STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
300 Capitol Mall, 17th Floor
Sacramento, CA 95814

PROPOSED DECISION

JANUARY 1, 2010 WORKERS' COMPENSATION CLAIMS COST BENCHMARK AND PURE PREMIUM RATES

FILE NUMBER REG-2009-00022

In the Matter of: Proposed adoption or amendment of the Insurance Commissioner's regulations pertaining to pure premium rates for workers' compensation insurance, California Workers' Compensation Uniform Statistical Reporting Plan—1995, Miscellaneous Regulations for the Recording and Reporting of Data, and the California Workers' Compensation Experience Rating Plan—1995. These regulations will be effective on **January 1, 2010, unless a different effective date is noted or specified**.

EXPLANATION AND SUMMARY OF PROCEEDINGS

A public hearing in the above captioned matter was held on October 6, 2009 at the time and place set forth in the Notice of Proposed Action and Notice of Public Hearing, File Number REG 2009-00022 dated August 24, 2009, which is included in the record. At the conclusion of that hearing, and as noticed in the Notice of Proposed Action and Notice of Public Hearing, the hearing officer announced that the record would be kept open for additional written comment until 5:00 p.m. on Friday, October 9, 2009. The record was closed at 5:00 p.m. on October 9, 2009.

The record discloses the persons and entities to whom or which the Notices were disseminated. The Notice summarized the proposed changes and recited that a summary of the information submitted by the Insurance Commissioner in connection with the proposed changes was available to the public. In addition, the "Filing Letter" dated August 18, 2009 submitted by the Workers' Compensation Insurance Rating Bureau of California (WCIRB) and related documents were available for inspection by the public at the Sacramento office of the California Department of Insurance (CDI) and were available online at the WCIRB website, www.wcirbonline.org.

The WCIRB's filings proposed a change in the Workers' Compensation Claims Cost Benchmark and Pure Premium Rates in effect since January 1, 2009 that reflect insurer loss costs and loss adjustment expenses and adjustments to the California Workers' Compensation Experience Rating Plan—1995 to conform to the proposed Pure Premium Rates. In addition, the WCIRB has proposed amendments to the California Workers' Compensation Uniform Statistical Reporting Plan—1995, Miscellaneous Regulations for the Recording and Reporting of Data, and California Workers' Compensation Experience Rating Plan—1995.

The initial filing of the WCIRB in this matter requested that the Commissioner adopt an increase of 22.8% for the Benchmark to be effective January 1, 2010. The filing consisted of +14.9% due to updated loss and Loss Adjustment Expense (LAE) experience, +5.8% for the Workers' Compensation Appeals Board (WCAB) en banc decisions in Ogilvie v. City and County of San Francisco and Almaraz v. Environmental Recovery Services/Guzman v. Milpitas Unified School District, and +1% for experience rating off-balance. Subsequent to the WCIRB's filing in this matter, the WCAB issued its Opinion and Decision After Reconsideration with respect to the Ogilvie and Almaraz/Guzman cases. On September 29, 2009, the WCIRB submitted a letter regarding the impact of these new WCAB decision upon the Benchmark and determined that the submitted Benchmark change should not be modified.

Also, on September 22, 2009, the WCIRB submitted a rule change to the Uniform Statistical Reporting Plan (USRP), previously noticed in this matter, proposing amendments pertaining to medical cost containment. These changes were intended to clarify the current USRP definition of medical cost containment, shift the cost of medical cost containment programs from medical loss to allocated loss adjustment expenses, and promote separate reporting of consistent information on the cost of medical cost containment programs. These changes were submitted at the direction of the Commissioner to have the WCIRB modify the medical loss definitions and reporting in the USRP pursuant to his Decision and Order dated July 8, 2009.

Subdivision (b) of California Insurance Code Section 11750 states that the Insurance Commissioner shall hold a public hearing within 60 days of receiving an advisory pure premium rate filing made by a rating organization pursuant to subdivision (b) of Insurance Code Section 11750.3 and either approve, disapprove, or modify the proposed rate. Subdivision (b) of Section 11750.3 states that a rating organization, such as the WCIRB, shall collect and tabulate information and statistics for the purpose of developing pure premium rates to be submitted to the Commissioner.

The WCIRB presents to the commissioner for his or her approval the overall average increase or decrease of the pure premium rates based upon its review of the entire claims costs in the workers' compensation system, which is referred to by the Commissioner as the Workers' Compensation Claims Cost Benchmark or Benchmark. The Claims Cost Benchmark approved by the Insurance Commissioner reflects only loss costs; it does not include any provision for general expenses, commissions, other acquisition expenses, premium taxes, or profits. These are accounted for in the rates filed by workers' compensation insurance companies.

The Claims Cost Benchmark is advisory only and does not reflect the actual premiums that insurers may charge employers. The law does not require insurers to adopt the Claims Cost Benchmark or its adjustment, and insurers may file rates as they deem appropriate so long as they are in compliance with the California Insurance Code and associated regulations and are neither discriminatory nor are inadequate so as to affect an insurer's financial solvency. The California workers' compensation rate laws do not limit the profit a workers' compensation insurance company may make.

Testimony, written and oral, was taken at a hearing in San Francisco on October 6, 2009 and exhibits were received into the record. Additional documentation requested by the hearing panel was submitted subsequent to the hearing but prior to the close of the time period to receive written comment along with correspondence and documents submitted by the public. The matter was submitted for decision at the conclusion of the period to receive written comment on October 9, 2009. The matter having been duly heard and considered, the following Proposed Decision and Proposed Order are hereby made.

DETERMINATION ON WORKERS' COMPENSATION CLAIMS COST BENCHMARK AND RECOMMENDATION TO THE INSURANCE COMMISSIONER

It is the recommendation of this Hearing Officer that the Insurance Commissioner adopt a 15.4% increase (+15.4%) to the current level of the Workers' Compensation Claims Cost Benchmark in effect since January 1, 2009. The change in the Benchmark recommended herein is based upon the hearing testimony and an examination of all materials submitted in the record as well as the Actuarial Analysis and Discussion set forth below by Department of Insurance Senior Actuaries Ron Dahlquist and Eric Johnson. The 15.4% increase consists of +10.4% due to loss (indemnity and medical benefits) and LAE experience and +4.6% due to the effects of the Ogilvie and Almaraz/Guzman decisions of the WCAB, as set forth in the Actuarial Analysis.

The +1% increase of the Benchmark due to the experience rating off-balance factor proposed by the WCIRB and reviewed by CDI actuaries is not included in this recommendation. Instead, the WCIRB is directed to adjust the Expected Loss Rates of the Experience Rating System to reflect the off-balance factor proposed. The reason for this is principally to require the Experience Rating System to balance itself when experience rated employers generate an average credit rather than increase the loss costs of the entire system.

Continuing Concerns Regarding WCIRB Analysis

As expressed in the Actuarial Analysis below and at hearing by this Hearing Officer, the WCIRB has not adequately or appropriately analyzed the changes to the permanent disability system resulting from the Ogilvie and Almaraz/Guzman cases despite the additional time that has been available since the previous filing. This is not the first time this has happened.

Much time and effort has been extended by CDI staff in working with the WCIRB to obtain adequate rate filings that provide the necessary information and lay out all the various approaches to quantify future costs in the California workers' compensation system; greater effort and creativity is necessary. In particular, the WCIRB appears to have the same difficulty in approaching the changes resulting from these WCAB

decisions that it had when the reforms to the Permanent Disability Rating System (PDRS) were implemented. It appears the WCIRB is uncomfortable in getting in front of an issue and promptly using broader resources to address it, and this seems especially true in cases of significant changes to law or regulations relating to benefit levels.

