff, approximately 60% of policy submissions are made electronically. The WCIRB is in the process of developing a new data processing system that will, among other things, improve document tracking, eliminate the need to produce paper copies of electronically submitted policy documents, and improve processing speed. The WCIRB expects its new data processing system to be operational sometime in 2014.

**Status Assessment:** Ongoing Monitoring Required. The WCIRB originally projected that its new data processing system would be operational by the end of 2011, then extended the date to 2012, and then extended it further to 2014. It appears that the delay was attributable to an unforeseen problem with a vendor, rather than any failure of diligence on the WCIRB's part, and that the WCIRB has taken aggressive steps to ensure that further slippage in the implementation date does not occur. However, given the importance of this issue, ongoing monitoring to confirm that the project stays on schedule is needed.

**4. 2009 Recommendations Pertaining to the Towers Report  
(Recommendations #12 through #15)**

***2009 RECOMMENDATION #12:*** *The WCIRB should consider multiple projection methods when making pure premium rate determinations, and review various diagnostic statistics and retrospective analyses to assist in determining which projection methods are appropriate for each accident year.*

**Implementation:** The WCIRB January 1, 2010 and January 1, 2011 pure premium rate filings each (a) include an Executive Summary with tables of alternative loss development, trending, and loss adjustment expense methodology projections; and (b) increase the number of alternative loss development methodologies, trending methodologies, and alternative LAE projection methodologies presented and, in each case, enhance the description of the underlying assumptions and bases of each methodology. These enhancements satisfy the objectives of this recommendation.

**Status Assessment:** Completed. Please note, however, that we recommend additional enhancements to the WCIRB's pure premium rate filings in Section VI (Role of the WCIRB in the Rate Making Process) of this Report.

***2009 RECOMMENDATION #13:*** *The WCIRB should select retrospective projected ultimate loss ratios ("LRs") judgmentally by accident year and should compare the original projected ultimate LRs to the updated projected ultimate LRs by accident year. Further, the WCIRB should prepare retrospective analyses annually so that changes in projected ultimate pure premium LRs by accident year can be observed and explained.*

**Implementation:** The WCIRB January 1, 2010 and January 1, 2011 pure premium rate filings each included retrospective evaluations of loss development

methodologies. The retrospective evaluations included in the pure premium rate filings satisfy the objectives of this recommendation.

**Status Assessment:** Completed. Please note, however, that we recommend additional enhancements to the WCIRB's pure premium rate filings in Section VI (Role of the WCIRB in the Rate Making Process) of this Report.

***2009 RECOMMENDATION #14:*** *After considering the results of multiple methods, the WCIRB should provide a range of reasonable pure premium rate level indications to the Actuarial Committee and the Governing Committee.*

**Implementation:** Based upon our review of Actuarial Committee and Governing Committee meeting minutes and discussions with WCIRB staff, it appears that the WCIRB staff is now providing a range of reasonable pure premium rate level indications to both the Actuarial and Governing Committees.

**Status Assessment:** Completed.

***2009 RECOMMENDATION #15:*** *The WCIRB should prepare and provide to the CDI a chart or side-by-side comparison showing projected on-level pure premium LRs by accident year using each method considered by the WCIRB. Further, the WCIRB should explain why it believes certain methods are more reasonable than others for particular accident years, and should also describe the key assumptions underlying each method, the extent to which it believes those assumptions are valid, and alternate scenario projections for key assumptions. The WCIRB should also explain the rationale behind the selected LRs by accident year.*

**Implementation:** The WCIRB January 1, 2010 and January 1, 2011 pure premium rate filings each included side-by-side comparisons showing projected on-level pure premium LRs by accident year using each method considered by the WCIRB. The filings also included the recommended explanations. The comparisons and explanations included in the pure premium rate filings satisfy the objectives of this recommendation.

**Status Assessment:** Completed. Please note, however, that we recommend additional enhancements to the WCIRB's pure premium rate filings in Section VI (Role of the WCIRB in the Rate Making Process) of this Report.

## **B. Recommendations Pertaining to the WCIRB's Implementation of 2009 Recommendations**

- 1. We recommend that the WCIRB, the public members and their actuary, and the CDI meet at least bi-annually to assess whether the level of communication by the public members and their actuary is sufficient to inform the CDI of their views and suggestions, and to discuss what the WCIRB is or could be doing to facilitate that communication. We further*

*recommend that the WCIRB establish a formalized process (e.g., including a formal "minority report" with each WCIRB rate filing) to ensure that the recent improvements in the quality and frequency of communication are maintained over time.*

2. *We recommend that the WCIRB report to the CDI on the status of (a) its medical transactional data system and (b) its data processing system for policy submissions once every calendar quarter until each system becomes operational. The report should state whether the development of each system remains on-schedule.*
3. *We recommend that the WCIRB report to the CDI in the 1<sup>st</sup> quarter of 2012 with respect to:*
  - a. *whether and to what extent the WCIRB has imposed processing charges, assessments, or otherwise used its new enforcement powers under SCAD with respect to untimely, incomplete or inaccurate data calls during 2011; and*
  - b. *whether and to what extent the instances of untimely, incomplete or inaccurate data calls decreased in 2011 compared to prior years.*

*If the increased enforcement powers are not being used by the WCIRB or have not resulted in improved timeliness, completeness and accuracy of data calls, the WCIRB should present a remediation plan to the CDI to further address this issue.*

4. *We recommend that the WCIRB report to the CDI on an annual basis (beginning in the first quarter of 2012) whether there were any instances in the preceding calendar year in which an insurer failed to obtain a "clean" audit opinion regarding its data report, and if so, what disciplinary action, if any, was taken by the Governing Committee.*
5. *We recommend that the WCIRB report to the CDI on an annual basis (beginning in the first quarter of 2012) on the steps that it took in the preceding calendar year to work with SCIF regarding SCIF's data collection and reporting system.*

**V. COMMITTEE MEETING PARTICIPATION  
AND PUBLIC ACCESS TO DATA**

**A. Findings Pertaining to Committee Meeting Participation and Public Access to Data**

**1. Introduction**

During this examination, we reviewed and evaluated the WCIRB's policies and practices with respect to participation in committee meetings and public access to data it collects or produces. Specifically, we first examined whether the WCIRB's policies and practices with respect to public participation in the meetings of the WCIRB's standing committees, subcommittees, special committees, and task forces, and with respect to public access to data, are (a) consistent with its prior agreement with the CDI on committee openness; and (b) appropriate in light of the sometimes competing regulatory goals that the WCIRB operate transparently with respect to the public while also operating efficiently and effectively. We next examined the WCIRB's policies and practices with respect to committee member participation in the meetings of, and committee member access to data regarding, those standing committees, subcommittees, special committees and task forces on which the committee member in question does not serve. Our goal was to evaluate whether these policies and practices sufficiently promote good corporate governance and optimize the ability of committee members to do their jobs well.

This issue raises an important regulatory concern because the WCIRB occupies a unique position as the CDI's designated workers' compensation statistical agent and the sole workers' compensation rating organization in the State of California. Although the WCIRB is a private corporation, its activities potentially affect every workers' compensation insurer and every employer (and indirectly, every employee) in the State of California. Its activities also influence legislative and regulatory actions regarding workers' compensation rates in California. Additionally, unlike most private corporations, the WCIRB is subject to close oversight by a regulator and has signed a Memorandum of Understanding pursuant to which it has agreed to operate openly.

On balance, the WCIRB attempts to operate in an open and transparent way, consistent with its prior commitments to the CDI and with a view toward public education, public input, and good corporate governance. However, some restrictions on public participation and access frustrate the regulatory goals of transparency and openness unnecessarily. Further, some restrictions on committee member participation and access fail to promote good corporate governance and to optimize the ability of committee members to do their jobs well.

**2. Corporate Governance – Lack of a Board of Directors**

This follow-up examination did not expressly include a review of the WCIRB's corporate governance. However, in the course of reviewing and evaluating the WCIRB's policies

and practices with respect to participation in committee meetings and public access to data, it came to our attention that the WCIRB treats all of its standing committees as “co-equal” with one another. Specifically, the Governing Committee does not have general oversight power over all WCIRB operations. Rather, the Governing Committee has its specific sphere of influence, the Actuarial Committee has its specific sphere of influence, and so on. As a result, the WCIRB lacks an over-arching governing body –akin to a traditional Board of Directors –responsible for the general oversight over all corporate operations.

Given the unique status of the WCIRB as the CDI’s designated workers’ compensation statistical agent and the sole workers’ compensation rating organization in the State of California, this finding is significant. Under its current structure, the WCIRB has no general governing body and no one other than management has unfettered access to and responsibility for all the operations of the organization.

### **3. Existing Regulatory and Corporate Governance Parameters**

The WCIRB and the CDI are parties to a Memorandum of Understanding regarding Committee Openness Proposal dated July 13, 1994 (the “MOU”). Pursuant to the MOU, the WCIRB agreed that:

- The meetings of the Governing Committee, the C&R Committee, and the Actuarial Committee will be open to the public, except:
  - With respect to the Governing Committee, during the discussion of issues, that are privileged, proprietary, or confidential<sup>3</sup>;
  - With respect to the C&R Committee, during compliance actions involving a specific employer or insurer and employer appeals. (The public may attend individual employer appeals unless the appellant objects. However, committee deliberations, discussions and voting with respect to employer appeals occur in executive session.)
- All persons interested in attending meetings of the Governing Committee, the C&R Committee, or the Actuarial Committee will be notified of the date, time and place of the meetings and provided with a list of the agenda items open to the public.
- All written information provided to the Governing Committee, the C&R Committee, or the Actuarial Committee will be made available to the public.

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<sup>3</sup> As used in the MOU, the term “privileged, proprietary or confidential” includes, but is not limited to, the following: (a) administrative matters; (b) legal matters; (c) legislative or regulatory actions affecting the WCIRB which are customarily confidential; (d) meetings with other organizations, governmental agencies, legislators, and employers which are customarily confidential; (e) basis of assessments, fees or fines; and (f) compliance actions involving a specific employer or insurer.

- Minutes of each meeting with respect to those issues open to the public will be made available to the public.
- Subject to a timely request to do so, the public may be permitted to present relevant information to the Governing Committee, C&R Committee or Actuarial Committee.
- Minutes of meetings of the Governing Committee (with respect to those issues open to the public), the C&R Committee (except with respect to compliance actions), and of the Actuarial Committee will be made available to the public.

Importantly, the MOU addresses public access to the three standing committees of the WCIRB (that is, the Governing Committee, the C&R Committee and the Actuarial Committee) only. It is silent with respect to the Claims Subcommittee, which did not exist as of the date of the MOU. It is also silent with respect to the Manual Subcommittee, which did exist as of the date of the MOU. Finally, it is silent with respect to special committees or task forces established from time to time by the WCIRB.

Although not addressed in the MOU, we understand that it has been the WCIRB's policy and practice for the past two to three years that:

- Public Members are able to fully and completely participate in all activities of the Governing Committee and will not be excluded from any meeting or session of the Governing Committee, including executive sessions, even in cases where they do not have the right to vote on the topic being discussed.
- The Public Members' actuary may attend all meetings (including those held in executive session) of the Actuarial Committee and may fully participate and vote on all items brought before that committee.
- Public Member experts and staff are free to attend any meeting of the WCIRB that is open to the public, and are also permitted to attend executive sessions of a WCIRB committee if requested to do so by a Public Member who is present at the meeting.

Additionally, Article X, Rule 8 of the WCIRB's Constitution provides that "[a] member of any committee may attend a meeting of another committee if (a) the committee is not meeting in executive session or (b) the committee believes the nonmember's participation will assist the committee in its deliberations." This rule applies equally to both the insurer and public members.

#### **4. Right to Attend and Participate in Committee Meetings – Members of the General Public**

##### **Standing Committees: Regular (Non-Executive) Sessions**

As noted above, members of the general public may attend any regular (non-executive) session meeting of the Governing Committee, the C&R Committee, and the Actuarial Committee; may present relevant information at the meeting; and are entitled to copies of any handouts or other written materials provided to the Committee members at the meeting.<sup>4</sup> Members of the general public may purchase copies of the agendas for and minutes of any such meeting through the WCIRB's on-line product catalog.

Although access to regular session standing committee meetings is open, information regarding the dates, times and locations of those meetings (and the fact that such meetings are open to the public) does not appear on the WCIRB's website and is not otherwise publicized by the WCIRB. An interested member of the public would have to call the WCIRB or would have to subscribe to the agenda and minutes of the standing committees (which are available for purchase on the WCIRB website) to obtain such information. Accordingly, although members of the general public have the right to attend regular sessions of the WCIRB's standing committees, they might not be aware of this right and lack easy access to the scheduling information that would allow them to exercise their right.

In this regard, the MOU requires that "all persons interested in attending [meetings of the Governing Committee, the C&R Committee, or the Actuarial Committee] will be notified of the date, time and place of the meetings and provided with a list of the agenda items open to the public." While the WCIRB complies with this requirement in a technical sense, posting committee meeting schedules and a list of agenda items (if not the actual agenda) on the WCIRB's public website, such that interested members of the public would have instant and free access to such information, would be more in keeping with the spirit of the requirement.

##### **Standing Committees: Executive Sessions**

Pursuant to the MOU, the Governing Committee may exclude the public from meetings in which "privileged, propriety or confidential" issues are discussed. Examples of "privileged, proprietary, or confidential" issues include administrative matters, legal matters, and legislative or regulatory actions that are customarily confidential.

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<sup>4</sup> We understand that the WCIRB, having become concerned that distributing documents in draft form would confuse the public, adopted a policy within the past several years that it would not distribute certain draft documents to attendees at Executive and C&R Committee meetings. We further understand that, after public complaints and consultation with the CDI, the WCIRB reversed this policy and once again distributes all applicable documents, including drafts, to attendees at committee meetings.

Based upon our review of selected agendas and minutes for recent executive sessions of the Governing Committee, the vast majority of items discussed in executive session are purely administrative or legal in nature, and therefore fall within the “privileged, proprietary, or confidential” category identified by the MOU. However, our review revealed that some issues that are not so obviously within the “privileged, proprietary, or confidential” category are also discussed in executive session. Specifically, various recommendations made in the 2009 Report, and the WCIRB’s proposals to address those recommendations were discussed by the Governing Committee in executive sessions held on August 12, 2009, December 9, 2009 and April 7, 2010 – dates well after the public release of the 2009 Report by the CDI. While some aspects of the Governing Committee’s discussions appear to be reasonably classified as “privileged, proprietary, or confidential” (e.g., discussions of the costs of implementation and a description of a meeting between WCIRB staff and the CDI to discuss the recommendations), other aspects of the Governing Committee’s discussions appear less reasonably classified as such (e.g., discussions of alternatives for modifying the mid-year rate filing process).

Pursuant to the MOU, the C&R Committee may exclude the public from meetings at which compliance actions involving a specific employer or insurer are addressed. The C&R Committee did not meet in executive session during 2009 or 2010. We understand from discussions with WCIRB staff, however, that if and when the C&R Committee does meet in executive session, it does so solely in connection with compliance actions.