The Actuarial Analysis provided below regarding the permanent disability discusses two independent approaches using available data, one from the WCIRB Public Member's actuary and the other from CDI's staff actuaries. This compares to the WCIRB utilizing a Claims/Legal Subcommittee of claims and legal experts and an Actuarial Committee with a number of actuaries, both of which appear to have greater resources, to provide a recommendation that remains basically unchanged from what was previously submitted and continues to rely on speculation and excessive tempering. CDI's observation of the WCIRB's process, including the conduct of its meetings, indicates that there is much room for improvement, which was noted at hearing when this Hearing Officer questioned the WCIRB regarding its failure to use any existing data in analyzing the WCAB decisions. Instead, the WCIRB President's response at hearing was, "...there is no data that we could possibly get our hands on, could have gotten our hands on, between these decisions and now that would even allow us to do that kind of analysis if there was a basis for doing that." [Transcript of Proceedings dated October 6, 2009, page 52, lines 6-10]

It is unknown what the final costs to the permanent disability system will be as a result of the WCAB decisions, but the Actuarial Analysis does provide an estimate. Judicial appeals are pending in those WCAB decisions and more cases will follow from the WCAB that will test the permanent disability reforms. However, the WCAB substantially revised and has limited its prior "fairness" standard in the Almaraz/Guzman cases and clarified its opinion in Ogilvie, so there is a stronger chance that these decisions will withstand appellate scrutiny. However, the WCIRB is directed to review the analyses of the CDI's actuaries and Mr. Priven and report back to the Commissioner.

In addition, the WCIRB testified that it has made no attempt to review or analyze the information generated by CDI in the last hearing, specifically the investigatory portion on medical costs and the resulting Investigatory Hearing Report on Workers Compensation Medical Cost Drivers. The WCIRB has not recognized the concerns of the Insurance Commissioner or the results of that investigatory hearing, nor has it reflected them in its analysis. Therefore, the CDI actuaries reviewing this filing have recommended that these issues, along with the continuing effects of the recent reforms, be thoroughly researched.

ACTUARIAL ANALYSIS AND DISCUSSION

Actuarial Recommendation:

We recommend an increase of 16.5% in the average level of the pure premium rates, for reasons set forth in the "Actuarial Analysis" section which follows. Our recommendation is our estimate of the average costs that are expected to prevail over the period the approved pure premiums will be in effect, policy year 2010.

We recommend that a study be done to determine the extent to which the reforms of AB 227, SB 228, and SB 899 have been implemented by both insurers and self-insured employers, the extent to which improvements in their implementation can be realized by both, and the potential for additional cost savings that might exist if the reforms are fully implemented by insurers. This is discussed further in the section entitled "Measurement of Potential Additional Reform Savings".

Actuarial Evaluation:

1. **Medical Severity**:

For reasons detailed below, we select a medical severity assumption of +11% per year.

The aggregate financial data provided in this filing presents a picture of increasing medical costs that is very similar to what was observed in the last filing. In the amendment to the July 1, 2009 filing dated April 23, the Bureau's ratemaking analysis yielded estimated ultimate medical severity increases of 14.8% for accident year 2006 relative to accident year 2005, 13.0% for accident year 2007 relative to 2006, and 18.2% for accident year 2008 relative to 2007. In this filing, these estimates have been revised to +15.2%, +12.9%, and +13.8%, respectively. We note that the first two percentage changes are close to their estimates in the previous filing, while the estimated increase for the most recent accident year has moderated substantially. The WCIRB's estimates of changes in on-level medical severity in this filing are +15.1% from accident year 2005 to accident year 2006, +15.4% from 2006 to 2007, and +14.4% from 2007 to 2008.

In our review of the WCIRB's July 1, 2009 filing (July 1 filing), we observed that detailed transaction level data on medical payments provided by the California Workers Compensation Institute (CWCI) showed that costs associated with medical cost containment, medical legal, and medical management have increased at a greater rate than medical expenses as a whole have increased. We stated then that we believed that these increases are the result of an increased level of effort in those areas that is necessitated by the new post-reform environment that requires greater scrutiny of all medical treatment and expenses. We believed then, and we believe now that these are permanent, one-time upward adjustments in costs, and should not be assumed to be indicative of continuing inflationary trends.

There is no new transaction level detail data that has been made available from either CWCI or the WCIRB in this filing. This is presumably because not enough time has passed, either for sufficient additional experience to accumulate or for that experience to be tabulated and analyzed. The overall data presented in the filing does not add any new accident periods; rather, it provides a slightly more updated evaluation of the experience of the same exposure periods. On an overall basis, it provides much the same picture of cost increases as did the aggregate data contained in the July 1 filing. Thus there is no new evidence to cause us to change the opinion we formed in the last filing review.

In the WCIRB's July 1 filing, we observed in Exhibit 2 of the first CWCI study that the categories of medical management, medical cost containment, and medical legal comprised approximately 15% of all medical payments in the study. These expenses were escalating at a rate between 16% and 20% over the most recent available 12-month period. We assumed that these costs will increase in the future at a rate similar to the medical care component of the Consumer Price Index, or approximately 4.5% per year, instead of the 16% to 20% rates seen in the most recent data. This assumption implied an overall reduction in medical trend of approximately 2% per year, from the 10.6% to 13.7% increases observed in the most recent available 12-month period to adjusted estimates of 8.8% to 11.3% based on the 4.5% assumption for these medical management expenses going forward. This 2% reduction in turn formed our basis for reducing the WCIRB's 7% medical pure premium trend assumption to 5%.

In this current filing, the WCIRB has separately projected frequency and severity for the first time. The WCIRB projects medical severity increasing at 13% per year, citing this selection as a compromise between the recent trend of +15% per year over the last three accident years and the longer-term pre-reform average trend of +11% per year.

We observe that the adjusted trend indications mentioned in the second preceding paragraph—roughly +9% to +11%—are significantly less than the 15% increases estimated by the WCIRB. We recognize that the adjusted indications from the CWCI data are based on paid losses, while the WCIRB estimates include both case and Incurred But Not Reported Losses (IBNR) reserve provisions, and that there may be legitimate reasons why ultimate severities may be increasing more rapidly than paid losses. Considering all of this, we believe that a medical severity assumption of +11% per year is reasonable.

Mr. Mark Priven of Bickmore Risk Services, Actuary for the Public Members, stated that his estimates of medical severity were similar to those of the WCIRB.

Adam Dombchik, President of the California Applicants' Attorneys' Association (CAAA), also submitted written comments on the filing and observed that the WCIRB's current estimate of medical severity for accident year 2008, based on its analysis of data valued as of June 30, 2009, shows an increase of 12.2% over accident year 2007. The letter noted that this increase was significantly less than the 18.2% increase for the same two accident years contained in the July 1 filing and based upon data as of December 31, 2008. The CAAA went on to state that "this data demonstrates that the sharp severity

increases seen in the immediate post-reform years are not representative of long term trends, but instead reflect one-time cost increases such as the increases in the medical fee schedule and the medical-legal fee schedule, the introduction of mandatory utilization review, and adoption of medical treatment guidelines and the *AMA Guides*." The CAAA concludes their comments on medical severity by asserting that it is not accurate to base trending projections on the immediate post-reform years, and by recommending that "the Department adopt a +11% medical severity trend, equal to the average long-term pre-reform growth rate in medical severities."

As detailed above, we are in agreement that the large increases in medical severity experienced in the last three years contain a large component of one-time increase to a permanently higher level of cost, and we expect that longer-term trend will not be as high as what has been recently experienced. We have settled on 11% per year as our estimate of medical severity inflation, not because it is the longer-term average, but because it appears to be in the range of what can be expected when one-time cost increases are factored out of the recent experience.

Although the CWCI presentation of transaction-level detail data in support of the July 1 filing was an incomplete picture of California workers compensation medical expenses, we found it to be very helpful in aiding our efforts to understand what has been causing medical benefits to escalate. We understand that the WCIRB will be collecting more complete detailed transaction level data itself within the next few years, and will be continuing to periodically provide data and analyses from CWCI in the interim. We wish to encourage both of these efforts, as we expect future detailed level data will provide valuable insights as to where medical costs are headed.

Finally, during the hearing, the WCIRB was requested to provide an explanation of the bar graph displayed on Page 1 of the Executive Summary of the filing. Our specific question was why the indicated deficiencies displayed for the latest two sets of approved pure premium rates: 33.5% for the July 1, 2007 pure premium rates, and 27.9% for the January 1, 2008 pure premium rates, both exceeded the requested pure premium rate increase of 22.8% contained in the current filing. Mr. Bellusci of the WCIRB provided a partial verbal explanation, but stated that the WCIRB would be providing a more complete written explanation. Since such an explanation was not included in the subsequent written response submitted by the WCIRB, we direct the WCIRB to provide a complete written explanation in response to the original question.

2. Indemnity Trend:

The WCIRB's previous filing included a flat indemnity on-level pure premium trend. In our decision, we recommended that the WCIRB pay more attention to the effects of the California economy on frequency. We adjusted the calculated pure premium ratio downward by 5%. The 5% was a judgmental selection, rather than an explicit calculation, with a starting point of -11.3% from the WCIRB's econometric indemnity frequency model.

In this filing, the WCIRB has responded favorably to our recommendation and has used the frequency model output directly in the calculation of indemnity frequency. At the same time, they have added a separate calculation of indemnity severity, projecting the 7.2% per average growth rate of the last three years to extend into the future.

Frequency

Mr. Priven also analyzed frequency and severity separately. For frequency, he employed the -11.7% output of the model for 2009, but for 2010 and 2011, he substituted -5.5%. This selection compares to the model output of -4.3% and -1.5%. In his oral testimony at the hearing, he explained that this number is in between the changes in 2006 and 2007, which are relatively unaffected by the reforms and the changes in the economy. He said he was not willing to rely on the UCLA Anderson forecast of an economic recovery.

The CAAA also challenged the WCIRB's frequency projections, saying that the major reduction in projected frequency declines in 2010 and 2011 is unwarranted. The CAAA stated that less experienced workers are generally the first to be laid off, and these workers have higher claim rates; that employment gains lag behind an economic upturn, and that it is unlikely these workers will be rehired soon; and that the most recent UCLA Anderson forecast projects employment in California to be virtually unchanged in 2010, with double-digit unemployment lasting until the end of 2011. The CAAA recommends that -10% and -5% be used for 2010 and 2011.

We reject these objections to the use of the model for frequency. While projecting the future is always fraught with uncertainty, the UCLA Anderson forecast is generally accepted as the most reliable source available. We also accept, generally, the specification of the WCIRB's frequency model. We note that the model does incorporate the unemployment rate and the aggregate employment number. We also note that, while the filing relies on the June forecast, the September forecast is not significantly different. It appears that the model projects frequency drops when the economy worsens, not when the economy is bad, for example, when the unemployment rate goes up, not when it is high. Thus, the common expectation for a jobless recovery does not imply that frequency will continue to drop.

Severity

Mr. Priven said his claim severity projection was similar to the WCIRB's.

The CAAA stated that the WCIRB did not consider adequately the impact of the reforms on apportionment. The CAAA notes that the WCIRB's estimate, that apportionment changes reduced PD benefits by 6%, improperly used data that it relied upon, and that data is unrepresentative because it only includes summary rated claims and predates the Benson case, which significantly lowered benefits for workers with multiple injury dates. The overall result is a 15% reduction, and the CAAA recommends changing the on-level adjustment and using a 5% severity trend.

Messrs McFarren and Gerlach of the CAAA also criticized the WCIRB in hearing testimony for ignoring the Benson decision.

The retrospective evaluations in the WCIRB's Legislative Cost Monitoring reports do not directly impact the result of the indicated advisory pure premium calculation in the filing. Changing the annual benefit change number for 2005 would lower the on-level factors for accident years 2004 and prior, but would not change the on-level factor for the more recent years, nor would it change 3-year average severity trend calculation of 7.2% that is based on post-reform data, which the WCIRB selected.

In order to determine the impact of the Benson case we would need to have a better sense of how often such cases occur and of how much awards are reduced. There is no information on either aspect in the record. Therefore, we reject the recommendations and accept the WCIRB's indemnity severity calculation. We also direct the WCIRB to attempt to quantify the impact of the Benson decision.

3. Permanent Disability (PD) Cases:

On September 3, 2009, the WCAB issued its opinion and decision after reconsideration on the Ogilvie and Almaraz/Guzman decisions. As the WCIRB notes in its September 29, 2009 letter, the WCAB essentially confirmed its earlier decision in the Ogilvie case. However, in the Almaraz/Guzman cases, the WCAB substantially limited the evidence that can be used to rebut whole person impairments. The WCIRB concluded that the limitation in the Almaraz/Guzman case was within the 75% tempering that was included in its previous estimate of the cost and therefore did not change its estimate of 5.8%.

The WCIRB's 5.8% cost increase estimate has four parts: an increase in the average PD rating, an increase in the number of ratable claims, an increase due to the utilization effect and an increase in frictional costs (ALAE and medical-legal). The WCIRB assumed that 40% of the claims would have their PD ratings double and that 25% more claims would become ratable. These assumptions were then tempered by 75%. The result is an increase of 9.2% in indemnity benefits (or 2.8% in total costs). With the longstanding 26% increased utilization assumption, the WCIRB calculates a further 2.2% increase in claim frequency, which translates into a 1.7% increase in overall costs. The increase in ALAE adds another 0.8% and the medical legal 0.4%.

Mr. Priven gave a range of estimates of the cost, from a low of 3.4% to a high of 12.6%, with a middle estimate of 5.1%. He said that in his opinion Ogilvie would primarily impact claims with lower PD ratings and Almaraz/Guzman would impact claims with larger PD ratings. For Ogilvie, he used proportional earnings losses distributed by PD rating and plugged them into the Future Earnings Capacity (FEC) formula prescribed in the Permanent Disability Rating Schedule (PDRS). For Almaraz/Guzman, he considered different hypothetical scenarios. Mr. Priven agreed with the WCIRB on the increase in the number of ratable claims but assumed that the severity on these claims would be 20-25% lower. He also assumed that the additional claims from increased utilization would

have 25% lower severity. Mr. Priven did not detail what effect, if any, he calculated for frictional costs.

Subsequent to the closing of the record, Mr. Priven provided a spreadsheet with his calculations, but we have not relied on it here.

The CAAA, in its letter, opined that the costs of these decisions would be considerably less than the WCIRB's estimate and that there is no need for any adjustment to the pure premium rates for the cases. The CAAA points to page 13 of the Ogilvie decision, which states "we are not persuaded that the continued existence of the 'prima facie evidence' language of section 4660(c), as we have interpreted it, will have any particular effect on the overall costs of permanent disability indemnity" and that there is nothing new in the interpretation of the law that PD ratings are rebuttable. The CAAA also challenged the WCIRB's conversion of the impact on indemnity to a 5.8% increase overall, saying that indemnity is only 10% of total benefits. The CAAA offered an alternative calculation, based on the assumptions that 10% of PD cases would see a 33% increase in their ratings, for a 3.3% increase in permanent disability costs or 0.33% overall.

Todd McFarren, legislative chair of CAAA, testified that the reconsideration of Almaraz/Guzman cases substantially limited the evidence that could be used for rebuttal, to the four corners of the AMA Guides, and the decisions would only affect 10% of PD cases with only minor changes in ratings. He testified that Ogilvie would affect even fewer cases and does not suggest going to a direct wage loss system.