Unlike the MOU’s express provisions relating to the Governing Committee and the C&R Committee, which anticipate public exclusion under limited circumstances, the MOU simply states that “[t]he Actuarial Committee meetings will be open to the public.” We understand that the WCIRB does not view the MOU as prohibiting the Actuarial Committee from meeting in executive session; rather, the WCIRB believes that the MOU is silent with respect to such executive sessions because they are exceedingly rare. In fact, according to WCIRB staff, the Actuarial Committee has met in executive session on only two occasions in its entire history, once in 2008 and once in 2009.

Although the MOU could be construed as prohibiting executive sessions of the Actuarial Committee, it appears appropriate for the Actuarial Committee to have the same right to meet in executive session as does the Governing Committee; that is, if the Actuarial Committee is discussing matters that are “privileged, proprietary, or confidential” within the meaning of the MOU, it should be able to do so in executive session.

Having said this, when the Actuarial Committee met in executive session on December 3, 2009, it did so to discuss certain recommendations made in the 2009 Report and alternative ways to implement those recommendations. For the reasons expressed above with respect to the Governing Committee executive sessions, we question whether these matters are properly classified as “privileged, proprietary, or confidential.”

## Special Committees, Subcommittees, and Task Forces

Under existing WCIRB policy, members of the general public may not attend any meeting (whether in executive session or not) of any Special Committee, Task Force or subcommittee (including the Manual Subcommittee and the Claims Subcommittee). The WCIRB has offered the following explanations for this restriction:

- subcommittees, special committees and task forces are means by which the WCIRB staff gathers information that is ultimately refined and submitted to one or more of the standing committees in the form of draft reports or recommendations;
- no public policy decisions or actions are taken by subcommittees, special committees or task forces; and
- public participation in these information gathering meetings would stifle open discussion and restrict staff's ability to collect the information necessary to formulate well reasoned recommendations.

Importantly, we understand that the WCIRB is not concerned that the information discussed at the subcommittee, special committee and task force level is confidential or proprietary; indeed, the WCIRB has stressed that reports and recommendations issued by or as a result of subcommittee, special committee or task force meetings are, once finalized, made available to the public.<sup>5</sup> Rather, the WCIRB appears to be concerned that public participation would stifle candid conversation and interfere with the ability of subcommittees, special committees or task forces, and the WCIRB staff that assist them, to do their jobs efficiently and effectively.

The WCIRB's concerns must be balanced, however, against the potential benefits of public participation and the goal of the CDI to make the workers' compensation rate making process as transparent as possible. The considerations that should be taken into account in determining the appropriate balance include:

- The unique status of the WCIRB as the CDI's designated workers' compensation statistical agent and the sole workers' compensation rating organization in the State of California. Although the WCIRB is a private corporation, its activities affect every workers' compensation insurer and every employer (and indirectly, every employee) in the State of California. Its activities also influence legislative and regulatory actions regarding workers' compensation rates in California. Accordingly, whenever the public can be reasonably accommodated, it should be.

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<sup>5</sup> Further, as discussed below, the minutes of the Claims Subcommittee are indirectly made public in that they are attached to the next occurring Actuarial Committee agendas, which are available for purchase by the public.

- The potential benefit of public input at a more “organic” level. Public input may provide WCIRB staff and subcommittee, special committee and task force members with information and perspectives to which they would not otherwise have access, and may influence the reports and recommendations ultimately issued. Including the public only after reports and recommendations have been drafted and submitted to a standing committee makes it less likely that the public will be able to have meaningful input into those reports and recommendations.
- The fact that the Claims Subcommittee is a subcommittee of the Actuarial Committee, the meetings of which are open to the public pursuant to the MOU. At the time the MOU was entered into, the Claims Subcommittee did not exist. Although the function of the Claims Subcommittee, and the tasks it performs, are somewhat different than those performed by the Actuarial Committee, they are directly related.<sup>6</sup>
- The fact that the Manuals Subcommittee is a subcommittee of the C&R Committee, the regular session meetings of which are open to the public pursuant to the MOU. The work performed by the Manuals Subcommittee is simply a subset of the work performed—in a public setting—by the full C&R Committee.

### **WCIRB Insurer-Members Treated as Members of the General Public**

Please note that insurer-members of the WCIRB (other than insurer-members that have been elected or appointed to a committee, subcommittee or task force) are subject to the same rules with respect to meeting attendance and participation as are members of the general public. For example, an officer of an insurer-member who wishes to attend and participate in a Governing Committee meeting may do so only if and to the extent that a member of the general public could do so.

### **5. Right to Attend and Participate in Committee Meetings – Members of Other Committees**

An elected or appointed member of a committee, subcommittee, or task force may, of course, attend and participate in meetings of the particular committee, subcommittee or task force on which he or she serves.<sup>7</sup> However, with respect to other committees,

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<sup>6</sup> Whereas the Actuarial Committee analyzes actuarial data collected by the WCIRB (and, as such, is focused on data that is at least several months old), the Claims Subcommittee looks at emerging trends—that is, it tries to determine what is happening with claims in “real time.” The composition of the Claims Subcommittee reflects this nuance; while the Actuarial Committee is composed of insurance actuaries, the Claims Subcommittee includes representatives of the California Division of Workers’ Compensation, the California Workers’ Compensation Institute, and the Commission on Health, Safety, and Workers’ Compensation.

<sup>7</sup> Insurer-members, not individuals, are elected or appointed, as the case may be, to most WCIRB committees and subcommittees; that is, although each insurer is represented at meetings by an individual (typically a corporate officer) who may act and vote on its behalf, as a technical matter, it is the insurer, not the individual representative, that is the Governing Committee member. A notable exception to this general practice is the Actuarial Committee, on which actuaries serve in their individual capacities, not as

subcommittees and task forces (i.e., those on which the person does not serve), the person is subject to the same rules with respect to meeting attendance and participation which govern members of the general public unless invited to do so by the committee, subcommittee or task force in question.

For example, a member of the Actuarial Committee is not permitted to attend meetings of the Claims Subcommittee, even though the Claims Subcommittee is a subcommittee of, and reports to, the Actuarial Committee. Similarly, a member of the C&R Committee is not permitted to attend meetings of the Manuals Subcommittee, even though the Manuals Subcommittee is a subcommittee of, and reports to, the C&R Committee. Additionally, members of the Actuarial and C&R Committees are not permitted to attend executive sessions of the Governing Committee.

In general, a member of the Governing Committee is not permitted to attend executive sessions of the Actuarial Committee or the C&R Committee, nor may he or she attend any meetings of the Claims Subcommittee, the Manuals Subcommittee, or any special committee or task force. WCIRB staff indicated that, despite this general policy, requests by Governing Committee members to attend any such meeting would be considered on a case-by-case basis.

These restrictions apply equally to both the insurer and public members. An exception to these restrictions exists if the committee in question believes the nonmember's participation will assist the committee in its deliberations.

The WCIRB offers several rationales for these restrictions, including:

- The desire for uniform reporting. The WCIRB has expressed concern about committee members getting different messages, in different ways, from the committees or subcommittees that report to them. For example, a member of the C&R Committee who attends a meeting of the Manuals Subcommittee will obtain information about matters being addressed by that subcommittee before that information is received by other C&R Committee members, and before the members of the Manuals Subcommittee have had the opportunity to finalize their report or recommendations to the C&R Committee regarding that information.
- The possibility of a stifling effect. The WCIRB believes that some subcommittee members might be less willing to express their views in the presence of non-committee members who hold senior insurance executive positions. For example, an actuary serving on the Claims Subcommittee might be reticent to express an opinion with which he knows a senior executive with his employer disagrees if that senior executive is sitting in the room.

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representatives of their insurer-employers. For ease of reference, we refer in this discussion to the individual representatives serving on various committees and subcommittees as if they were committee members.

- The co-equal status of the standing committees. The WCIRB views the three standing committees as co-equal; that is, no committee is subordinate to any other committee. Specifically, the WCIRB does not view the Governing Committee as having oversight responsibility over the C&R and Actuarial Committees (as it would if the Governing Committee were a Board of Directors responsible for the corporate governance of the entire entity).

These concerns must be balanced against other considerations, including:

- Committee members should be encouraged to gain as much knowledge of the work of the WCIRB and the rate making process as possible. A member of the C&R Committee who is permitted to observe the operations of the Manuals Subcommittee, or a member of the Actuarial Committee who is permitted to observe the operations of the Claims Subcommittee, may gain a deeper understanding of pertinent issues that will help that member do his or her job better.
- Because there is some overlap between the membership of the Actuarial Committee and Claims Subcommittee, and between the membership of the C&R Committee and Manuals Subcommittee, the WCIRB's stated concern over committee members receiving different messages in different ways from their subcommittees is already a reality. Allowing those individuals who serve on a committee, but not on the subcommittee that reports to it, to attend subcommittee meetings simply "levels the playing field."
- The WCIRB does not have a Board of Directors. If the Governing Committee is not responsible for the general oversight of the WCIRB operations, no one is. From a basic corporate governance standpoint, it is imprudent to have an organization in which there is no general governing body and in which no one other than management has unfettered access to all the operations of the organization.

## 6. Public Access to Data

The public has access to a wide variety of information that is either posted on the WCIRB website or available for purchase from the WCIRB's product catalog (which may be accessed on the WCIRB website). Information available to the public includes:

- *Educational Information*

Examples include articles regarding experience rating; a glossary of workers' compensation terms; and a list of frequently asked questions, and answers, regarding medical transactional data reporting.

■ *Certain Data and Reports*

Examples include the WCIRB's Legislative Cost Monitoring Report; the WCIRB's Annual Report; the WCIRB's annual Summary of Policy Year Statistics; and the WCIRB's Quarterly Report on Statewide Insurance Experience.

■ *Regulatory Filings and Related information*

Examples include the WCIRB's annual pure premium rate filings and the Insurance Commissioner's decisions with respect thereto.

■ *Commissioner-Approved Plans and Regulations*

Examples include the current editions of the Experience Rating Plan and the Uniform Statistical Reporting Plan.

■ *Advisory Manuals, Plans and Reference Materials*

Examples include the California Large Risk Deductible Plan, the California Retrospective Rating Plan, and the California Test Audit Program Manual.

■ *Certain Information Releases and Miscellaneous Information*

Examples include WCIRB Wire News stories; Policyholder Ombudsman information; WCIRB Bulletins and WCIRB General Notices.

■ *Certain Committee Meeting Agenda and Minutes*

This category includes (a) agendas and minutes for the regular (non-executive) sessions of the Governing Committee, the C&R Committee, and the Actuarial Committee; and (b) agendas and minutes of executive sessions of the C&R Committee involving disciplinary actions, although the identifying insurer or employer information is excluded.

Information to which the public does not have access includes the following:

■ *Insurer-Specific Data and Reports*

Insurer-specific classification experience and insurer-specific aggregate financial experience data are made available only to the insurer to whom the information relates. Based on our review, this restriction appears to be appropriate.

■ *Experience Modification Master File*

This product contains experience modification information for all experience rated employers. Based on our review, this restriction appears to be appropriate.

■ *Certain Data Quality Programs*

The WCIRB does not provide public access to its Data Quality Enhancement Program, its SCAD Program, and its California Large Risk Classification Validation Program. These programs set out membership assessments for failure to meet specified reporting standards. WCIRB staff conceded that these programs do not contain proprietary or insurer-specific or employer-specific information, and indicated that the fact that these programs are not public is more a function of never having received a request for their public release than from a conscious decision to restrict access.<sup>8</sup>

■ *Employer Specific Information*

This category includes Unit Statistical Reports, Insurance Policy Records, Experience Rating Worksheets, and Classification Inspection Reports. These documents include confidential and proprietary employer information and insurer-specific information. Generally, access is restricted to the particular employer, agent or broker, and insurer involved. Based on our review, this restriction appears to be appropriate.

■ *WCIRB Member Notices*

These are notices sent from time to time by the WCIRB to its insurer-members. Topics include corporate governance matters (e.g., information regarding the date and time of the annual members meetings and committee nominations); technical data reporting specifications; and legal matters. Based on our review, it appears that some member notices contain confidential and proprietary information to which the public is not entitled, while others do not.

■ *Certain Meeting Agendas and Minutes*

This category consists of (a) the agendas and minutes to all executive sessions of the Governing Committee and the Actuarial Committee; (b) the agendas and minutes to all meetings of the Manuals Subcommittee; (c) the agendas to all meetings of the Claims Subcommittee; and (c) the agenda and minutes (if any) to all special committees and task forces. Based on our review, the restrictions on access to agenda and minutes of standing committee executive sessions appear

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<sup>8</sup> Additionally, the WCIRB might have chosen to keep these programs confidential on the basis of the MOU's definition of "privileged, proprietary or confidential," which includes the "[b]asis of Assessments, fees or fines to be established by the WCIRB."

appropriate to the extent that the executive sessions involve confidential and proprietary matters to which the public is denied access by the MOU. However, the restrictions on access to the agenda and minutes of subcommittees, special committees and task forces, to the extent that they do not disclose confidential and proprietary information, appear to be questionable. The primary rationale for excluding members of the public from the meetings of subcommittees, special committees and task forces—that public participation may stifle candid conversation among the members and interfere with the efficient operation of the meeting—does not apply to agenda and minutes. Further, the same considerations (discussed above under Section A.2.) that weigh against excluding the public from subcommittee, special committee, and task force meetings also weigh against denying public access to the agenda and minutes relating to those meetings.