Mark Gerlach, an insurance consultant for CAAA testified that only rarely would cases not be rated according the PDRS and that rebuttal would not be any more prevalent.

The CAAA and its representatives at hearing stated that ratings could also be rebutted by the defendant.

Our evaluation and conclusion of the PD cases are as follows.

Ogilvie

We agree that Ogilvie will have a substantial cost impact. However, that impact will be somewhat constrained by the decision's preservation of the FEC formula in the PDRS. That formula divides the proportional earnings loss into the number 1.81, multiplies the results by 0.1, and then adds 1.0:

$$([1.81/a] \times .1) + 1$$

These factors are multiplied by the whole person impairment determined from the AMA Guides, and the resulting product is then adjusted, up or down, separately for occupation and age, to arrive at the PD rating. The FEC formula is used to set eight FEC ranks determined by part of the body injured, which were based on data published by RAND in December of 2004. This data established that, under the 1997 PD Schedule, the ratio of

PD rating divided by proportional earnings loss varied from .45 for psychiatric injuries to 1.81 for vision injuries. This is approximately a range from 1 to 4.

Two notable qualities of the FEC formula are that, first, it compresses the 1-to-4 variation of adequacy of compensation into a range of 1.1 to 1.4 and, second, that the formula is applied to AMA whole person impairment ratings even though the ranks were derived from 1997 Schedule permanent disability ratings data. The former is significant in the quantification of the costs of the Ogilvie decision.

We made a rough approximation of the costs of Ogilvie by starting with data published by RAND in 2005. This data is similar to the data published in 2004 that the Division of Workers Compensation used to derive the FEC formula. The report has proportional earnings losses and final ratings under the 1997 schedule for about 75,000 claims, summarized into a table by body part injured.

We used the numbers in the table to calculate a PD rating under the 2005 schedule in two ways. The first calculation multiplied whole person impairments by the FEC rank adjustment factors in the schedule to approximate the unrebutted PD rating. The second calculation derived a new FEC adjustment factor using the formula and the ratio of the whole person impairment to the proportional earnings loss to approximate the revised PD rating after rebuttal. The difference between the two approximates the cost of the Ogilvie decision on PD ratings. It does not include the cost of newly ratable claims, increased utilization or frictional costs.

For example, the 2005 schedule assigns to a shoulder injury an FEC Rank of seven and a corresponding adjustment factor of 1.357. RAND data shows that, on average, a shoulder injury results in a proportional earnings loss of 12.3% and a final rating of 11.1 under the 1997 schedule.

To perform the calculations, we must make some assumptions about how final ratings under the 1997 schedule map onto AMA whole person impairments. We know from the Legislative Cost Monitoring Report that average PD ratings under the 2005 schedule are approximately 60% of ratings under the 1997 schedule. We can estimate from the distribution of injuries from the RAND table that the average a value is 1.19 and that FEC adjustment factor is 1.16. Assuming that the occupation and age adjustments are neutral, we can estimate that the AMA whole person impairments are 52% of the 1997 PD ratings.

Plugging the 52% ratio into the two calculations, we calculate that the value in the FEC formula decreases from 1.19 to .69 and that the FEC adjustment factor increases from 1.16 to 1.28. The final result is an increase in the average PD rating of 10.5%. This compares to the WCIRB's estimate of 40% before tempering and 10% after and to Mr. Priven's untempered estimate of 30 to 55%.

The WCIRB calculated an overall 8.3% increase to indemnity costs from a 10% average increase in PD ratings. Applying a simple ratio, we calculate an 8.7% increase from a 10.5% increase.

In addition to the many assumptions already noted, we also have to assume that using the average values for each body part gives the same result as using the detailed underlying distribution of values, that the RAND sample is representative of the whole population, that the FEC adjustment factors are reconsidered in every case and that the distribution of injuries by body types has not changed.

Almaraz/Guzman

We agree with the witnesses from the CAAA that the limitations on allowable rebuttal evidence in the revised Almaraz/Guzman cases significantly reduce the cost impact. The salient quotes from the decision are that "[I]t is not permissible to go outside the four corners of the AMA Guides" and "[A] physician's WPI opinion that is not based on the AMA Guides does not constitute substantial evidence".

Nevertheless we concur with the WCIRB and Mr. Priven that it is reasonable to assume that ratable claims will increase in number by 6.25%. We agree with Mr. Priven that it is reasonable to assume that these newly rated claims will have a 25% lower severity than average.

We also accept the WCIRB's general approach on increased utilization and frictional costs; however the numbers shall be reduced appropriately for our lower estimate of the increase in the average rating on existing claims and the lower severity on newly rated claims.

We reject the CAAA assertion that the WCIRB improperly converted the effect of the impact on indemnity to an overall percentage cost. When considering more than proportionally higher awards for higher ratings, life pensions, newly rated claims, utilization and frictional costs, we find that the conversion has been done accurately.

We are troubled that, in the several months between filings, the WCIRB has not attempted to refine its estimate but, instead, continues to rely on sweeping assumptions that the reforms would be almost entirely undone, combined with seemingly arbitrary tempering. What we found reasonable in the compressed time frame of the previous filing (though the hearing officer did not) becomes unreasonable as the available time to analyze increases. The WCIRB defends its method by saying that it took a similar approach during the reform years, when costs were going in the other direction. We were critical of the WCIRB's approach then and we do not find it any more acceptable now.

Overall, we calculate a 4.6% increase in the overall rate from the WCAB PD decisions. This includes a 2.6% increase overall from the 10.5% increase in the average PD rating, a 0.7% increase from newly rated claims , an 0.8% increase from LAE and 0.4% from

medical legal. The calculation of the increase from average PD ratings and from newly rated claims excludes any cost from higher utilization of medical benefits.

4. Loss Adjustment Expense:

The WCIRB filing again derives its loss adjustment expense load by giving the experience of the State Compensation Insurance Fund 50% weight consistent with half of its current market share. The result is a provision of 23.0% of losses. We again reject this approach, for the same reasons we have in previous decisions, and instead approve a loss adjustment expense load based exclusively on the experience of private insurers. This load would be 21.9% of losses if we had concluded that the WCIRB's projected on-level pure premium ratio of .934 was appropriate. Since we have arrived at a lower conclusion, a projected ratio of .899, we need to adjust this percentage upward to produce the same dollar provision. This adjustment results in a provision of 22.7% of losses.

5. Experience Rating Off-balance Correction Factor:

The WCIRB recommendation is to increase the experience rating off-balance correction factor from 1.030 to 1.040.

We note, as we have in prior Proposed Decisions, that the 1.040 multiplier is the long-term average off-balance factor indicated by the WCIRB's calculations of at least the last decade. As we have stated previously, an evaluation of the WCIRB methodology for calculating the off-balance correction factor indicates that the calculation is subject to considerable "noise" due to the imprecision inherent in some of the formula's input values. The formula itself implicitly recognizes this by placing limitations on the size of the changes in values in the formula. We do not believe that this formula is capable of calculating the off-balance with precision, and so we are skeptical of the need for changing the factor from one year to the next.

We are convinced, however, that there is a clear indication that the experience of experience-rated risks is consistently better over the long run than the experience of non-experience rated risks. It is clear that the experience rating plan will consistently generate an average credit. Because of this, we conclude that it is appropriate to apply an off-balance correction factor to increase the pure premium rates so that the rating system will be in balance after the application of experience rating. We also conclude that the WCIRB's proposed experience rating off-balance correction factor of 1.040, because it is the long-term average indicated factor, should be approved.

Measurement of Potential Additional Reform Savings

The June 8 Investigatory Hearing

The Investigatory Hearing Report on Workers Compensation Medical Cost Drivers summarized the results of the June hearing and was issued as part of the Proposed Decision in the July 1, 2009 Claims Cost Benchmark. It offered a series of 27

recommendations for change to the California workers compensation system. We recommend that the comprehensive study we propose should include an evaluation of the feasibility, cost savings impact, and cost-effectiveness of each of these 27 recommendations.