## **B. Recommendations Pertaining to Committee Meeting Participation and Public Access to Data**

- 1. We recommend that the WCIRB expand the role of its Governing Committee to that of a traditional Board of Directors with general oversight over, and responsibility for, the operations of the WCIRB.*
- 2. We recommend that the WCIRB post the meeting schedules (including the date, time, and place of meeting) of each regular session of the Governing Committee, C&R Committee and Actuarial Committee on its public website along with a statement that these meetings are open to the public. We also recommend that the agenda (or alternatively, a simple list of agenda items) with respect to each meeting be posted on the public website in advance of each meeting (rather than being available only for purchase through the product catalog).*
- 3. We recommend that the WCIRB review its practices regarding matters discussed in the executive sessions of the Governing Committee vs. matters discussed in the regular sessions of the Governing Committee. Specifically, the WCIRB should evaluate whether matters that are not “privileged, proprietary or confidential” pursuant to the MOU are discussed in executive sessions, and if so, should in the future discuss such matters in the regular sessions instead.*
- 4. We recommend that the WCIRB permit members of the Actuarial Committee to attend meetings of the Claims Subcommittee, and members of the C&R Committee to attend meetings of the Manuals Subcommittee. If the WCIRB believes it is appropriate to do so to address some of its concerns, it could restrict participation by such members in the meeting (i.e., they may attend and observe, but they may not speak unless invited to do so).*

5. *We recommend that the WCIRB provide unfettered access to Governing Committee members to all committee, subcommittee, special committee and task force meetings conducted by the WCIRB. If the WCIRB believes it is appropriate to do so to address some of its concerns, it could restrict participation by such members in the meeting (i.e., they may attend and observe, but they may not speak unless invited to do so).*
6. *We recommend that the WCIRB re-evaluate whether its Data Quality Enhancement Program, Submission of California Aggregate Data Program, and California Large Risk Classification Validation Program should be made available to the public.*
7. *We recommend that those member notices that do not contain privileged, proprietary or confidential information be made available to the public.*
8. *We recommend that the agenda and minutes to meetings of the Claims Subcommittee and the Manuals Subcommittee and the agenda and minutes (if any) to special committees and task forces be made available to the public. We further recommend that these agendas and minutes be made available to the public on a stand-alone basis (other than, as is the case with the Claims Subcommittee minutes, only as an attachment to the agendas of a standing committee).*
9. *We recommend that the WCIRB eliminate its blanket ban on public participation in all meetings of the Claims Subcommittee, the Manuals Subcommittee, special committees and task forces. Specifically, we recommend that the WCIRB review the factors discussed above that weigh in favor of public participation, and in light of these factors, take a more nuanced approach to public participation. The WCIRB should report to the CDI regarding its proposed new approach by no later than December 31, 2011.*

## **VI. ROLE OF THE WCIRB IN THE RATE MAKING PROCESS**

### **A. Findings Pertaining to the Role of the WCIRB in the Rate Making Process**

#### **1. Introduction**

During this examination, we reviewed and evaluated the role of the WCIRB in the rate making process and considered whether it is properly fulfilling this role, particularly with regard to its pure premium rate filings. To do this, we took a fresh look at the California workers' compensation rate making process by asking a number of questions: Does the public understand the purpose of the WCIRB rate filings? How much of the current content of the WCIRB rate filings is an accident of history, and how much actually makes sense in light of existing realities? Without new legislation, is there a way to transform the WCIRB rate filings, and the regulatory process that surrounds them, to better serve

the needs of the Commissioner, policy makers, insurers, employers, and the general public?

What we found, at a threshold level, is a great deal of confusion. The public perception of how workers' compensation rates are made, how much control the Commissioner has over those rates, and the meaning and purpose of the WCIRB "pure premium" rate filings, is inaccurate.

We further found that many aspects of the WCIRB's filings (including the terminology used, the focus on a number that represents the "average" loss costs for approximately 500 classification codes, and the presentation of that number as a comparison to prior Commissioner decisions rather than as a comparison to rates actually charged by workers' compensation insurers) feed into the confusion.

Because of this confusion, the public debate regarding the WCIRB filings is largely disconnected from the reality of the rates actually being charged to businesses in California.

The WCIRB plays an essential role in the workers' compensation rate making process by aggregating loss cost data and evaluating trends. But the way in which it structures its filings, and the regulatory process surrounding those filings, hamper the ability of the WCIRB to fulfill this essential role in light of modern realities. For this reason, the WCIRB needs to transform its filings into something more useful to the Commissioner, insurers, policy makers, employers and the general public, with a view to retaining and enhancing that which adds value and eliminating that which does not.

## **2. The WCIRB Pure Premium Rate Filing – General Overview**

The WCIRB serves two distinct but related roles. First, the WCIRB is the CDI's designated statistical agent. As statistical agent, the WCIRB is responsible for gathering and compiling the loss and expense experience that workers' compensation insurers are required to report to the CDI. [CIC §11751.5] Second, the WCIRB is a licensed California rating organization.<sup>9</sup> [CIC §11750, *et. seq* (the "Rating Organization Law")]

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<sup>9</sup> A "rating organization" is any organization which "has as its primary objective or purpose the collecting of loss and expenses statistics and other statistical information and data, the making of pure premium rates and [rating plans] for workers' compensation insurance and employer's liability insurance incidental thereto . . . and presenting them to the commissioner for approval." [CIC §11750.1(b)] A rating organization may be organized for purposes that include (among others):

- To provide reliable statistics and rating information relating to workers' compensation insurance;
- To collect and tabulate information and statistics for the purpose of developing pure premium rates;
- To formulate rules and regulations in connection with pure premium rates and the administration of classifications and rating systems; and
- To perform all acts necessary, incidental or convenient to carry out its purposes or the provisions of the California Insurance Code relating to rating organizations.

Although the California Insurance Code contemplates the possibility of multiple rating organizations, the WCIRB is the only workers' compensation rating organization presently licensed and operating in the state.

As a rating organization, the WCIRB is permitted (but not required) to make "advisory pure premium rate" filings with the CDI. The Rating Organization Law does not prescribe the frequency of pure premium rate filings, nor does it expressly require that a rating organization make pure premium rate filings at all. If and when a rating organization files pure premium rates, however, the Commissioner must hold a public hearing within 60 days thereafter. [CIC §11750(b)] Within 30 days of the conclusion of the public hearing, the Commissioner must approve, disapprove or modify the proposed rate. *Id.* Nothing in the Rating Organization Law prescribes or limits the scope of the hearing, or provides guidance regarding factors the Commissioner may or must consider when approving, disapproving or modifying the proposed pure premium rate.

Historically, the WCIRB makes two pure premium rate filings per year: one with a proposed effective date of January 1<sup>st</sup> and one with a proposed effective date of July 1<sup>st</sup>. Each filing typically seeks the Commissioner's approval with respect to the following three matters:

- An increase or decrease (stated as a percentage) in the average pure premium rate level;
- Changes (sometimes referred to as class relativities) to the pure premium rate for each of approximately 500 classifications based on the overall percentage increase/decrease and the estimated change in each classification's share of the total statewide losses;
- Changes to the Uniform Statistical Reporting Plan and/or the Workers' Compensation Experience Rating Plan.

It is the first matter – the percentage increase (or decrease) in the average pure premium rate level requested by the WCIRB – that receives the most attention. Indeed, the WCIRB gives this percentage a prominent place in the rate filings and in its press releases (*see, e.g.*, WCIRB press release of August 18, 2010, with the headline "WCIRB SUBMITS FILING RECOMMENDING A 29.6% INCREASE IN PURE PREMIUM RATES EFFECTIVE JANUARY 1, 2011").<sup>10</sup>

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[CIC §11750.3] For the purposes of the Rating Organization Law, the term "pure premium rate" means "that portion of the rate which represents the loss cost per unit of exposure, including loss adjustment expense." [CIC §11730(f)] The term "claims cost benchmark" is sometimes used by the WCIRB and the CDI interchangeably with the term "pure premium rate."

<sup>10</sup> Please note that the WCIRB subsequently amended its filing to reflect a pure premium rate indication of 27.7%.

### 3. Public Perception

The public appears to believe that each WCIRB pure premium rate filing is a rate request made by the WCIRB on behalf of insurance companies writing workers' compensation insurance in California. The public also appears to believe that the loss cost projection percentage announced by the WCIRB is the rate change that workers' compensation insurers are seeking. For example, if the WCIRB describes its rate filing as a "27.7% increase in the overall pure premium rate level," the public appears to believe that the WCIRB is seeking approval on behalf of insurance companies for a 27.7% increase in rates.

Further, the public appears to believe that the Commissioner has the power to grant or reject changes in workers' compensation rates by accepting or rejecting the WCIRB filing—in other words, if the Commissioner approves a WCIRB request for a 27.7% increase, workers' compensation rates will go up by 27.7%, whereas if the Commissioner rejects the WCIRB request, workers' compensation rates will not go up. Indeed, the assumption that the Commissioner can control workers' compensation rates through his or her WCIRB rate decisions appears even in a recent letter from Governor Schwarzenegger to Commissioner Poizner, in which he expressed concern over the WCIRB's January 1, 2011 pure premium rate proposal and urged the Commissioner to "not allow such a tremendous financial burden on California businesses at this time." See Letter from Arnold Schwarzenegger to Steve Poizner dated August 10, 2010.

Finally, the public appears to believe that the Commissioner has the ability to use the WCIRB rate making process to force workers' compensation insurers to control costs and to improve efficiency. In other words, if the Commissioner rejects or modifies the WCIRB request on the grounds that workers' compensation insurers are not controlling costs, the public appears to believe that workers' compensation insurers will be required to better control costs or will be penalized in some way for failing to do so.

Each of these perceptions is inaccurate.

Allowing these public misperceptions to continue creates numerous problems. The Commissioner is put in an untenable position because he or she is expected to control rising workers' compensation rates even though the legislature has not given the Commissioner the authority to do so. These misperceptions also prompt people to argue over whose projections about the future is best, thereby diverting attention from what has already actually happened in the workers' compensation market. Further, the WCIRB's emphasis on a simplified loss cost percentage confuses the public about how much the WCIRB believes workers' compensation rates will change in the coming year.

#### **4. The Reality of the Workers' Compensation Rate Making Process**

##### **The WCIRB makes projections, not rates**

Filings that lead to workers' compensation rate changes in California are made by individual workers' compensation insurance companies, not by the WCIRB. The WCIRB filing is merely a loss cost projection—i.e., the filing describes what the WCIRB believes will happen to workers' compensation loss costs in the future. When determining actual rates, workers' compensation insurers can consider the WCIRB filing or not, as they choose.

##### **Individual workers' compensation insurers may file whatever rates they deem appropriate**

Each workers' compensation insurer must file with the Commissioner all rates and supplementary rate information that the insurer intends to use in the state of California. [CIC §11735(a)] The rates filed by individual workers' compensation insurers must be filed at least 30 days prior to the effective date of the rates (although the Commissioner may authorize an earlier effective date). *Id.*

When an insurer files new or modified workers' compensation rates, it is required to identify two primary rate components: (1) the pure premium (loss and loss expense) component and (2) the underwriting expense load component (e.g., administration, commissions, profit, etc.). It is the first component (pure premium) that mirrors the subject of the WCIRB pure premium rate filing. However, the insurer need not adopt the pure premium rates recommended by the WCIRB or approved by the Commissioner. Rather, the insurer has a wide range of options, including:

- adopting the pure premium rates and class relativities approved by the Commissioner (whether in the Commissioner's most recent WCIRB rate decision or in one of the Commissioner's previous WCIRB rate decisions), without modification;
- adopting the pure premium rates and class relativities approved by the Commissioner (whether in the Commissioner's most recent WCIRB rate decision or in one of the Commissioner's previous WCIRB rate decisions), with a uniform class modification;
- adopting the pure premium rates and class relativities approved by the Commissioner (whether in the Commissioner's most recent WCIRB rate decision or in one of the Commissioner's previous WCIRB rate decisions), with selected class deviations;
- adopting the pure premium rates and class relativities requested by the WCIRB (whether in its most recent rate filing or in a previous filing, and

without regard to whether the Commissioner approved, disapproved or modified such rates), without modification;

- adopting the pure premium rates and class relativities requested by the WCIRB (whether in its most recent rate filing or in a previous filing, and without regard to whether the Commissioner approved, disapproved or modified such rates), with a uniform class modification;
- adopting the pure premium rates and class relativities requested by the WCIRB (whether in its most recent rate filing or in a previous filing, and without regard to whether the Commissioner approved, disapproved or modified such rates), with selected class deviations; or
- adopting pure premium rates and class relativities developed independently by the insurer, without reference to or reliance on the WCIRB rate filings or the Commissioner's decisions with respect thereto.

Further, as noted above, the pure premium rates and class relativities adopted by an insurer is just one component of its filed rates. The insurer also "loads" onto its pure premium its administrative expenses and desired profit margin. As a result, two insurers adopting the same pure premium rates might have quite different workers' compensation rates if, for example, one has high administrative expenses and/or desires a high profit margin and the other has low administrative expenses and/or desires a more moderate profit margin. Likewise, two insurers that adopt vastly different pure premium rates might nonetheless have quite similar workers' compensation rates if these differences are equalized through the administrative and underwriting expense load component of their rate filings.

**The Commissioner's statutory power to reject individual workers' compensation insurer rate filings is limited**

California is a "file and use" state for workers' compensation insurance. This means that, although workers' compensation insurers must file their rates with the CDI, they do not need the CDI's approval before charging the rates they have filed. [CIC §11735(a)] Rates filed by workers' compensation insurers become effective, without action by the Commissioner, unless affirmatively disapproved by the Commissioner. *Id.* Under the California Insurance Code, the commissioner may disapprove an individual workers' compensation insurer rates if, but only if, the Commissioner finds that:

- The rates are not adequate to cover an insurer's losses and expenses (i.e., if the rates are too low);
- The rates will tend to create a monopoly in the market;
- The rates are unfairly discriminatory; or

- The insurer has failed to comply with the statutory filing requirements.

[CIC §11737(a) & (b)] Additionally, the Commissioner must disapprove an insurer's rates if the Commissioner determines that the premiums charged, in the aggregate, resulting from the use of the rates would, if continued in use, tend to impair or threaten the solvency of the insurer (i.e., if the rates are too low). [CIC §11737(c)]

As a result of this statutory framework, the Commissioner's ability to block rate increases or disapprove rate filings is very limited. For example, the Commissioner does not have the authority to block a rate increase for the reason that the Commissioner believes the rates are too high. Additionally, the Commissioner does not have the statutory authority—either through the WCIRB rate filing process or through the “file and use” process for individual workers' compensation insurers—to force workers' compensation insurers to improve efficiency or to control costs.

#### **Filed rates are not the rates actually charged to employers**

The workers' compensation rates filed with the CDI by individual insurers are mere starting points for determining what an individual employer will actually pay for workers' compensation insurance. Workers' compensation insurers routinely apply debits and credits to their filed rates, based on factors such as employer claims experience and competition. For example, an insurer with relatively high filed workers' compensation rates might, with respect to a given employer on a given day, offer very competitive rates in the marketplace.

#### **The WCIRB's Loss Cost Projection Percentage bears little relationship to rates actually charged in the workers' compensation marketplace and, as such, is flawed and confusing**

The loss cost projection percentage announced by the WCIRB as part of its rate filings does not represent how much current workers' compensation rates will increase or decrease in the marketplace. This is true for a number of reasons, including the following:

- The WCIRB's loss cost projection percentage reflects the cumulative effect of the rejection by the Commissioner of most of the WCIRB's average pure premium rate requests over a multi-year period, not the projected increase in loss costs over a 1-year period. For example, in the case of the WCIRB's January 1, 2011 filing, the proposed 27.7% increase in pure premium rates reflects the following 3-year history:
  - The WCIRB projected a 5.2% average increase in loss costs in its January 1, 2008 rate filing. The Commissioner approved 0%.

- The WCIRB projected a 16.0% average increase in loss costs in its January 1, 2009 rate filing. The 16.0% reflected the 5.2% previously rejected plus an additional average increase of 10.8%. The Commissioner approved 5%.
- The WCIRB projected a 23.7% average increase in loss costs in its July 1, 2009 rate filing. The 23.7% reflected the 11% previously rejected [5.2% + 10.8% = 16% — 5% approved = 11%] plus an additional average increase of 12.7%. The Commissioner approved 0%.
- The WCIRB projected a 22.8% average increase in loss costs in its January 1, 2010 rate filing. The 22.8% reflected the 23.7% previously rejected [5.2% + 10.8% + 12.7 = 28.7% requested — 5% approved = 23.7%] less an average decrease of 0.9%. The Commissioner approved 0%.
- The WCIRB projected a 27.7% average increase in loss costs in its amended January 1, 2011 rate filing. The 27.7% reflects the 22.8% previously rejected [5.2% + 10.8% + 12.7 — 0.9% = 27.8% requested — 5% approved = 22.8%] plus an additional average increase of 4.9%.