The Investigatory Hearing Report's recommendations affecting insurers appear to primarily involve two areas: better use of medical provider networks and a rethinking of how utilization review is used.
With respect to medical provider networks, the recommendations called for more tailored medical provider networks specializing in occupational medicine rather than general networks composed of preferred provider lists that are primarily non-occupational in nature. They also called for measurement of injured worker return to work outcomes and cost-effectiveness of networks along with better communication with physicians, more emphasis on results and less on minimizing cost.

With respect to utilization review, the recommendations called into question the very need for its continued use. Insurers were called upon to review and determine if the costs and delays inherent in utilization review are effective. The suggestion was made that effectively managed medical provider networks could achieve better medical and cost outcomes without the use of utilization review.

The study we recommend should focus particularly on whether medical provider networks and utilization review are achieving optimal results in returning injured workers to work, and whether they are achieving this objective in the most cost-effective manner. Tailored medical provider networks focused on occupational medicine and optimization of medical outcomes should be compared to more general networks, both in terms of effectiveness of medical outcomes and in terms of cost savings. A cost-benefit analysis of utilization review should also be conducted.

We wish to sound a cautionary note, however; while achieving more cooperative working relationships with treating physicians would seem to be highly desirable, the experience of the post-*Minniear* years and the lessons learned from that time period should not be forgotten. It was during that time that the treating physician's opinion was given the presumption of correctness, and it was also during that time that medical costs increased very dramatically. Before utilization review is discarded, it would seem to be necessary to ensure that appropriate cost-controlling safeguards are in place to prevent a recurrence of the post-*Minniear* experience.

Finally, we note that a large number of the recommendations appear to be directed in part or entirely at the Workers Compensation Appeals Board. It appears that one major implication of the Investigatory Hearing Report would be that regulatory reform is likely to be at least as important as insurer efforts in more fully realizing the cost savings intended to be achieved through the recent reform legislation.

Self-Insured Employers

Considerable qualitative evidence was presented in the Investigatory Hearing Report that compared self-insured employers favorably to insurers both in their ability to manage the treatment of injured workers and in their ability to achieve cost reductions. To date, the available quantitative evidence in support of these favorable comparisons appears to be limited.

The study we recommend should quantify the performance of self-insurers (individually and collectively) relative to the performance of insurers, both in terms of the level of cost savings achieved and in terms of the effectiveness of medical treatment outcomes. It should include an assessment of the quality and quantity of self-insured data available, its uses and limitations, and what changes need to be made in the data obtained and the process of validating it, in order to make it more useful for comparison to insured employer data and as an aid in policy decision-making. We believe that such a study would be both informative and useful.

We did receive one piece of related quantitative evidence at the hearing: a CWCI bulletin on self-insured experience. It has been entered into the hearing record. It appears to be of limited value.

The Bulletin provides paid and incurred loss data and reported claim counts taken from the website of the Department of Industrial Relations' (DIR) Office of Self-Insurance Plans (OSIP). It also calculates paid and incurred medical and indemnity severity, or average claim costs, for each of the last six calendar years for private self-insured employers, and for each of the last six fiscal years ending June 30 for public self-insured employers. From this data, it is possible to calculate year-over-year changes in paid and incurred severity.

We performed these calculations, and found that there is evidence of renewed medical inflation in the self-insured data. Specifically, for the private self-insured employers, paid medical severity increased by 9.1% in 2006 relative to 2005, by 1.7% in 2007 relative to 2006, and by 16.4% in 2008 relative to 2007. Incurred medical severity increased by 6.4% in 2006, by 6.2% in 2007, and by 6.4% in 2008. For the public self-insured employers, paid medical severity increased by 3.1% in the fiscal year ending June 30, 2007 and by 9.1% in the fiscal year ending June 30, 2008. Incurred medical severity increased by 6.4% in 2006, by 6.0% in the fiscal year ending June 2007, and by 9.0% in the fiscal year ending June 2008.

We were not satisfied that we understood the basis of this data, so we followed the link to the DIR website provided in the CWCI Bulletin. After viewing the additional data and information available on the DIR website, it appears that the data presented by the CWCI is on a report year basis and is valued as of December 31 of each calendar year for the private self-insured employers and as of June 30 of each calendar year for the public self-insured employers. Upon examination of the additional data available on the website, it appears that the experience of each report year can be traced for a total of five valuations

12 months apart. For example, for the private self-insured employers, data is available for report year 2004 as of all five year ends from 2004 through 2008. The available data is reported and open claim counts, paid losses, case loss reserves, and total incurred losses, separately for medical and indemnity benefits.

Examination of the claim counts in particular leave us with a less than satisfying feeling as to the accuracy and usefulness of this data. The report forms clearly indicate that the data should be on a report year basis. This means that the total reported counts for each year should be frozen: they should not change in subsequent valuations. A cursory examination of the reports available on the website indicates, however, that subsequent values of reported counts are different for every single year for every single valuation. Furthermore, the values increase in some cases and decrease in others.

We expect that these observations are probably indicative of varying degrees of accuracy in the individual data submissions made to the Office of Self-Insurance Plans (OSIP) by individual self-insured employers. While we have no knowledge of the procedures used by OSIP to validate the data submissions it receives, our observations on the claim count data suggest to us that the end result is likely to be less than satisfactory. We believe this data should be used with caution, and we are inclined to conclude that it will be difficult to make proper cost comparisons between self-insured employers and insurers until accurate detailed data on both is available.

We also think it needs to be stated that a thorough cost comparison between insurers and self-insured employers would necessarily involve analysis of data at the rating classification level of detail. Self-insured employers such as Safeway typically have advantages of size and homogeneity. They have large aggregations of exposure and claims volume in single classes or small groups of related classes that make it easier for them to implement loss control measures and probably to manage claims as well. Insurers typically will have advantages of size, but will not typically have the advantage of homogeneity. The fact that a single self-insured employer is concentrated in one or a few rating classes means that its experience should be compared to the insurance industry's aggregate experience for that individual class or mix of classes, not to the industry experience as a whole. We think that such a detailed analysis would be likely to be very helpful in quantifying relative cost savings achieved by self-insurers.

OTHER MATTERS

Amendments to the California Workers' Compensation Uniform Statistical Reporting Plan—1995 (USRP)

The WCIRB has proposed amendments to the USRP to be effective on January 1, 2010 with respect to new and renewal policies as of the first anniversary rating date of a risk on or after January 1, 2010. Those amendments include the following:

1. Amend Part 1, *General Provisions*, Section I, *Introduction*, Rule 3, *Effective Date*, to show that the effective date of the amended USRP is 12:01 A.M., January 1, 2010.

2. Amend Part 2, *Policy Document Filing Requirements*, Section I, *General Instructions*, Rule 1, *Policies*, Subrule a(2)(d), to eliminate the optional Social Security Number reporting requirement for policyholders that do not have a FEIN, due to privacy concerns.

3. Amend Part 3, *Standard Classification System,* Section V, *Payroll – Remuneration*, Rule 1, *Payroll – Remuneration*, Subrule j, *Executive Officers*, Subrule k, *Partners*, Subrule l, *Individual Employers*, and Subrule m, *Members of a Limited Liability Company*, to adjust the minimum and maximum payroll limitations for executive officers, partners, individual employers, and members of a limited liability company to reflect wage inflation since the minimum and maximum payroll limitations were last amended in 2009.

4. Amend Part 3, Section VII, *Standard Classifications,* Rule 1, *Classification Section*, Subrule a, *Industry Groups,* to reflect the proposed establishment of *Food Packaging and Processing* as an industry group and to renumber the subsequent listings in the Rule.