Notwithstanding, when members of the public hear that the WCIRB is proposing a pure premium rate increase of 27.7% for 2011, they could very reasonably think that the WCIRB is proposing that 2010 rates increase by 27.7% in 2011.

- The WCIRB's loss cost projection percentage is based on data submitted by all insurers writing workers' compensation insurance in California. However, there is likely to be wide variation in the efficiency of insurers. Some insurers have loss costs that are higher than the "average" while other insurers have loss costs that are lower than the "average." The WCIRB's loss cost projection percentage only shows loss costs predicted for a mythical "average insurer."
- The WCIRB's loss cost projection percentage is based on a weighted average of the projected loss costs for approximately 500 different rate classifications. However, the rates charged to employers are based on the class rates, not on the "average." The rates for some classes will be higher than the "average" whereas the rates for other classes will be lower than the "average." The rate to be charged to an employer will differ depending on the rate class applicable to its business.
- As noted previously, workers' compensation insurers file their own pure premium rates and are free to use or ignore the WCIRB's loss cost projections in doing so.
- As noted previously, the WCIRB filing pertains only to the "pure premium" component of rates. However, the rates actually charged also incorporate the insurer's expense and profit expectations. Therefore, the change in the rate to be charged to an employer could be less or more than the expected change in loss costs depending on whether an insurer seeks to absorb some of the rate increase (by reducing expenses or profit) or to increase profit or expense loads.

- As noted previously, even if a workers' compensation insurer filed pure premium rates that track the WCIRB's loss cost projections exactly, that insurer is free to apply various "debits and credits" to the filed (manual) rates at the time that it underwrites individual businesses. The resulting rate will therefore be higher than the "average" class rate for some employers and lower than the "average" class rate for other employers.

To summarize, then, the actual rate to be charged to any specific employer depends on a variety of factors. These factors include the insurance company issuing the policy, the rate class applicable to the employer's business, the adjustments to the class rate during the underwriting process, and whether the insurer writing the business will adjust its expense and/or profit expectations. Therefore, even if loss costs were to increase, "on average," by 7% during a given year, the actual rate impact on employers would range widely: some employers would likely receive rate reductions while others would have rate increases significantly greater than the 7% "average." The focus by the WCIRB on a single number does not reflect the reality.

#### **B. Recommendations Pertaining to the Role of the WCIRB in the Rate Making Process**

1. *We recommend that the WCIRB take steps to educate the public regarding the reality of the workers' compensation rate making process. Employers and policy makers should receive the clear message that, under existing California law, the Commissioner does not have the power to stop rate increases (regardless of what the Commissioner does relative to the WCIRB advisory filing). Examples of steps that could be taken include:*
  - *In press materials and at the public hearing relative to the WCIRB filing, the WCIRB could point out that the WCIRB's filing is purely advisory and that individual insurers can adopt the WCIRB's rates or not, as they choose. For example, the public could be told that insurers can adopt the WCIRB's rates in full even if the WCIRB filing is totally rejected by the Commissioner.*
2. *We recommend that the WCIRB take steps to reduce the confusion prompted by its focus on a single loss cost projection percentage, particularly since the projection percentage used by the WCIRB is calculated in relation to multiple years of loss cost development and has little relationship to what will happen to actual workers' compensation rates in the real world. The goal of these recommended steps is to focus public and policy-maker attention on what is actually happening in the workers' compensation industry and reduce the focus as to whose prediction about the future is the best. These steps could include:*

- *Restructuring the WCIRB pure premium rate filing to contain two sections, as follows:*
  - *The first section—which would be informational in nature—would contain an analysis of the actual pure premium rates currently being charged by workers’ compensation insurers in California (both on an aggregate basis and on a class-by-class basis). The first section would be akin to an “index” (such as the Consumer Price Index), which measures “what is” rather than “what is expected” or “what should be.”*
  - *The second section would contain the WCIRB’s projections of loss costs (i.e., the pure premium rate and class relativities for which it is seeking approval) for the coming year. This second section would be akin to a projection or estimate of “what is expected” (analogous to economic projections of unemployment rates) rather than a statement of what the WCIRB believes the loss costs “should be.” This second section would resemble the filing currently made by the WCIRB, but would be modified as suggested below to increase its utility and reduce the confusion surrounding it.*
- *Describing its projections of future loss costs (the second part of the restructured filing discussed above) using more appropriate comparisons, such as the percentage change the current filing reflects compared to (1) the rate filing made by the WCIRB in the prior year (this would show what the WCIRB believes will be the change in the pure premium part of the rate from one year to the next); and (2) the pure premium rates actually filed by workers’ compensation insurers (this would show how much the WCIRB believes the pure premium component of insurer rates will change compared to what workers’ compensation insurers have actually filed with the CDI).*
- *Including in its filing a historical comparison of (1) the actual loss cost development in the workers’ compensation industry for the preceding year to (2) the WCIRB’s projections of loss cost development in its filing for the preceding year. Doing so would provide information regarding the accuracy of the WCIRB’s prior predictions regarding loss costs.*
- *More clearly show that it is less certain about its projections of future loss costs than is implied by the use of a specific number. For example, rather than saying that it believes pure premium costs will increase by 7.6% in the coming year, the WCIRB could say that it believes pure premium costs will rise somewhere between 3% and 10%, with a “best estimate” of 7.6%.*

- *More clearly show that it is less certain about the assumptions used in making its projections than is implied by the use of a specific number. For example, rather than saying it believes that a particular Workers' Compensation Board ruling will cause medical costs to rise by 3.2%, the WCIRB could say that it believes the Board ruling will cause medical costs to rise somewhere between 1% and 5%, with a "best estimate" of 3.2%.*
- *Describe its loss cost projections in terms of the effect on the rates by class—since class rates are closer to the rates that will actually be charged—rather than describing them as an "average" of all classes. For example, rather than (or in addition to) saying that it believes loss costs will increase by an average of 7.6% in the coming year, the WCIRB could say that it believes that loss costs by class will change in the coming year, ranging from a decrease of 6.4% for Class X to an increase of 27.9% for Class Y. Another possible enhancement would be to include a scatter graph or bell curve graph showing the distribution of changes across all class codes. Such a graph would provide readers with a snapshot of the entirety of the class code changes.*
- *Use terminology that more accurately reflects the nature of the WCIRB's filing. For example, in discussing the actual pure premium rates being charged by workers' compensation insurers (the subject of the first section of the restructured filing), the WCIRB could refer to these rates as the "actual current workers' compensation loss costs" or the "workers' compensation industry loss cost index." Likewise, in discussing its projections of future loss costs (the subject of the second section of the restructured filing), the WCIRB could simply use terms such as "loss cost projections" or "future loss cost estimates" instead of "advisory pure premium rate" or "loss cost benchmark."*
- *Finally, the WCIRB needs to discontinue its practice of measuring its proposed pure premium rate changes against the advisory pure premium rates most recently approved by the Commissioner. The reasons for this directive include many of the factors previously mentioned: (1) the fact that the Commissioner's prior approved rates are only advisory, and insurers are free to file whatever set of pure premium rates they wish; (2) the fact that the prior approved advisory pure premium rates are largely unrelated to the pure premium rates actually filed by insurers and to actual market conditions; and (3) the fact that the use of the prior approved advisory pure premium rates misinforms and confuses the public as to the true extent of the proposed adjustment. The current process, which resembles the old "minimum rate law" analysis and recommendations, fails to accurately reflect insurer practices in the new open-rating system.*

3. *We recommend that the WCIRB begin collecting data from its member insurers sufficient to allow it, and/or the CDI, to compare and contrast the following three numbers:*

- *The “pure premium” rate filed by each workers’ compensation insurer with the CDI (“X per \$100 of payroll”);*
- *The standard premium or manual rate (i.e., the “fully loaded” premium rate, including administrative expenses and profit margin) filed by each workers’ compensation insurer with the CDI (“Y per \$100 of payroll”); and*
- *The discounted premium or charged rate (i.e., the rates actually charged, after taking debits and credits into account) actually charged by each workers’ compensation insurer (“Z per \$100 of payroll”).*

*A number of comparisons using this data could be made. For example, a comparison of “X” to “W” would show the difference that exists between the pure premium rates approved by the Commissioner and the pure premium rates filed by insurers. Likewise, a comparison of “Z” to “Y” would show the level of insurer discounting or surcharging.*

*Currently, the WCIRB collects data from its member insurers with respect to the last category for solvency monitoring purposes. Expanding the WCIRB’s data calls to include the first and second categories, and requiring the WCIRB to present the data in a comparative form on an industry average and individual insurer basis, would not only enhance the CDI’s ability to make “apple to apple” comparisons of workers’ compensation insurers for solvency monitoring purposes, but would also allow for additional consumer-oriented information to be made available. For example, such information could be used to generate reports that enhance the public’s understanding of the components that make up premium rates and the variables that affect what rates are actually charged.*

## VII. CONCLUSION

We would like to thank the WCIRB and its staff for their assistance and cooperation in connection with this Operational Examination. We found the WCIRB staff to be hard working and dedicated to performing the tasks given the WCIRB pursuant to the California Insurance Code and the WCIRB's governing documents.

Throughout this Report, we provide a number of recommendations that, if implemented, will (a) advance the successful implementation of our 2009 recommendations; (b) improve the public's access to data and the ability of WCIRB Committee members to be fully informed and engaged in WCIRB operations; (c) transform the role of the WCIRB in the workers' compensation rate making process; and (d) enhance the ability of the Commissioner to hold workers' compensation insurers accountable for avoidable costs and inefficiencies. A comprehensive list of all recommendations found throughout this Report is attached as Exhibit B. We hope that the CDI and the WCIRB will find our recommendations useful.

*ReCTOR & Associates, Inc.*

RECTOR & ASSOCIATES, INC.

**EXHIBIT A**  
**Status of 2009 Recommendations Matrix**

<u>Full Text of The 2009 Recommendations</u>	<u>Excerpts from the WCIRB's Plan of Implementation Updated as of 6/14/10</u>	<u>Our Observations/Testing Based on Document Review and WCIRB Personnel Interviews*</u>
<b><u>2009 Recommendations Pertaining to the WCIRB's Governing System</u></b>		
<p>1. <i>(2009 Report Numbering: Section IV, Recommendation #1):</i> "We recommend that procedures be adopted whereby the views of public members of the Governing Committee and the actuary they retain be presented to the CDI on a routine basis. Such views could be presented in any of a number of ways, ranging from a memorandum by the public members' actuary to the CDI following each meeting of the Actuarial Committee (in which the actuary notifies the CDI of any major differences between his views and those adopted by the Committee) to a formal "minority report" of the public members that accompanies any pure premium rate filing with which they disagree. In making this recommendation, we note that CIC Section 11751.35(c) provides not only that the public members of the Governing Committee may retain experts (including an actuary), but also that "[t]he public members may submit information obtained from these experts, as well as any other information they deem appropriate, to the commissioner for his or her consideration in approving a change of any matter specified in subdivision (a)" (which</p>	<p>"WCIRB staff continues to work with the CDI and the public members of the Governing Committee to facilitate the public members' efforts to present their views and those of their actuary to the CDI on a routine basis. The public members and their actuary regularly present their findings directly to the Commissioner at the CDI pure premium rate hearings. With respect to the January 1, 2010 filing, the public members submitted a letter into the record detailing their position and two of the four public members testified at the October 6, 2009 hearing. Additionally, the public members' actuary submitted his analysis of the WCIRB's pure premium rate filing into the record and testified at the October 6, 2009 hearing as well.</p> <p>"Going forward, the CDI will continue to receive the views of public members of the Governing Committee and their actuary on a routine basis through the WCIRB Committee process. CDI representatives regularly attend Governing Committee and Actuarial Committee meetings where the public members and their actuary express their views. Further, the CDI is provided copies of the minutes of all WCIRB committee</p>	<p>We reviewed the documentation referenced by the WCIRB relating to the public members' participation in the CDI hearing relating to the January 1, 2009 rate filing. We also reviewed similar documentation relating to the January 1, 2010 rate filing.</p> <p>WCIRB Personnel also provided us with information suggesting that regular attendance by the public members at Governing Committee meetings has materially improved in recent years.</p> <p>WCIRB Personnel also anecdotally noted that CDI representatives and public members often have the opportunity to discuss WCIRB-related matters before and after WCIRB Committee meetings.</p>

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<u>Full Text of The 2009 Recommendations</u>	<u>Excerpts from the WCIRB's Plan of Implementation Updated as of 6/14/10</u>	<u>Our Observations/Testing Based on Document Review and WCIRB Personnel Interviews*</u>
<p>includes changes in pure premium rate filings). We encourage the public members to use this statutory right, when appropriate. By doing so, the Commissioner can be assured of having additional relevant information for his or her consideration."</p>	<p>meetings."</p>	
<p>2. (2009 Report Numbering: Section IV, Recommendation #2): "We recommend that the WCIRB staff consider expanding the minutes of Committee meetings so that such minutes better describe the various points of view expressed in the meetings."</p>	<p>"Further, as specified in the WCIRB's June 18, 2009 preliminary implementation plan, the WCIRB has expanded the minutes of committee meetings to ensure that all alternative viewpoints expressed by committee members, including the public members or their actuary, or CDI staff are fully presented."</p>	<p>Among other testing, we compared (a) the minutes of the August 4, 2010 Actuarial Committee meeting in which the January 1, 2011 pure premium rate filing was considered, to (b) the minutes of the July 31, 2009 and August 5, 2008 Actuarial Committee meetings, at which the January 1, 2010 and January 1, 2009 filings, respectively, were considered.</p> <p>We found that the alternative views of the public actuary were expressly included in the 2010 minutes, but not in the 2009 or 2008 minutes.</p>
<p>3. (2009 Report Numbering: Section IV, Recommendation #3): "We recommend that steps be taken to allow more time for the review of pure premium rate recommendations before "mid-year" rate</p>	<p>"The CDI has indicated that inasmuch as mid-year filings should be made on an exception basis, if at all, there is a need for greater actuarial review and support for such filings. At the meeting of December 9, 2009,</p>	<p>Among other testing, we reviewed the documentation (including Actuarial and Governing committee meeting minutes and the 2010 mid-year informational filing) to confirm</p>

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**Status of 2009 Recommendations Matrix**