5. Amend Classification 9181, *Athletic Teams or Parks – all players on the salary list of employer, whether regularly played or not*, to increase the annual payroll limitation for players from $94,900 to $97,500 per year per person to reflect wage inflation since the threshold was last amended in 2009.

6. Amend the footnote for Classification 8324, *Automobile Gasoline Stations – retail,* for clarity and consistency.

7. Amend the footnote for Classification 8393, *Automobile or Automobile Truck Body and Fender Repairing and Painting – all employees including estimators, service writers and customer service representatives*, to direct that towing, roadside assistance, and freeway service patrol operations when conducted on vehicles not owned by the employer shall be separately classified.

8. Amend Classification 8391, *Automobile or Automobile Truck Dealers – all employees other than automobile or automobile truck salespersons*, to direct that the classification includes the transporting of vehicles that are owned by the employer. In addition, amend the classification footnote to direct that towing, roadside assistance, and freeway service patrol operations when conducted on vehicles not owned by the employer shall be separately classified.

9. Amend Classification 3821, *Automobile or Automobile Truck Dismantling – including the salvaging or junking of parts and store operations*, to direct that the classification includes the transporting of vehicles that are owned by the employer. Also, add a footnote to direct that towing, roadside assistance, and freeway service patrol operations when conducted on vehicles not owned by the employer shall be separately classified.

10. Amend the footnote for Classification 8389, *Automobile or Automobile Truck Repair Shops or Garages – no retail gasoline sales*, to direct that towing, roadside assistance, and freeway service patrol operations when conducted on vehicles not owned by the employer shall be separately classified.

11. Amend the footnote for Classification 8387, *Automobile or Automobile Truck Service Stations – all employees*, to direct that towing, roadside assistance, and freeway service patrol operations when conducted on vehicles not owned by the employer shall be separately classified, and for clarity and consistency.

12. Amend the footnote for Classification 8392, *Automobile or Automobile Truck Storage Garages or Parking Stations or Lots – no repair*, to direct that this classification does not apply to the storage of impounded vehicles that the employer tows to its premises. Also, add a footnote to direct that towing, roadside assistance, and freeway service patrol operations when conducted on vehicles not owned by the employer shall be separately classified.

13. Establish Classification 7227, *Automobile or Automobile Truck Towing, Roadside Assistance or Freeway Service Patrol – for vehicles not owned by employer*. The Towing, Roadside Assistance and Freeway Service Patrol industry constitutes a distinct and identifiable industry of sufficient size to generate a statistically credible pure premium rate.

14. Establish a cross-reference to indicate that Classification 2003, *Bakeries and Cracker Mfg.*, is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

15. Establish a cross-reference to indicate that Classification 2163, *Bottling – beverages,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

16. Establish a cross-reference to indicate that Classification 2121, *Breweries or Malt Houses – including bottling or canning,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

17. Establish a cross-reference to indicate that Classification 4717, *Butter Substitutes Mfg.*, is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

18. Establish a cross-reference to indicate that Classification 4683(2), *Cottonseed Oil Mfg. or Refining – during both active and dormant seasons,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

19. Establish a cross-reference to indicate that Classification 2063, *Creameries and Dairy Products Mfg.*, is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

20. Establish a cross-reference to indicate that Classification 2142(2), *Distilling – N.O.C.*, is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

21. Establish a cross-reference to indicate that Classification 2113, *Fish or Seafood Products Mfg. – including packaging,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

22. Establish an industry group for food packaging and processing and for those classifications in the new industry group:

    - Amend Classification 2113, *Canneries – fish,* to clarify its intended application.

    - Amend Classification 6504, *Confections and Food Sundries Mfg. or Processing – N.O.C.*, to clarify its intended application.

    - Amend the footnote to Classification 2108, *Fruit – citrus fruit packing and handling,* to clarify the distinction between Classifications 2108 and 2123, *Fruit or Vegetable Processing – fresh – ready-to-eat.*

    - Amend Classification 2107, *Fruit – fresh fruit packing and handling,* to indicate that it is a "not otherwise classified" classification. In addition, amend the footnote to clarify the distinction between Classifications 2107 and 2123, *Fruit or Vegetable Processing – fresh – ready-to-eat.*

    - Amend Classification 2111(1), *Canneries – N.O.C.*, to clarify its intended application.

    - Establish Classification 2123, *Fruit or Vegetable Processing – fresh – ready-to-eat*. The "ready-to-eat" produce industry constitutes a distinct and identifiable industry of sufficient size to generate a statistically credible pure premium rate. Also amend several related classifications for clarity and consistency.

    - Amend Classification 2117, *Vegetable or Fruit Processors – frozen,* for clarity and consistency.

    - Amend Classification 2095, *Meat Products Mfg. – N.O.C.,* to remove the "not otherwise classified" indication and to clarify its intended application.

    - Establish Classification 0096, *Nut Hulling, Shelling or Processing.* Nut processing constitutes a distinct and identifiable industry of sufficient size to generate a statistically credible pure premium rate.

- Amend the footnote to Classification 8209, *Vegetables – fresh vegetable and tomato packing and handling,* to clarify the distinction between Classifications 8209 and 2123, *Fruit or Vegetable Processing – fresh – ready-to-eat.*

23. Establish a cross-reference to indicate that Classification 6504, *Food Products Mfg. or Processing – N.O.C.,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

24. Establish a cross-reference to indicate that Classification 2108, *Fruit – citrus fruit packing and handling,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

25. Establish a cross-reference to indicate that Classification 2109, *Fruit – dried fruit packing and handling,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

26. Establish a cross-reference to indicate that Classification 2107, *Fruit – fresh fruit packing and handling,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

27. Establish a cross-reference to indicate that Classification 2116, *Fruit Juice or Concentrate Mfg.,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

28. Establish a cross-reference to indicate that Classification 2102, *Fruit or Vegetable Evaporation or Dehydrating,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

29. Establish a cross-reference to indicate that Classification 2111(1), *Fruit or Vegetable Preserving – including packaging,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

30. Establish a cross-reference to indicate that Classification 2123, *Fruit or Vegetable Processing – fresh – ready-to-eat,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

31. Establish a cross-reference to indicate that Classification 2117, *Fruit or Vegetable Processing – frozen,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

32. Establish a cross-reference to indicate that Classification 2014(1), *Grain or Rice Milling,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

33. Establish a cross-reference to indicate that Classification 2002, *Macaroni Mfg.*, is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

34. Establish a cross-reference to indicate that Classification 2095, *Meat Products Mfg. – including packaging,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

35. Amend Classification 9610, *Motion Pictures – production*, to increase the annual payroll limitation for actors, musicians, producers and the motion picture director from $94,900 to $97,500 per person to reflect wage inflation since the threshold was last amended in 2009.

36. Establish a cross-reference to indicate that Classification 0096, *Nut Hulling, Shelling or Processing,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

37. Establish a cross-reference to indicate that Classification 4683(1), *Oil Mfg. or Refining – vegetable,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

38. Establish a cross-reference to indicate that Classification 2111(2), *Olive Handling – sorting, curing, packing and canning,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

39. Establish a cross-reference to indicate that Classification 2111(3), *Pickle Mfg.*, is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

40. Amend the footnote to Industry Group *Property Management/Operation*, Classification 8740(3), *Building Operation – N.O.C.*, for consistency.

41. Amend Classification 7610, *Radio, Television or Commercial Broadcasting Stations – all employees*, to increase the annual payroll limitation for players, entertainers or musicians from $94,900 to $97,500 per person to reflect wage inflation since the threshold was last amended in 2009.

42. Establish a cross-reference to indicate that Classification 2030, *Sugar Mfg. or Refining – beet or cane,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

43. Amend Classification 7365, *Taxicab Operations – all employees*, to increase the minimum annual payroll per taxicab from $26,500 per year to $27,300 to reflect wage inflation since the threshold was last amended in 2009.