<p align="center"><u>Full Text of The 2009 Recommendations</u></p>	<p align="center"><u>Excerpts from the WCIRB's Plan of Implementation Updated as of 6/14/10</u></p>	<p align="center"><u>Our Observations/Testing Based on Document Review and WCIRB Personnel Interviews*</u></p>
<p>filings are made with the CDI. We do not have a specific recommendation as to how this should be accomplished, but options that could be considered include not submitting a "mid-year" filing, moving the proposed effective date of the "mid-year" filing to a date other than July 1, and basing the primary analysis pertaining to the "mid-year" filings on data submitted as of an earlier date so that there is sufficient time for data review and analysis. The WCIRB should also consider holding a second meeting of the Actuarial Committee prior to voting on pure premium rate recommendations if Actuarial Committee members propose significant changes to the WCIRB staff recommendation in the initial meeting. We also refer the reader to our comments pertaining to Section V of this Report ("The WCIRB's Data Collection and Compilation Activities"). In that Section, we make recommendations that might streamline the data collection process and thereby free up time that could be used to perform additional analysis and review. Further, our understanding is that the WCIRB and Actuarial Committee prepare and review full rate indications quarterly, even though pure premium rate filings are made only twice a year. Another way to free up time may be to prepare and review full rate</p>	<p>the WCIRB Governing Committee approved the implementation of two process enhancements intended to address the CDI's concerns regarding mid-year pure premium rate filings. First, the Committee adopted a guideline providing that the WCIRB would only make a mid-year pure premium rate filing if the December 31 evaluation of experience produced a change in the WCIRB's pure premium rate indication of at least five percentage points (plus or minus). Second, the Committee approved a schedule that facilitates a more comprehensive Actuarial Committee review of December 31 experience in consideration of a potential mid-year pure premium rate filing.</p> <p>"These procedures were implemented with respect to a potential July 1, 2010 pure premium rate filing as follows:</p> <p>(a) On March 15, 2010, the Actuarial Committee reviewed the December 31, 2009 experience and a comprehensive set of system diagnostics that had also been reviewed by the Claims Subcommittee.</p> <p>(b) On April 1, 2010, the Actuarial</p>	<p>the ways in which the mid-year filing process has changed.</p> <p>We note that, with respect to the 2010 mid-year filing process, the Actuarial Committee appeared to have more information, and more time to review and ask questions about that information, than with respect to the 2009 mid-year filing process.</p> <p>WCIRB Personnel expressed concern that if, under the new process, a rate filing is required (i.e., there has been 5%+ swing in the pure premium rate indication), the filing timeline would be very condensed, and that the CDI likely would receive the rate filing approximately 2 weeks later than in past years.</p>

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<p>indications only twice a year—in conjunction with the rate filings.”</p>	<p>Committee again reviewed the December 31, 2009 experience. The information reviewed included a projection based on the methodologies used in the January 1, 2010 pure premium rate filing as well as a number of additional projections based on a wide range of alternative loss development and trending methodologies. Based on this review, the Committee adopted a set of loss and loss adjustment expense projection methodologies for use in a potential July 1, 2010 pure premium rate filing.</p> <p>(c) On April 7, 2010, the Governing Committee reviewed the recommendations of the Actuarial Committee. Since the July 1, 2010 pure premium rate increase based on the methodologies adopted by the Actuarial Committee at their April 1, 2010 meeting of 21.1% was within five percentage points of the 21.6% increase reflected in the WCIRB's January 1, 2010 pure premium rate filing, the Governing Committee recommended that no July 1, 2010 pure premium rate filing be made. In lieu of a rate filing, the WCIRB submitted an informational analysis</p>	

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<p>4. (2009 Report Numbering: Section IV, Recommendation #4): "We recommend that the WCIRB begin to collect the detailed, transaction-level data needed to perform refined analyses of the potential impact of legislative, regulatory and judicial actions and of why specific components of claim costs are rising or falling."</p>	<p>to the CDI documenting the indicated pure premium rate increase based on December 31, 2009 experience, a copy of which was also provided to insurers."</p>	
<p>4. (2009 Report Numbering: Section IV, Recommendation #4): "We recommend that the WCIRB begin to collect the detailed, transaction-level data needed to perform refined analyses of the potential impact of legislative, regulatory and judicial actions and of why specific components of claim costs are rising or falling."</p>	<p>"In response to the CDI's directive that the WCIRB begin to collect transactional medical data directly, the WCIRB established a special multi-discipline committee to develop a series of diagnostic measures that could be reviewed on a regular basis by the WCIRB's Actuarial Committee and Claims Subcommittee in preparation for the WCIRB's annual pure premium rate filing. The Special Committee completed its work and has recommended that the WCIRB collect medical transactional data directly that is consistent with the information scheduled to be collected in other jurisdictions by the National Council on Compensation Insurance.</p> <p>"At its meeting of December 9, 2009, the Governing Committee approved the recommendations of the Special Committee with respect to medical transactional data. The Committee also approved an implementation plan that provides that (a) the WCIRB system to collect data will be</p>	<p>Among other testing, we reviewed the pertinent portions of the minutes of the December 9, 2009 executive session of the Governing Committee. We also reviewed the WCIRB's implementation plan with respect to the new data base.</p>

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	<p>available for beta testing (receive insurer test submissions) by the end of 2011, (b) insurer submissions will be required and subject to edit and audit by mid-2012, (c) the detailed requirements for the systems needed to facilitate the WCIRB's actuarial analysis of the data (e.g., the data warehouse) will be completed in 2012 and (d) initial actuarial analyses of the data will commence by the second quarter of 2013. In the interim until the WCIRB's medical transactional database is ready, the WCIRB anticipates continuing to rely on CWCi medical transactional data for its research needs. Exhibit 1 summarizes the preliminary implementation schedule. Exhibit 2 provides a high level summary of implementation tasks for 2010 and beyond. The WCIRB is proceeding in accordance with the approved implementation plan."</p>	

<u>2009 Recommendations Pertaining to Data Collection &amp; Compilation Activities</u>		
<p>5. (2009 Report Numbering: Section V, Recommendation #1): "We recommend the WCIRB require all insurers to submit their aggregate financial data call reports via eSCAD and require insurers to resolve</p>	<p>General Response (applicable to #5 through #10): "While recognizing the effectiveness of the WCIRB in correcting insurer data</p>	<p>Among other testing, we reviewed the July 1, 2010 amendments to the SCAD Program, the Large Risk Classification Validation Program, as approved by the Governing</p>

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<p>all data validation errors prior to submitting the information to the WCIRB."</p>	<p>submissions, the CDI examiners expressed concern with the volume of aggregate data that was submitted inaccurately, inasmuch as inaccurate data submissions can impact WCIRB resources as well as overall data quality. The WCIRB agreed to review aggregate collection and compliance programs and procedures with appropriate WCIRB committees and develop a series of recommended enhancements for submission to the CDI by the second quarter of 2010. The areas to be addressed include (a) to (f) below.</p> <p>"The WCIRB has augmented its data validation procedures in a number of areas to address the issues raised in the CDI Examination. Many of these were reflected in the updated Program for the Submission of California Aggregate Data (SCAD), which were adopted by the Governing Committee to be effective July 1, 2010."</p> <p><u>Response specific to #5:</u></p> <p>"Additional incentives to facilitate the use of the eSCAD software and consistent reporting formats (a).</p> <p>"Fees for the non-eSCAD submission of WCIRB aggregate data calls previously adopted were added to the updated SCAD</p>	<p>Committee in its June 9, 2010 executive session meeting, and pertinent provisions of the minutes of the Governing Committee's August 12, 2009 executive session meeting.</p> <p>WCIRB Personnel clarified that nearly 100% of insurers are submitting financial data via eSCAD.</p> <p>WCIRB Personnel acknowledged that much of the enforcement is driven by financial penalties, however the enforcement always includes the "threat" that insurers may be referred to CDI for audit or examination. WCIRB Personnel further clarified that while financial penalties may be imposed, ultimately the insurers are required to cure their flawed filings.</p>

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	<p>Program. (See Exhibit 3, Section III, Subsection A, paragraph 3, subparagraph a.) In addition, new SCAD fees were imposed for (i) the Annual Call for Direct Workers' Compensation Experience – Abridged if not submitted directly via the eSCAD application and (ii) the Annual Call for Long-Term Loss Development Survey on California Workers' Compensation Claims if not submitted electronically in conformity with the template and instructions provided by the WCIRB. (See Exhibit 3, Section III, Subsection A, paragraph 3, subparagraphs b and c, respectively.)</p> <p align="center">***</p> <p>"Additional penalties and procedures for submission of inaccurate data (c).</p> <p>"The WCIRB is implementing several changes to its data validation procedures to increase financial penalties when inaccurate data is submitted by an insurer. First, at the August 12, 2009 Governing Committee meeting, the Committee authorized the WCIRB president to levy a special assessment whenever it is determined that a member insurer's unit statistical report submissions were materially inaccurate due to a widespread systemic failure or deficiency that caused numerous experience</p>	

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	<p>modifications to be incorrect. Exhibit 4 is an excerpt from the August 12, 2009 Governing Committee meeting agenda that describes this special assessment.</p> <p>"Second, the SCAD program has been augmented effective July 1, 2010 to impose an assessment of \$50,000 per affected rate filing whenever it is determined that an insurer's inaccurate data submissions have significantly impacted a previous WCIRB pure premium rate filing. (See Exhibit 3, Section V.)"</p> <p>"Third, the Governing Committee, at its June 9, 2010 meeting, approved the Large Risk Classification Validation Program which provides for a \$5,000 assessment to be levied for each sampled large unit statistical submission in which there is a significant misreporting of payroll or claims. Exhibit 5 is a copy of the draft WCIRB Large Risk Classification Validation Program that was adopted by the Governing Committee."</p>	
<p>6. (2009 Report Numbering: Section V, Recommendation #2): "For those data elements not covered by eSCAD, we recommend that the WCIRB determine the most efficient means for insurers to submit data electronically. We further recommend that the WCIRB proscribe a single, uniform</p>	<p>See <u>General Response</u> under #5 above.</p> <p><u>Response specific to #5:</u></p> <p>None provided.</p>	<p>Although the WCIRB did not specifically respond to this recommendation in its Plan of Implementation, our testing confirmed that the WCIRB has addressed this recommendation through the following amendments</p>

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<p>method by which insurers submit such data to the WCIRB.”</p>		<p>to the SCAD (each of which is effective July 1, 2010): (a) a non-eSCAD submission will be considered “complete” only if it includes a completed transmission letter containing specified information and is in a prescribed format; (b) a non-eSCAD submission that is not submitted electronically is subject to a \$100 processing fee.</p>
<p>7. (2009 Report Numbering: Section V, Recommendation #3): “We recommend that the WCIRB alert the CDI if it determines that there is a significant problem with the completeness, accuracy, or timeliness of aggregate financial data filed by insurer groups with significant market share. It is important that the CDI be alerted promptly—within 20 days, for example—after the problem is discovered. By making the CDI aware of such problems, the WCIRB can gain additional support and/or advice regarding the proper course of action with the insurer to remediate current and future reporting problems.”</p>	<p>See <u>General Response</u> under #5 above. <u>Response specific to #7:</u> “Earlier CDI notification of potential significant data quality issues (b). “The July 1, 2010 update to the SCAD program included new provisions by which the CDI is notified whenever (i) significant data has not been submitted within thirty days after the due date [see Exhibit 3, Section III, Subsection A, paragraph 4, subparagraph b(iii)] or (ii), a significant potential data inaccuracy has not been resolved within thirty days (see Exhibit 3, Section III, Subsection B, paragraph 4).”</p>	<p>Among other testing, we reviewed the amendments to the SCAD Program effective July 1, 2010.  WCIRB Personnel concurred that the process of tracking is manual in nature and should eventually be automated. The WCIRB Personnel explained that WCIRB is vigilant with its reporting requirements and, when necessary, staff take reporting issues to senior executives at the insurance companies for correction. While this is a fairly new change to internal procedures, the WCIRB Personnel anticipate that it will be fairly rare for significant data not to be reported within 30 days of due dates.</p>

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<p>8. (2009 Report Numbering: Section V, Recommendation #4): "We recommend the WCIRB take remedial action with respect to any insurer group that is required to obtain an independent auditor's report attesting to the insurer group's annual aggregate data report but is unable to obtain a "clean" opinion regarding such data report. The failure of an insurer to obtain such a report should raise questions regarding the effectiveness of the insurer's internal controls over financial reporting. Accordingly, we further recommend that the WCIRB's existing remedial action procedures be supplemented by having the WCIRB Governing Committee authorize WCIRB staff, or independent persons engaged by the WCIRB, to perform an on-site audit of insurers that are unable to obtain such a "clean" independent audit report."</p>	<p>See <u>General Response</u> under #5 above.</p> <p><u>Response specific to #8:</u></p> <p>"Potential on-site audits of insurers (e)."</p> <p>"The SCAD program has been augmented to add provisions authorizing the retention of an independent auditor to conduct an onsite audit of the insurer's data reporting systems at the insurer's expense if the insurer is unable to promptly remediate a significant data reporting issue. (See Exhibit 3, Section IV, Subsection C, paragraph 4.)"</p>	<p>We reviewed the amendments to the SCAD Program effective July 1, 2010. Specifically, we note that the SCAD Program now provides: "The WCIRB Governing committee may impose any additional lawful disciplinary action it deems necessary, reasonable, or appropriate to encourage the insurer's implementation of adequate remedial measures, including but not limited to, reporting the insurer to the California Insurance commissioner and/or requiring an onsite audit, by an independent auditor and at the insurer's expense, of the insurer's systems with respect to the data referenced in the remediation plan."</p> <p>We commented that this process appears to be very subjective. WCIRB personnel concurred with this observation and further commented that this is a very new process with no instances of application yet. WCIRB Personnel anticipate that it would be very rare to require an audit of the data and an audit of this kind would require</p>

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<p>9. (2009 Report Numbering: Section V, Recommendation #5): "We recommend that the WCIRB implement a program applicable to the largest insurers whereby the senior management and the controllers of the insurers attest to the effectiveness of the insurers' statistical and financial reporting systems. Such a program should increase the accuracy of the insurers' reports. The WCIRB may wish to pattern its program after a similar program that has been implemented by the National Council on Compensation Insurance, Inc. ("NCCI"). Similar to the recommendation 4 above, we further recommend that the WCIRB authorize WCIRB staff, or independent persons engaged by the WCIRB, to perform an on-sight audit of insurers that do not file the attestation report."</p>	<p>See <u>General Response</u> under #5 above. <u>Response specific to #9:</u> "Data Certification Program. A new WCIRB Financial Call Data Certification (d). "Form has been adopted and incorporated into the SCAD Program (Exhibit 3, Section II, Subsection E). Annual submission of this form, which is modeled on the NCCI current certification form, will be required beginning with the certification of aggregate financial data evaluated as of December 31, 2010 to be submitted by June of 2011. Exhibit 6 is a sample copy of the new WCIRB certification form."</p>	<p>WCIRB Board approval. Additionally, it was suggested that the WCIRB Board would not approve such an audit unless "there was a significant issue with rate making implications."</p>
<p>9. (2009 Report Numbering: Section V, Recommendation #5): "We recommend that the WCIRB implement a program applicable to the largest insurers whereby the senior management and the controllers of the insurers attest to the effectiveness of the insurers' statistical and financial reporting systems. Such a program should increase the accuracy of the insurers' reports. The WCIRB may wish to pattern its program after a similar program that has been implemented by the National Council on Compensation Insurance, Inc. ("NCCI"). Similar to the recommendation 4 above, we further recommend that the WCIRB authorize WCIRB staff, or independent persons engaged by the WCIRB, to perform an on-sight audit of insurers that do not file the attestation report."</p>	<p>See <u>General Response</u> under #5 above. <u>Response specific to #9:</u> "Data Certification Program. A new WCIRB Financial Call Data Certification (d). "Form has been adopted and incorporated into the SCAD Program (Exhibit 3, Section II, Subsection E). Annual submission of this form, which is modeled on the NCCI current certification form, will be required beginning with the certification of aggregate financial data evaluated as of December 31, 2010 to be submitted by June of 2011. Exhibit 6 is a sample copy of the new WCIRB certification form."</p>	<p>We reviewed the amendments to the SCAD Program effective July 1, 2010. WCIRB Personnel confirmed that this requirement also applies to State Compensation Insurance Fund ("SCIF"). They also indicated that the WCIRB form was customized from the NCCI form, which is a form that the insurers already complete and that this fact should facilitate implementation. WCIRB Personnel indicated that they plan to enforce financial penalties where necessary.</p>

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<p>10. (2009 Report Numbering: Section V, Recommendation #6): "We recommend that the WCRIB work closely with SCIF to assure that SCIF's data collection and reporting system is functioning effectively. Given SCIF's share of the workers' compensation market in California, it is important that SCIF's data-capturing and reporting systems function effectively."</p>	<p>See <u>General Response</u> under #5 above.</p> <p><u>Response specific to #10:</u></p> <p>"State Fund aggregate data reporting (f).</p> <p>"On December 18, 2009, WCIRB actuarial staff met with State Fund data reporting staff to discuss a number of detailed data reporting issues — including premium reporting, loss adjustment expense differences, and the treatment of medical liens. Information provided by State Fund subsequent to the meeting resulted in several modifications in the data used by the WCIRB in the December 31, 2009 analysis of loss experience. Exhibit 7 is a summary of the December 18, 2009 WCIRB and State Fund meeting. Exhibit 8 is a copy of the March 28, 2010 plan pertaining to enhancing communication between WCIRB actuarial staff and State Fund aggregate data reporting staff on aggregate data issues."</p>	<p>We reviewed the Summary of the WCIRB's December 18, 2009 meeting with SCIF and the March 28, 2010 plan pertaining to communication between the WCIRB and SCIF.</p> <p>At the time of our interview, WCIRB Personnel explained that David Bellucci was drafting a letter to CDI (Christopher Citko - Senior Staff Counsel) regarding the "January 1, 2011 Pure Premium Rate Filing – SCIF Experience"</p> <p>The draft letter was finalized and issued to CDI on September 2, 2010.</p>

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<b><u>2009 Recommendations Pertaining to Activities Other Than Data Collection And Compilation</u></b>		
<p>11. (2009 Report Numbering: Section VI, Recommendation #1): "We recommend that the WCIRB move toward requiring insurers to file policy information in a standard filing medium, preferably electronically. We note that insurers currently file policy information in both hard copy and electronic format."</p>	<p>"Over time, the WCIRB has worked with insurers to increase the volume of policy data submitted electronically. Currently, approximately 60% of policy submissions are made electronically. The WCIRB is in the process of developing a new data processing system that will further facilitate the electronic submission of policy data. The new system's functionality will (a) process all types of policy documents and transactions electronically, (b) improve document tracking, (c) eliminate the need to produce paper output of electronically submitted documents, and (d) improve processing speed. The WCIRB's new data processing system, which will facilitate the electronic submission of policy data, is now estimated to be operational in 2014. In the interim, staff will continue to work with insurers to increase electronic submission of policies."</p>	<p>WCIRB Personnel stated that approximately 60% of all policy submissions are made electronically. They added that they continue to encourage insurers to submit policy data electronically.</p> <p>WCIRB Personnel indicated that the delay in implementation (originally scheduled for the end of 2011) is due to problems with the vendor originally hired for this project. WCIRB Personnel reviewed a number of steps that they have taken during 2010 to avoid additional delays.</p> <p>WCIRB Personnel anticipate that once WCIRB's new data processing system is operational in 2014, the approximately 10 WCIRB employees responsible for policy data collection will probably not be necessary. These employees are aware of the possible job</p>

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		eliminations and are encouraged to seek other commensurate roles within the WCIRB.

**2009 Recommendations Pertaining to the Towers Report**

<p>12. (2009 Report Numbering: Section VII, Recommendation #1): "We recommend that the WCIRB consider multiple projection methods when making pure premium rate determinations. No one projection method will be appropriate for all accident years. The WCIRB also should review various diagnostic statistics and retrospective analyses to assist in determining which projection methods are appropriate for each accident year."</p>	<p><u>General Response (Applicable to #12 through #15):</u></p> <p>"CDI staff has indicated that while it is recognized that a number of alternative loss projections are included in WCIRB pure premium rate filings, CDI examiner believed the alternative projections should be presented in a more prominent way that can be better understood and considered in the pure premium rate setting process. In response to these concerns, the WCIRB expanded the discussion of alternative loss projections in its January 1, 2010 filing by including a summary of the key assumptions as well as a discussion as to why that methodology is appropriate or inappropriate as the case may be. In addition, the WCIRB included an executive summary of the filing in order to highlight the salient points of the filing, and the WCIRB made the presentation</p>	<p>WCIRB Personnel highlighted how the enhanced alternative methodologies, set forth in the 2011 and 2010 pure premium rate filings, compared to the 2009 pure premium rate filing. WCIRB Personnel provided the relevant sections of the pure premium rate filings, as well as a summary of the enhancements. Specifically:</p> <ol style="list-style-type: none"> <li>1. Prior to the January 1, 2010 pure premium rate filing, no Executive Summary was included.</li> <li>2. Subsequent to the January 1, 2010 pure premium rate filing:             <ol style="list-style-type: none"> <li>(a) The Executive Summary was added along with tables of alternative loss development,</li> </ol> </li> </ol>
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	<p>of alternative methodologies more prominent and understandable to a non-actuarial audience."</p>	<p>trending, and loss adjustment expense methodology projections. (Pages 11 - 13 of the 1/1/11 filing and Pages 10 -12 of the 1/1/10 filing).</p> <p>(b) The number of alternative loss development methodologies presented, the description of the underlying assumptions, and the basis of each of the methodologies was significantly augmented. (Part A, Section B Appendix B of 1/1/10 &amp; 1/1/11 filings; Pages A:B-49 to A:B-52 and Exhibits 13 - 24 of 1/1/11 filing; and Pages A:B-38 to A:B-42 and Exhibits 15 - 26 of 1/1/10 filing).</p> <p>(c) The number of alternative trending methodologies presented, the description of the underlying assumptions, and the basis of each of the methodologies was significantly augmented (Part A, Section B Appendix C of 1/1/10 and 1/1/11 filings; Pages A:B-148 to A:B-149</p>

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		<p>and Exhibits 5 – 12 of 1/1/11 filing; and Pages A:B-141 to A:B-143 and Exhibits 7 - 12 of 1/1/10 filing).</p> <p>(d) The number of alternative LAE projection methodologies presented, the description of the underlying assumptions, and the basis of each of the methodologies was significantly augmented (Part A, Section B Appendix D of 1/1/10 &amp; 1/1/11 filings; Pages A:B-180 to A:B181, A:B-182 to A:B-185, and Exhibits 8 - 12 and Exhibits 14 - 31 of 1/1/11 filing; and Pages A:B-172 to A:B-173 and A:B-174 to A:B-177, and Exhibits 8 - 2 and Exhibits 14 - 31 of 1/1/10 filing).</p>

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<p>13. (2009 Report Numbering: Section VII, Recommendation #2): "We recommend that retrospective projected ultimate loss ratios ("LRs") be selected judgmentally by accident year and that the original projected ultimate LRs be compared to the updated projected ultimate LRs by accident year. Further, we recommend that retrospective analyses be prepared annually so that changes in projected ultimate pure premium LRs by accident year can be observed and explained."</p>	<p>See <u>General Response</u> under #12 above.</p> <p><u>Response specific to #13:</u></p> <p>None provided.</p>	<p>WCIRB Personnel explained that retrospective evaluations of loss development methodologies were not included in pure premium rate filings made prior to January 1, 2010. They further highlighted where the retrospective evaluations of loss development methodologies are now located in their rate filings and how this differed from those of 2009 and 2008.</p> <p>Specifically, for the:</p> <ol style="list-style-type: none"> <li>2011 rate filing, the retrospective evaluation of loss development methodologies is discussed in Part A, Section B, Appendix B, Page A:B-46 and presented in Exhibit 12.</li> <li>2010 rate filing, the retrospective evaluation of loss development methodologies is discussed in Part A, Section B, Appendix B, Page A:B-36</li> </ol>

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		<p>and presented in Exhibit 14</p> <p>It was further clarified that the pure premium rate filing provides a six month retrospective look by accident year and incorporates various methods and diagnostic discussions which are shared with both the Actuarial and Governing Committees. It is the WCIRB's practice to apply hybrid calculation methods which place more weight on the latest year's development. WCIRB believes that once the market stabilizes, they will begin to introduce more development years (e.g. three years).</p>
<p>14. (2009 Report Numbering: Section VII, Recommendation #3): "After considering the results of multiple methods, we recommend that the WCIRB provide a range of reasonable pure premium rate level indications to the Actuarial Committee and the Governing Committee."</p>	<p>See <u>General Response</u> under #12 above.</p> <p><u>Response specific to #14:</u></p> <p>"Additionally, in response to the recommendations of the 2008 Towers Perrin report as well as those contained in recent CDI pure premium rate decisions, the WCIRB formed a special committee consisting of representatives with actuarial, claims or data reporting expertise. The objective of this Special Committee was to identify the key diagnostic measures and</p>	<p>Among other testing, we reviewed the Actuarial Committee meeting minutes for June 11, 2010. It appears from our review that WCIRB staff provided, and the Actuarial Committee discussed, a range of methodologies and resulting rate indications in connection with the proposed January 1, 2011 pure premium rate filing.</p>

**EXHIBIT A**  
**Status of 2009 Recommendations Matrix**

<u>Full Text of The 2009 Recommendations</u>	<u>Excerpts from the WCIRB's Plan of Implementation Updated as of 6/14/10</u>	<u>Our Observations/Testing Based on Document Review and WCIRB Personnel Interviews*</u>
<p>15. (2009 Report Numbering: Section VII, Recommendation #4): "Rather than presenting the CDI with the results of only one method, we recommend that the WCIRB prepare and provide to the CDI a chart or side-by-side comparison showing projected on-level pure premium LRs by accident year using each method considered by the WCIRB. Providing this information will allow the CDI to better understand the variability surrounding the projections and the extent to which projections are sensitive to alternate assumptions. We also believe it would be helpful for the WCIRB to explain why it believes certain methods are more reasonable than others for particular accident years. We recommend that the</p>	<p>leading indicators that should be reviewed by the WCIRB Actuarial Committee and Claims Subcommittee on a regular basis in order to identify the environmental conditions impacting loss and loss adjustment expense emergence.</p> <p>"In addition, the WCIRB contracted with Towers Perrin to develop recommendations as to specific loss development methodologies that will be most appropriate given the environmental conditions existing at the time the projections are made."</p>	<p>The fulfillment of this requirement has been presented in the January 1, 2011 pure premium rate filing as follows:</p> <ol style="list-style-type: none"> <li>1. Executive Summary: Exhibit 2 (page 11) and Exhibit 3 (page 12) provide the "Projected Policy Year 2011 Loss Ratios and Indicated Pure Premium Rate Level - Changes Based on Alternative Loss Development Methodologies." These exhibits provide a summary level of the methodologies without an accident year level assessment.</li> </ol>
<p>15. (2009 Report Numbering: Section VII, Recommendation #4): "Rather than presenting the CDI with the results of only one method, we recommend that the WCIRB prepare and provide to the CDI a chart or side-by-side comparison showing projected on-level pure premium LRs by accident year using each method considered by the WCIRB. Providing this information will allow the CDI to better understand the variability surrounding the projections and the extent to which projections are sensitive to alternate assumptions. We also believe it would be helpful for the WCIRB to explain why it believes certain methods are more reasonable than others for particular accident years. We recommend that the</p>	<p>See <u>General Response</u> under #12 above.</p> <p><u>Response specific to #15:</u></p> <p>None provided.</p>	<p>The fulfillment of this requirement has been presented in the January 1, 2011 pure premium rate filing as follows:</p> <ol style="list-style-type: none"> <li>1. Executive Summary: Exhibit 2 (page 11) and Exhibit 3 (page 12) provide the "Projected Policy Year 2011 Loss Ratios and Indicated Pure Premium Rate Level - Changes Based on Alternative Loss Development Methodologies." These exhibits provide a summary level of the methodologies without an accident year level assessment.</li> </ol>

**EXHIBIT A**  
**Status of 2009 Recommendations Matrix**

<u>Full Text of The 2009 Recommendations</u>	<u>Excerpts from the WCIRB's Plan of Implementation Updated as of 6/14/10</u>	<u>Our Observations/Testing Based on Document Review and WCIRB Personnel Interviews*</u>
<p>WCIRB describe the key assumptions underlying each method, the extent to which the WCIRB believes those assumptions are valid, and alternate scenario projections for key assumptions. We also recommend that the WCIRB explain its rationale behind the selected LRs by accident year."</p>		<p>2. Part A, Section B, Appendix B – Exhibits 13 to 24 on pages A:B - 85 to A:B – 140. These exhibits provide the twelve methodologies on an accident year basis.</p>

\* On September 1-2, 2010, representatives from R&A met with Brenda Keys (Senior Vice President, Legal) and David Bellusci (Senior Vice President & Chief Actuary), collectively referenced as "WCIRB Personnel," to discuss and review the status of the 2009 recommendations. Additionally, we obtained supplemental information from WCIRB Personnel through email correspondence and telephone interviews. We also reviewed documents provided by the WCIRB as evidence of progress on, or completion of, each recommendation.

## EXHIBIT B

### Comprehensive List of Examination Recommendations

#### A. Recommendations Pertaining to the WCIRB's Implementation of 2009 Recommendations

1. We recommend that the WCIRB, the public members and their actuary, and the CDI meet at least bi-annually to assess whether the level of communication by the public members and their actuary is sufficient to inform the CDI of their views and suggestions, and to discuss what the WCIRB is or could be doing to facilitate that communication. We further recommend that the WCIRB establish a formalized process (e.g., including a formal "minority report" with each WCIRB rate filing) to ensure that the recent improvements in the quality and frequency of communication are maintained over time.
2. We recommend that the WCIRB report to the CDI on the status of (a) its medical transactional data system and (b) its data processing system for policy submissions once every calendar quarter until each system becomes operational. The report should state whether the development of each system remains on-schedule.
3. We recommend that the WCIRB report to the CDI in the 1<sup>st</sup> quarter of 2012 with respect to:
  - a. whether and to what extent the WCIRB has imposed processing charges, assessments, or otherwise used its new enforcement powers under SCAD with respect to untimely, incomplete or inaccurate data calls during 2011; and
  - b. whether and to what extent the instances of untimely, incomplete or inaccurate data calls decreased in 2011 compared to prior years.