44. Amend Classification 9156, *Theaters – dance, opera and theater companies*, to increase the annual payroll limitation for performers and directors of performers from $94,900 to $97,500 per person to reflect wage inflation since the threshold was last amended in 2009.

45. Amend Classification 9151, *Theaters – music ensembles*, to increase the annual payroll limitation for performers and directors of performers from $94,900 to $97,500 per person to reflect wage inflation since the threshold was last amended in 2009.

46. Establish a cross-reference to indicate that Classification 8209, *Vegetables – fresh vegetable and tomato packing and handling,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

47. Establish a cross-reference to indicate that Classification 2142(3), *Vinegar Mfg.,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

48. Establish a cross-reference to indicate that Classification 4831, *Vitamin or Food Supplement Mfg. – compounding, blending or packaging only,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

49. Amend the footnote to Classification 8215(2), *Warehouses – grain or bean,* to reflect other recommendations proposed elsewhere in the filing.

50. Establish a cross-reference to indicate that Classification 2142(1), *Wineries – all operations,* is listed under the *Food Packaging and Processing* Industry Group as proposed elsewhere in the filing.

51. Amend Section VIII, *Abbreviated Classifications – Numeric Listing*, for consistency with recommendations proposed elsewhere in the filing.

52. Amend Part 4, *Unit Statistical Report Filing Requirements*, Section I, *General Instructions*, Rule 5, *Hard Copy Reporting*, to eliminate all references to the Supplemental Loss Report form for consistency with other recommendations proposed elsewhere in the filing.

53. Amend Part 4, Section II, *Definitions*, to conform to the Workers Compensation Insurance Organizations' *WCIO Workers Compensation Data Specifications Manual* for the electronic reporting of unit statistical report data, as applicable to California, as well as for consistency and clarity.

54. Amend Part 4, Section III, *Policy Information (Header)*, to conform to the Workers Compensation Insurance Organizations' *WCIO Workers Compensation Data Specifications Manual* for the electronic reporting of unit statistical report data, as applicable to California, and for consistency with other recommendations proposed elsewhere in the filing.

55. Amend Part 4, Section IV, *Exposure and Premium Information*, to conform to the Workers Compensation Insurance Organizations' *WCIO Workers Compensation Data Specifications Manual* for the electronic reporting of unit statistical report data, as applicable to California, and for consistency with other recommendations proposed elsewhere in the filing.

56. Amend Part 4, Section V, *Loss Information*, to conform to the Workers Compensation Insurance Organizations' *WCIO Workers Compensation Data Specifications Manual* for the electronic reporting of unit statistical report data, as applicable to California, and for consistency with other proposed recommendations made elsewhere in the filing.

57. Amend Part 4, Section V, *Loss Information*, Subsection B, *Loss Data Elements*, Rule 13, to eliminate the Social Security Number reporting requirement due to privacy concerns, to be effective with respect to claims required to be valued on or after January 1, 2010, and to renumber all subsequent rules due to the elimination of Rule 13.

58. Amend Part 4, Section VI, *Subsequent Reports, Correction Reports, and Reporting Methods,* to conform to the Workers Compensation Insurance Organizations' *WCIO Workers Compensation Data Specifications Manual* for the electronic reporting of unit statistical report data, as applicable to California, and for consistency with other recommendations proposed elsewhere in the filing.

59. In addition, the Insurance Commissioner's Decision on the WCIRB's July 1, 2009 pure premium rate filing directed the WCIRB to propose rule changes, effective January 1, 2010, to require that the cost of medical cost containment programs be reported as allocated loss adjustment expense instead of medical loss and be separately reported so as to be able to be monitored. The WCIRB has proposed amendments to the USRP definition and reporting requirements related to medical cost containment and submitted those proposed amendments on September 22, 2009. However, the WCIRB has advised that in light of the complexity of the insurer system modifications needed to facilitate the new reporting requirements, the WCIRB proposes that the amendments become effective July 1, 2010. The amendments to require that the cost of medical cost containment programs be reported as allocated loss adjustment expense instead of medical loss and be separately reported so as to be able to be monitored amend the definitions of *a. Allocated Loss Adjustment Expense(s)* and *b. Unallocated Loss Adjustment Expense(s)* contained in Part 4, Section II, Rule 19 of the USRP and the definition of *Medical Loss(es)* contained in Part 4, Section II, Rule 22 of the USRP.

Appendices to the USRP

The WCIRB's recommendations are as follows:

1. Amend Appendix IV to eliminate the Supplemental Loss Report Form as it is no longer applicable.

2. Amend Appendix V, *Required Loss Fields for Particular Injury Types and Types of Claims,* to conform to the Workers Compensation Insurance Organizations' *WCIO Workers Compensation Data Specifications Manual* for the electronic reporting of unit statistical report data, as applicable to California, and for consistency with other recommendations proposed elsewhere in the filing. Also, amend to eliminate the Social Security Number reporting requirement, due to privacy concerns, to be effective with respect to claims required to be valued on or after January 1, 2010.

3. Amend Appendix VI, *Injury and Accident Description Codes,* to conform to the Workers Compensation Insurance Organizations' *WCIO Workers Compensation Data Specifications Manual* for the electronic reporting of unit statistical report data, as applicable to California, as well as for consistency and clarity.

Rulings on Amendments to the USRP and its Appendices

Amendments to the USRP in items 1 through 58 above and Appendices to USRP in items 1 to 3 above have been reviewed, along with the trade group notices and other materials provided by the WCIRB, and, having received no objections to them, are approved as being reasonable and consistent with the purpose of the USRP.

With regard to item 59 above, objection to the WCIRB's amendments was received from Advocal on behalf of the California Society of Industrial Medicine and Surgery, the California Society of Physical Medicine and Rehabilitation, and U.S. HealthWorks, Inc. The objection to the amendment was primarily over the fact that it was not specific enough to disallow expenses associated with the cost of nurse case management, medical management programs, or costs related to "coordination of care." It was recommended by Advocal that the definition for *Medical Loss(es)* be, "For the purpose of reporting within the USRP, the medical costs are defined as only the reimbursement paid directly to physicians and other medical providers for services provided by the physician or medical provider directly to injured workers in accordance with Labor Code Section 4600."

Additionally, Advocal requested that the implementation of the amendments in item 59 above be on or before January 1, 2010 since the data already exists and can be reported by the insurers before July 1, 2010.

The concerns of Advocal regarding the definitions in item 59 above are valid, but the definition it has provided is too narrow. Such a definition could, arguably, not include lump-sum settlements of medical costs, medical mileage, interpreter fees, and a host

other items that are medical and not just medical cost containment expenses. Therefore, Advocal's proposed definition is rejected. However, its point regarding nurse case management and other medical cost containment programs expenses being accounted for as medical loss rather than loss adjustment expense does have some validity.
This Hearing Officer expressed to the WCIRB at the hearing that the definitions were not as clear as they could be. The WCIRB responded that the definitions are similar to those used in other jurisdictions where medical cost containment expenses are accounted for as loss adjustment expenses rather than medical losses. The WCIRB also noted that the definition of "medical management" should not be specified since it was overly broad and components of medical management, such as coordinating care, visiting, monitoring of the injured worker's progress, etc., should continue to be in medical. This Hearing Officer agrees with this analysis in part and disagrees with it in another.

The WCIRB appears to have created definitions of medical losses and loss adjustment expenses that in some ways comport with what other jurisdictions use but does not take into account interpretations of what has been defined in California. For example, the WCAB has ruled that nurse case managers that interact or coordinate medical care with the injured workers constitute medical care. [See *Lamin v. City of Los Angeles, et al.* (2004) 69 Cal. Comp. Cases 1002] This compares to the expenses incurred by insurers using nurses or nurse case management or other medical management programs to effectively advise the insurer and oversee medical care without directly working with or being provided to the injured employee, which appear to be a claim adjustment expense as asserted by Advocal.