If the increased enforcement powers are not being used by the WCIRB or have not resulted in improved timeliness, completeness and accuracy of data calls, the WCIRB should present a remediation plan to the CDI to further address this issue.

4. We recommend that the WCIRB report to the CDI on an annual basis (beginning in the first quarter of 2012) whether there were any instances in the preceding calendar year in which an insurer failed to obtain a "clean" audit opinion regarding its data report, and if so, what disciplinary action, if any, was taken by the Governing Committee.

5. We recommend that the WCIRB report to the CDI on an annual basis (beginning in the first quarter of 2012) on the steps that it took in the preceding calendar year to work with SCIF regarding SCIF's data collection and reporting system.

**B. Recommendations Pertaining to Committee Meeting Participation and Public Access to Data**

1. We recommend that the WCIRB expand the role of its Governing Committee to that of a traditional Board of Directors with general oversight over, and responsibility for, the operations of the WCIRB.
2. We recommend that the WCIRB post the meeting schedules (including the date, time, and place of meeting) of each regular session of the Governing Committee, C&R Committee and Actuarial Committee on its public website along with a statement that these meetings are open to the public. We also recommend that the agenda (or alternatively, a simple list of agenda items) with respect to each meeting be posted on the public website in advance of each meeting (rather than being available only for purchase through the product catalog).
3. We recommend that the WCIRB review its practices regarding matters discussed in the executive sessions of the Governing Committee vs. matters discussed in the regular sessions of the Governing Committee. Specifically, the WCIRB should evaluate whether matters that are not "privileged, proprietary or confidential" pursuant to the MOU are discussed in executive sessions, and if so, should in the future discuss such matters in the regular sessions instead.
4. We recommend that the WCIRB permit members of the Actuarial Committee to attend meetings of the Claims Subcommittee, and members of the C&R Committee to attend meetings of the Manuals Subcommittee. If the WCIRB believes it is appropriate to do so to address some of its concerns, it could restrict participation by such members in the meeting (i.e., they may attend and observe, but they may not speak unless invited to do so).
5. We recommend that the WCIRB provide unfettered access to Governing Committee members to all committee, subcommittee, special committee and task force meetings conducted by the WCIRB. If the WCIRB believes it is appropriate to do so to address some of its concerns, it could restrict participation by such members in the meeting (i.e., they may attend and observe, but they may not speak unless invited to do so).
6. We recommend that the WCIRB re-evaluate whether its Data Quality Enhancement Program, Submission of California Aggregate Data Program,

and California Large Risk Classification Validation Program should be made available to the public.

7. We recommend that those member notices that do not contain privileged, proprietary or confidential information be made available to the public.
8. We recommend that the agenda and minutes to meetings of the Claims Subcommittee and the Manuals Subcommittee and the agenda and minutes (if any) to special committees and task forces be made available to the public. We further recommend that these agendas and minutes be made available to the public on a stand-alone basis (other than, as is the case with the Claims Subcommittee minutes, only as an attachment to the agendas of a standing committee).
9. We recommend that the WCIRB eliminate its blanket ban on public participation in all meetings of the Claims Subcommittee, the Manuals Subcommittee, special committees and task forces. Specifically, we recommend that the WCIRB review the factors discussed above that weigh in favor of public participation, and in light of these factors, take a more nuanced approach to public participation. The WCIRB should report to the CDI regarding its proposed new approach by no later than December 31, 2011.

### **C. Recommendations Pertaining to the Role of the WCIRB in the Rate Making Process**

1. We recommend that the WCIRB take steps to educate the public regarding the reality of the workers' compensation rate making process. Employers and policy makers should receive the clear message that, under existing California law, the Commissioner does not have the power to stop rate increases (regardless of what the Commissioner does relative to the WCIRB advisory filing). Examples of steps that could be taken include:
  - In press materials and at the public hearing relative to the WCIRB filing, the WCIRB could point out that the WCIRB's filing is purely advisory and that individual insurers can adopt the WCIRB's rates or not, as they choose. For example, the public could be told that insurers can adopt the WCIRB's rates in full even if the WCIRB filing is totally rejected by the Commissioner.
2. We recommend that the WCIRB take steps to reduce the confusion prompted by its focus on a single loss cost projection percentage, particularly since the projection percentage used by the WCIRB is calculated in relation to multiple years of loss cost development and has little relationship to what will happen to actual workers' compensation rates in the real world. The goal of these recommended steps is to focus public and policy-maker attention on what is actually happening in the workers' compensation industry and reduce the

focus as to whose prediction about the future is the best. These steps could include:

- Restructuring the WCIRB pure premium rate filing to contain two sections, as follows:
  - The first section—which would be informational in nature—would contain an analysis of the actual pure premium rates currently being charged by workers’ compensation insurers in California (both on an aggregate basis and on a class-by-class basis). The first section would be akin to an “index” (such as the Consumer Price Index), which measures “what is” rather than “what is expected” or “what should be.”
  - The second section would contain the WCIRB’s projections of loss costs (i.e., the pure premium rate and class relativities for which it is seeking approval) for the coming year. This second section would be akin to a projection or estimate of “what is expected” (analogous to economic projections of unemployment rates) rather than a statement of what the WCIRB believes the loss costs “should be.” This second section would resemble the filing currently made by the WCIRB, but would be modified as suggested below to increase its utility and reduce the confusion surrounding it.
- Describing its projections of future loss costs (the second part of the restructured filing discussed above) using more appropriate comparisons, such as the percentage change the current filing reflects compared to (1) the rate filing made by the WCIRB in the prior year (this would show what the WCIRB believes will be the change in the pure premium part of the rate from one year to the next); and (2) the pure premium rates actually filed by workers’ compensation insurers (this would show how much the WCIRB believes the pure premium component of insurer rates will change compared to what workers’ compensation insurers have actually filed with the CDI).
- Including in its filing a historical comparison of (1) the actual loss cost development in the workers’ compensation industry for the preceding year to (2) the WCIRB’s projections of loss cost development in its filing for the preceding year. Doing so would provide information regarding the accuracy of the WCIRB’s prior predictions regarding loss costs.
- More clearly show that it is less certain about its projections of future loss costs than is implied by the use of a specific number. For example, rather than saying that it believes pure premium costs will increase by 7.6% in the coming year, the WCIRB could say that it believes pure premium costs will rise somewhere between 3% and 10%, with a “best estimate” of 7.6%.

- More clearly show that it is less certain about the assumptions used in making its projections than is implied by the use of a specific number. For example, rather than saying it believes that a particular Workers' Compensation Board ruling will cause medical costs to rise by 3.2%, the WCIRB could say that it believes the Board ruling will cause medical costs to rise somewhere between 1% and 5%, with a "best estimate" of 3.2%.
- Describe its loss cost projections in terms of the effect on the rates by class—since class rates are closer to the rates that will actually be charged—rather than describing them as an "average" of all classes. For example, rather than (or in addition to) saying that it believes loss costs will increase by an average of 7.6% in the coming year, the WCIRB could say that it believes that loss costs by class will change in the coming year, ranging from a decrease of 6.4% for Class X to an increase of 27.9% for Class Y. Another possible enhancement would be to include a scatter graph or bell curve graph showing the distribution of changes across all class codes. Such a graph would provide readers with a snapshot of the entirety of the class code changes.
- Use terminology that more accurately reflects the nature of the WCIRB's filing. For example, in discussing the actual pure premium rates being charged by workers' compensation insurers (the subject of the first section of the restructured filing), the WCIRB could refer to these rates as the "actual current workers' compensation loss costs" or the "workers' compensation industry loss cost index." Likewise, in discussing its projections of future loss costs (the subject of the second section of the restructured filing), the WCIRB could simply use terms such as "loss cost projections" or "future loss cost estimates" instead of "advisory pure premium rate" or "loss cost benchmark."
- Discontinue its practice of measuring its proposed pure premium rate changes against the advisory pure premium rates most recently approved by the Commissioner. The reasons for this directive include many of the factors previously mentioned: (1) the fact that the Commissioner's prior approved rates are only advisory, and insurers are free to file whatever set of pure premium rates they wish; (2) the fact that the prior approved advisory pure premium rates are largely unrelated to the pure premium rates actually filed by insurers and to actual market conditions; and (3) the fact that the use of the prior approved advisory pure premium rates misinforms and confuses the public as to the true extent of the proposed adjustment. The current process, which resembles the old "minimum rate law" analysis and recommendations, fails to accurately reflect insurer practices in the new open-rating system.

3. We recommend that the WCIRB begin collecting data from its member insurers sufficient to allow it, and/or the CDI, to compare and contrast the following three numbers:

- The “pure premium” rate filed by each workers’ compensation insurer with the CDI (“X per \$100 of payroll”);
- The standard premium or manual rate (i.e., the “fully loaded” premium rate, including administrative expenses and profit margin) filed by each workers’ compensation insurer with the CDI (“Y per \$100 of payroll”); and
- The discounted premium or charged rate (i.e., the rates actually charged, after taking debits and credits into account) actually charged by each workers’ compensation insurer (“Z per \$100 of payroll”).

A number of comparisons using this data could be made. For example, a comparison of “X” to “W” would show the difference that exists between the pure premium rates approved by the Commissioner and the pure premium rates filed by insurers. Likewise, a comparison of “Z” to “Y” would show the level of insurer discounting or surcharging.

Currently, the WCIRB collects data from its member insurers with respect to the last category for solvency monitoring purposes. Expanding the WCIRB’s data calls to include the first and second categories, and requiring the WCIRB to present the data in a comparative form on an industry average and individual insurer basis, would not only enhance the CDI’s ability to make “apple to apple” comparisons of workers’ compensation insurers for solvency monitoring purposes, but would also allow for additional consumer-oriented information to be made available. For example, such information could be used to generate reports that enhance the public’s understanding of the components that make up premium rates and the variables that affect what rates are actually charged.

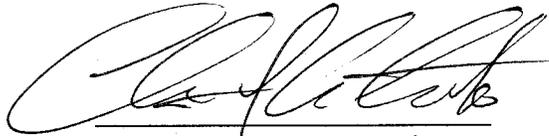
STATE OF CALIFORNIA

DEPARTMENT OF INSURANCE

I, **CHRISTOPHER A. CITKO**, SENIOR STAFF COUNSEL OF THE CALIFORNIA DEPARTMENT OF INSURANCE AND EXAMINER-IN-CHARGE ON THE EXAMINATION OF THE **WORKERS' COMPENSATION INSURANCE RATING BUREAU OF CALIFORNIA**, CERTIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF CALIFORNIA THAT I HAVE READ THE FOREGOING REPORT OF EXAMINATION OF THE **WORKERS' COMPENSATION INSURANCE RATING BUREAU OF CALIFORNIA** DATED AUGUST 10, 2011, AND THAT I KNOW THE CONTENTS THEREOF, AND THAT THE CONTENTS ARE TRUE AND CORRECT.

WITNESS MY HAND THIS

22<sup>ND</sup> DAY OF AUGUST, 2011

A handwritten signature in black ink, appearing to read 'Christopher A. Citko', written over a horizontal line.

CHRISTOPHER A. CITKO  
SENIOR STAFF COUNSEL

September 21, 2011

**By Email and U.S. Mail**

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**Robert G. Mike**  
President & CEO

**RE: California Department of Insurance Report on Operational Examination of the  
Workers' Compensation Insurance Rating Bureau of California dated August 10, 2011**

Dear Mr. Citko:

This letter is in response to the August 10, 2011 California Department of Insurance Report (CDI Report) on Operational Examination of the Workers' Compensation Insurance Rating Bureau of California (WCIRB). The WCIRB's response to each of the recommendations is provided below. The text of each recommendation appears before the WCIRB's response.

**WCIRB'S IMPLEMENTATION OF 2009 RECOMMENDATIONS**

**Recommendation 1**

*We recommend that the WCIRB, the public members and their actuary, and the CDI meet at least bi-annually to assess whether the level of communication by the public members and their actuary is sufficient to inform the CDI of their views and suggestions, and to discuss what the WCIRB is or could be doing to facilitate that communication. We further recommend that the WCIRB establish a formalized process (e.g., including a formal "minority report" with each WCIRB rate filing) to ensure that the recent improvements in the quality and frequency of communication are maintained over time.*

**WCIRB Response:** Although the public members of the Governing Committee are encouraged to contact WCIRB staff at any time for assistance, the WCIRB, the public members and their actuary, and the CDI set aside time to meet before or after each Governing Committee meeting to discuss a variety of issues. In order to optimize communication, the public members have been provided a single point of contact at the WCIRB who can facilitate responses to any questions or concerns they may have. In addition, the WCIRB provides the public members with administrative support as needed.

The recommendation that the WCIRB include "a formal 'minority report' with each WCIRB rate filing" does raise some concerns since the WCIRB's Governing Committee does not operate in a segmented fashion and the public members are not a subcommittee of the board. Currently, the public members work with their actuary to submit public comments to the Commissioner including their evaluation of the WCIRB's filing after they have had an opportunity to thoroughly review the WCIRB's rate filing and this process has worked well. WCIRB staff believes this practice is efficient and effective, but we will schedule a meeting with the CDI in the next 90 days to discuss this recommendation.

Christopher A. Citko, Esq.  
California Department of Insurance  
September 21, 2011

**Recommendation 2**

*We recommend that the WCIRB report to the CDI on the status of (a) its medical transactional data system and (b) its data processing system for policy submissions once every calendar quarter until each system becomes operational. The report should state whether the development of each system remains on schedule.*

**WCIRB Response:** The WCIRB advises the CDI regularly as to the status of the medical transactional data system in addition to any concerns regarding changes in its core processing systems. We will continue to inform the CDI about the status of the medical transactional data system and the data processing system for policy submissions at least quarterly until each system becomes operational.

**Recommendation 3**

*We recommend that the WCIRB report to the CDI in the 1<sup>st</sup> quarter of 2012 with respect to:*

- a. *whether and to what extent the WCIRB has imposed processing charges, assessments, or otherwise used its new enforcement powers under SCAD with respect to untimely, incomplete or inaccurate data calls during 2011; and*
- b. *whether and to what extent the instances of untimely, incomplete or inaccurate data calls decreased in 2011 compared to prior years.*

*If the increased enforcement powers are not being used by the WCIRB or have not resulted in improved timeliness, completeness and accuracy of data calls, the WCIRB should present a remediation plan to the CDI to further address this issue.*

**WCIRB Response:** The WCIRB will provide the requested report to the CDI in the first quarter of 2012.

**Recommendation 4**

*We recommend that the WCIRB report to the CDI on an annual basis (beginning in the first quarter of 2012) whether there were any instances in the preceding calendar year in which an insurer failed to obtain a "clean" audit opinion regarding its data report, and if so, what disciplinary action, if any, was taken by the Governing Committee.*

**WCIRB Response:** WCIRB policy and practice is to notify the CDI in writing as soon as the WCIRB determines that an insurer's data is not accurate or cannot be sufficiently validated as accurate (e.g., failure to provide a required independent audit review or data call certification) and, as a result, cannot be used in a WCIRB pure premium rate filing. CDI staff is invited to participate in the remediation process with the insurer and to attend all Governing Committee meetings. Consequently, the CDI has contemporaneous knowledge about any disciplinary action taken by the Governing Committee regarding this or any other issue. Therefore, the WCIRB believes that the current notification process is adequate, but we will schedule a meeting with the CDI in the next 90 days to discuss this recommendation.

**Recommendation 5**

*We recommend that the WCIRB report to the CDI on an annual basis (beginning in the first quarter of 2012) on the steps that it took in the preceding calendar year to work with SCIF regarding SCIF's data collection and reporting system.*

**WCIRB Response:** We recognize that changes in experience for State Fund, the largest insurer in the state, can have a significant impact on the WCIRB's pure premium rate level indication. Therefore, we have worked closely with State Fund and implemented new procedures to ensure

Christopher A. Citko, Esq.  
California Department of Insurance  
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that its data collection and reporting system is functioning effectively. The WCIRB will schedule a meeting with the CDI in the next 90 days to discuss modifications to this process.

## COMMITTEE MEETING PARTICIPATION AND PUBLIC ACCESS TO DATA

### **Recommendation 1**

*We recommend that the WCIRB expand the role of its Governing Committee to that of a traditional Board of Directors with general oversight over, and responsibility for, the operations of the WCIRB.*

**WCIRB Response:** It appears that there may have been a miscommunication between WCIRB staff and the examiners with respect to the role of the WCIRB's Governing Committee, which does have general oversight over, and responsibility for, the operations of the WCIRB. Article VII of the WCIRB's Constitution specifically provides that the Governing Committee has "complete charge and management of the affairs of the WCIRB." Further, the Governing Committee exercises oversight of the Classification and Rating (C & R) Committee and the Actuarial Committee by reviewing and approving the minutes of each meeting of both committees. The only limitation on the Governing Committee's authority with respect to the WCIRB's standing committees is that the Governing Committee cannot modify the scope of the Committees' responsibilities as detailed in the WCIRB Constitution. The WCIRB believes that the current procedures are adequate and will schedule a meeting with the CDI in the next 90 days to further discuss this recommendation.

### **Recommendation 2**

*We recommend that the WCIRB post the meeting schedules (including the date, time, and place of meeting) of each regular session of the Governing Committee, C&R Committee and Actuarial Committee on its public website along with a statement that these meetings are open to the public. We also recommend that the agenda (or alternatively, a simple list of agenda items) with respect to each meeting be posted on the public website in advance of each meeting (rather than being available only for purchase through the product catalog).*

**WCIRB Response:** The WCIRB agrees with this recommendation and, in fact, implemented this practice in early 2011.

### **Recommendation 3**

*We recommend that the WCIRB review its practices regarding matters discussed in the executive sessions of the Governing Committee vs. matters discussed in the regular sessions of the Governing Committee. Specifically, the WCIRB should evaluate whether matters that are not "privileged, proprietary or confidential" pursuant to the MOU are discussed in executive sessions, and if so, should in the future discuss such matters in the regular sessions instead.*

**WCIRB Response:** The WCIRB believes that the matters discussed in executive sessions of the Governing Committee are "privileged, proprietary or confidential" pursuant to the WCIRB's MOU with the CDI. The WCIRB will review its practices and provide its evaluation to the CDI in the first quarter of 2012.

Christopher A. Citko, Esq.  
California Department of Insurance  
September 21, 2011

**Recommendation 4**

*We recommend that the WCIRB permit members of the Actuarial Committee to attend meetings of the Claims Subcommittee, and members of the C&R Committee to attend meetings of the Manuals Subcommittee. If the WCIRB believes it is appropriate to do so to address some of its concerns, it could restrict participation by such members in the meeting (i.e., they may attend and observe, but they may not speak unless invited to do so).*

**WCIRB Response:** The WCIRB agrees to permit members of the Actuarial Committee attend meetings of the Claims Subcommittee and members of the C & R Committee attend meetings of the Manual Subcommittee. Staff will evaluate whether it would be appropriate to restrict participation by such members in the meeting and report to the CDI on this issue in the first quarter of 2012.

**Recommendation 5**

*We recommend that the WCIRB provide unfettered access to Governing Committee members to all committee, subcommittee, special committee and task force meetings conducted by the WCIRB. If the WCIRB believes it is appropriate to do so to address some of its concerns, it could restrict participation by such members in the meeting (i.e., they may attend and observe, but they may not speak unless invited to do so).*

**WCIRB Response:** The WCIRB agrees, except in unique circumstances such as a conflict of interest, to provide Governing Committee members access to all committee, subcommittee, special committee and task force meetings conducted by the WCIRB. Staff will evaluate whether it would be appropriate to restrict participation by such members in the meeting and report to the CDI on this issue in the first quarter of 2012.

**Recommendation 6**

*We recommend that the WCIRB re-evaluate whether its Data Quality Enhancement Program, Submission of California Aggregate Data Program, and California Large Risk Classification Validation Program should be made available to the public.*

**WCIRB Response:** The WCIRB agrees to re-evaluate whether its Data Quality Enhancement Program, Submission of California Aggregate Data Program, and California Large Risk Classification Validation Program should be made available to the public. The WCIRB's evaluation will be provided to the CDI in the first quarter of 2012.

**Recommendation 7**

*We recommend that those member notices that do not contain privileged, proprietary or confidential information be made available to the public.*

**WCIRB Response:** The WCIRB agrees to make information contained in member notices that is not privileged, proprietary, confidential or administrative available to the public. The WCIRB will schedule a meeting with the CDI in the next 90 days to discuss this issue.

**Recommendation 8**

*We recommend that the agenda and minutes to meetings of the Claims Subcommittee and the Manuals Subcommittee and the agenda and minutes (if any) to special committees and task forces be made available to the public. We further recommend that these agendas and minutes be made available to the public on a stand-alone basis (other than, as is the case with the Claims Subcommittee minutes, only as an attachment to the agendas of a standing committee).*

**WCIRB Response:** Consistent with Recommendation 2 above, the WCIRB agrees to make a list of agenda items for the Claims Subcommittee and Manual Subcommittee available to the public.

Christopher A. Citko, Esq.  
California Department of Insurance  
September 21, 2011

The minutes of the Claims Subcommittee and the Manual Subcommittee have been made public as part of the Actuarial Committee agenda and the C & R Committee agenda, respectively; but the WCIRB will make these minutes available on a stand-alone basis going forward.

The WCIRB believes that each special committee and task force (if any) should be evaluated on a case by case basis to determine whether the agendas and minutes for these meetings should be made public. The WCIRB will schedule a meeting with the CDI in the next 90 days to further discuss this recommendation.

#### **Recommendation 9**

*We recommend that the WCIRB eliminate its blanket ban on public participation in all meetings of the Claims Subcommittee, the Manuals Subcommittee, special committees and task forces. Specifically, we recommend that the WCIRB review the factors discussed above that weigh in favor of public participation, and in light of these factors, take a more nuanced approach to public participation. The WCIRB should report to the CDI regarding its proposed new approach by no later than December 31, 2011.*

**WCIRB Response:** The WCIRB agrees to review this issue and report back to the CDI regarding the proposed approach for dealing with public participation in all meetings of the Claims Subcommittee, the Manual Subcommittee, special committees and task forces. However, the WCIRB requests that the date for this report be extended to March 31, 2012.

### **ROLE OF THE WCIRB IN THE RATE MAKING PROCESS**

#### **Recommendation 1**

*We recommend that the WCIRB take steps to educate the public regarding the reality of the workers' compensation rate making process. Employers and policy makers should receive the clear message that, under existing California law, the Commissioner does not have the power to stop rate increases (regardless of what the Commissioner does relative to the WCIRB advisory filing). Examples of steps that could be taken include:*

- *In press materials and at the public hearing relative to the WCIRB filing, the WCIRB could point out that the WCIRB's filing is purely advisory and that individual insurers can adopt the WCIRB's rates or not, as they choose. For example, the public could be told that insurers can adopt the WCIRB's rates in full even if the WCIRB filing is totally rejected by the Commissioner.*

**WCIRB Response:** The WCIRB agrees with this recommendation and is implementing it in connection with its 2012 pure premium rate filing. The WCIRB will schedule a meeting with the CDI in the next 90 days to discuss this issue.

#### **Recommendation 2**

*We recommend that the WCIRB take steps to reduce the confusion prompted by its focus on a single loss cost projection percentage, particularly since the projection percentage used by the WCIRB is calculated in relation to multiple years of loss cost development and has little relationship to what will happen to actual workers' compensation rates in the real world. The goal of these recommended steps is to focus public and policy-maker attention on what is actually happening in the workers' compensation industry and reduce the focus as to whose prediction about the future is the best. These steps could include:*

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- *Restructuring the WCIRB pure premium rate filing to contain two sections, as follows:*
  1. *The first section—which would be informational in nature—would contain an analysis of the actual pure premium rates currently being charged by workers' compensation insurers in California (both on an aggregate basis and on a class-by-class basis). The first section would be akin to an "index" (such as the Consumer Price Index), which measures "what is" rather than "what is expected" or "what should be."*
  2. *The second section would contain the WCIRB's projections of loss costs (i.e., the pure premium rate and class relativities for which it is seeking approval) for the coming year. This second section would be akin to a projection or estimate of "what is expected" (analogous to economic projections of unemployment rates) rather than a statement of what the WCIRB believes the loss costs "should be." This second section would resemble the filing currently made by the WCIRB, but would be modified as suggested below to increase its utility and reduce the confusion surrounding it.*
- *Describing its projections of future loss costs (the second part of the restructured filing discussed above) using more appropriate comparisons, such as the percentage change the current filing reflects compared to (1) the rate filing made by the WCIRB in the prior year (this would show what the WCIRB believes will be the change in the pure premium part of the rate from one year to the next); and (2) the pure premium rates actually filed by workers' compensation insurers (this would show how much the WCIRB believes the pure premium component of insurer rates will change compared to what workers' compensation insurers have actually filed with the CDI).*
- *Including in its filing a historical comparison of (1) the actual loss cost development in the workers' compensation industry for the preceding year to (2) the WCIRB's projections of loss cost development in its filing for the preceding year. Doing so would provide information regarding the accuracy of the WCIRB's prior predictions regarding loss costs.*
- *More clearly show that it is less certain about its projections of future loss costs than is implied by the use of a specific number. For example, rather than saying that it believes pure premium costs will increase by 7.6% in the coming year, the WCIRB could say that it believes pure premium costs will rise somewhere between 3% and 10%, with a "best estimate" of 7.6%*
- *More clearly show that it is less certain about the assumptions used in making its projections than is implied by the use of a specific number. For example, rather than saying it believes that a particular Workers' Compensation Board ruling will cause medical costs to rise by 3.2%, the WCIRB could say that it believes the Board ruling will cause medical costs to rise somewhere between 1% and 5%, with a "best estimate" of 3.2%.*
- *Describe its loss cost projections in terms of the effect on the rates by class—since class rates are closer to the rates that will actually be charged—rather than describing them as an "average" of all classes. For example, rather than (or in addition to) saying that it believes loss costs will increase by an average of 7.6% in the coming year, the WCIRB could say that it believes that loss costs by class will change in the coming year, ranging from a decrease of 6.4% for Class X to an increase of 27.9% for Class Y. Another possible enhancement would be to include a scatter graph or bell curve graph showing the distribution of changes across all class codes. Such a graph would provide readers with a snapshot of the entirety of the class code changes.*

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September 21, 2011

- *Use terminology that more accurately reflects the nature of the WCIRB's filing. For example, in discussing the actual pure premium rates being charged by workers' compensation insurers (the subject of the first section of the restructured filing), the WCIRB could refer to these rates as the "actual current workers' compensation loss costs" or the "workers' compensation industry loss cost index." Likewise, in discussing its projections of future loss costs (the subject of the second section of the restructured filing), the WCIRB could simply use terms such as "loss cost projections" or "future loss cost estimates" instead of "advisory pure premium rate" or "loss cost benchmark."*
- *Finally, the WCIRB needs to discontinue its practice of measuring its proposed pure premium rate changes against the advisory pure premium rates most recently approved by the Commissioner. The reasons for this directive include many of the factors previously mentioned: (1) the fact that the Commissioner's prior approved rates are only advisory, and insurers are free to file whatever set of pure premium rates they wish; (2) the fact that the prior approved advisory pure premium rates are largely unrelated to the pure premium rates actually filed by insurers and to actual market conditions; and (3) the fact that the use of the prior approved advisory pure premium rates misinforms and confuses the public as to the true extent of the proposed adjustment. The current process, which resembles the old "minimum rate law" analysis and recommendations, fails to accurately reflect insurer practices in the new open-rating system.*

**WCIRB Response:** The WCIRB believes the information reflected in its 2012 pure premium rate filing largely addresses these recommendations. The WCIRB will schedule a meeting with the CDI in the next 90 days to discuss the inclusion of additional information in its future pure premium rate filings.

### **Recommendation 3**

*We recommend that the WCIRB begin collecting data from its member insurers sufficient to allow it, and/or the CDI, to compare and contrast the following three numbers:*

- *The "pure premium" rate filed by each workers' compensation insurer with the CDI ("X per \$100 of payroll");*
- *The standard premium or manual rate (i.e., the "fully loaded" premium rate, including administrative expenses and profit margin) filed by each workers' compensation insurer with the CDI ("Y per \$100 of payroll"); and*
- *The discounted premium or charged rate (i.e., the rates actually charged, after taking debits and credits into account) actually charged by each workers' compensation insurer ("Z per \$100 of payroll").*

*A number of comparisons using this data could be made. For example, a comparison of "X" to "W" would show the difference that exists between the pure premium rates approved by the Commissioner and the pure premium rates filed by insurers. Likewise, a comparison of "Z" to "Y" would show the level of insurer discounting or surcharging.*

*Currently, the WCIRB collects data from its member insurers with respect to the last category for solvency monitoring purposes. Expanding the WCIRB's data calls to include the first and second categories, and requiring the WCIRB to present the data in a comparative form on an industry average and individual insurer basis, would not only enhance the CDI's ability to make "apple to apple" comparisons of workers'*

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*compensation insurers for solvency monitoring purposes, but would also allow for additional consumer-oriented information to be made available. For example, such information could be used to generate reports that enhance the public's understanding of the components that make up premium rates and the variables that affect what rates are actually charged.*

**WCIRB Response:** The WCIRB currently collects data that allows for the determination of (1) the average pure premium rate filed by each insurer, (2) the average manual rate filed by each insurer, and (3) the average net charged rate for each insurer. The WCIRB's 2012 pure premium rate filing included: (1) the industry average filed pure premium rate, (2) the industry average filed manual rate, and (3) the industry average net charged rate. The WCIRB will schedule a meeting with the CDI in the next 90 days to discuss the collection and inclusion of additional information with respect to insurer rates.

The WCIRB is committed to working collaboratively with the CDI to affect the recommendations and will contact the CDI within 90 days after the recommendations are adopted to discuss a plan of action. Please let me know if you have any questions or if there is any additional information we can provide.

Sincerely,



Robert G. Mike  
President

RGM:smd