Given the objection by Advocal and the minimal explanation provided by the WCIRB, in both its testimony and documentation, on how it arrived at these definition changes, the definitions require modification. Therefore, the definition of *a. Allocated Loss Adjustment Expense(s)* contained in Part 4, Section II, Rule 19 of the USRP as proposed by the WCRIB shall be modified by adding subsection (d) to Section (4) as follows:

> (d) Costs of medical management except for nurse case management or case management that directly interacts and is coordinated with the injured employee and others, who are all parties to the employee's need for medical care.

The purpose of the addition of subsection (d) is to establish the rule that medical management costs are to be accounted for as loss adjustment expenses unless they are directly provided to the injured employee as a medical benefit. Those expenses may be allocated or unallocated pursuant to Section (4).

As to the effective date of this change, the WCIRB testified that implementation of the changes set forth in item 59, noted above, would be difficult and the workers' compensation insurance industry could not respond to a rule change that would be effective in less than 60 days. Despite the protest by Advocal that the industry was already collecting the expense data, there was no information that this was being done universally based upon a rule of the Insurance Commissioner. It appears appropriate to

allow time for uniform compliance by all insurers, especially with the change noted in this decision to the definition of *a. Allocated Loss Adjustment Expense(s)*. Therefore the effective date for the change to item 59, *a. Allocated Loss Adjustment Expense(s)* (including the modification noted above) and *b. Unallocated Loss Adjustment Expense(s)* contained in Part 4, Section II, Rule 19 of the USRP and the definition of *Medical Loss(es)* contained in Part 4, Section II, Rule 22 of the USRP, shall be effective as of July 1, 2010.

Amendments to the Miscellaneous Regulations for the Recording and Reporting of Data

The WCIRB has proposed amendment to the Miscellaneous Regulations for the Recording and Reporting of Data to be effective on January 1, 2009 with respect to new and renewal policies as of the first anniversary rating date of a risk on or after January 1, 2009. That amendment is:

1. Amend Part 1, *General Provisions*, Section I, *Introduction*, Rule 2, *Effective Date*, to show that the effective date of the amended Miscellaneous Regulations is 12:01 A.M., January 1, 2010 to be consistent with the effective date of the California Workers' Compensation Uniform Statistical Reporting Plan—1995 for ease of reference.

This amendment, having been reviewed and having received no objections regarding it, is approved as being reasonable and consistent with the purpose of these Miscellaneous Regulations.

Amendments to the California Workers' Compensation Experience Rating Plan—1995 (ERP)

The WCIRB has proposed amendments to the ERP to be effective on January 1, 2010 with respect to new and renewal policies as of the first anniversary rating date of a risk on or after January 1, 2010. Those amendments include the following:

1. Amend Section I, *General Provisions*, Rule 2, *Effective Date*, to show that the effective date of the amended Experience Rating Plan is 12:01 A.M., January 1, 2010.

2. Amend Section III, *Eligibility and Experience Period*, Rule 1, *Eligibility Requirements for California Workers' Compensation Insurance*, to adjust the experience rating eligibility threshold from $15,700 to $20,100 to reflect wage inflation and the indicated change in the claims cost benchmark reflected in the filing.

3. Amend Section VII, *Rating Procedure*, Rule 1, *Primary Actual Losses*, to replace the formula for computing the primary actual loss value with a new method for determining the primary actual loss value.

4. Eliminate the values in Table I, *Primary Values of Actual Losses*, and replace with a reference to Section VII, Rule 1, for clarity and to conform to recommendations proposed elsewhere in the filing.

5. Amend the D-ratios shown in Table II, *Expected Loss Rates and Full Coverage D-Ratios*, to reflect the most current data available and an enhanced methodology to project expected loss rates.

6. Amend the credibility ("B" and "W") values shown in Table III to reflect the most current data available.

The WCIRB recommends the following amendments to the ERP be approved effective January 1, 2011 with respect to new and renewal policies as of the first anniversary rating date of a risk on or after January 1, 2011. The WCIRB recommends that:

1. Amend Section II, *Definitions*, to add a definition of Loss-Free Rating and to renumber all subsequent Rules.

2. Amend Section V, *Application of Experience Modification*, Rule 5, *Notification of Experience Modification,* to require the notice to reflect (a) the risk's Loss-Free Rating and (b) a summary explanation of the experience modification computation.

The amendments to the ERP have been reviewed, and no objection to them has been received. These amendments are also reasonable and consistent with the Plan and are approved and will be effective on the dates noted above; however, we have concluded the change of the Pure Premium Rates should be +15.4%. Therefore, the WCIRB is directed to adjust the eligibility threshold to reflect the Insurance Commissioner's adopted Claims Cost Benchmark in order to maintain approximately the same volume of experience rated employers.

The WCIRB is directed to review the amendments that are effective January 1, 2011 regarding Loss-Free Ratings contained in the ERP and determine how the experience modification information will be provided to the employer. Currently there is no requirement for this. Since the WCIRB is responsible for calculating employer experience modifications and this information is provided to its insurer members, the WCIRB shall propose an additional rule to require that employers receive notification of their experience modification with the new Loss-Free Rating information directly from either the WCIRB or the insurer. The proposal for this change shall be submitted for review by the Commissioner at the next hearing for rate and rule changes to be effective January 1, 2011.

PROPOSED ORDER

WHEREFORE, IT IS ORDERED, by virtue of the authority vested in the Insurance Commissioner of the State of California by California Insurance Code sections 11734, 11750, 11750.3, 11751.5, and 11751.8 that the advisory workers' compensation pure premium rates filed by the WCIRB and Sections 2318.6, 2353.1 and 2354 of Title 10 of the California Code of Regulations are hereby amended and modified in the respects specified herein and in accordance with the Commissioner's adjustment to the Workers' Compensation Claims Cost Benchmark;

IT IS FURTHER ORDERED that the definition of *a. Allocated Loss Adjustment Expense(s)* contained in Part 4, Section II, Rule 19 of the USRP as proposed by the WCRIB shall be modified by adding subsection (d) as follows:

> (d) Costs of medical management except for nurse case management or case management that directly interacts and is coordinated with the injured employee and others, who are all parties to the employee's need for medical care.;

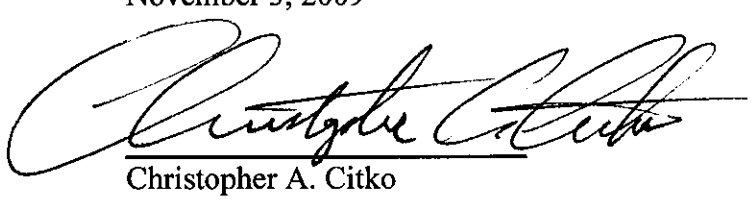
IT IS FURTHER ORDERED that the experience rating threshold be calculated to reflect the adjustment of the Workers' Compensation Claims Cost Benchmark adopted by the Commissioner;

IT IS FURTHER ORDERED that the Expected Loss Rates be modified and/or adjusted to reflect the off-balance created by average experience rated employer credits in lieu of increasing the Benchmark by +1%; and

IT IS FURTHER ORDERED that these regulations shall be effective January 1, 2010 for all new and renewal policies with anniversary rating dates on or after that date, unless another effective date is noted or specified.

I HEREBY CERTIFY that the foregoing constitutes my Proposed Decision and Proposed Order in the above entitled matter as a result of the hearing held before me as a Senior Staff Counsel of the Department of Insurance on October 6, 2009, and I hereby recommend its adoption as the Decision and Order of the Insurance Commissioner of the State of California.

November 3, 2009



Christopher A. Citko
Senior Staff Counsel