

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

DECISION AND ORDER

**JANUARY 1, 2021 WORKERS' COMPENSATION CLAIMS COST BENCHMARK
AND ADVISORY PURE PREMIUM RATES**

FILE NUMBER REG-2020-00014

In the Matter of: Proposed adoption or amendment of the Insurance Commissioner's regulations pertaining to the Workers' Compensation Insurance Claims Cost Benchmark and Advisory Pure Premium Rates. CDI File Number REG-2020-00014. The benchmark will be effective on **January 1, 2021**.

The WCIRB's thorough efforts to estimate COVID-19 costs are noted and appreciated but I am not persuaded that there is sufficient and reliable data upon which to base an adjustment for COVID-19 costs. Insurance companies are encouraged to take under advisement the actuarial analyses provided in the proposed decision as well as ongoing developments when evaluating whether and to what extent an adjustment for the costs of COVID-19 should be incorporated into a given insurer's rate filing.

DECISION AND ORDER

I adopt the Proposed Decision and Order of Patricia Hein dated November 24, 2020, in part, and order that

1. The WCIRB adopt an average advisory claims cost benchmark of \$1.45 per \$100 of employer payroll and adjust the pure premium rates for individual classifications, excluding the additional adjustment for COVID-19, based upon this benchmark;
2. Insurance companies shall submit any rate component and/or rating plan that includes an adjustment for COVID-19; the filed rates and rating plans in 2021 shall reflect the expected cost of COVID-19 claims on the policies to which they apply and be clearly identified in the rate filings submitted to the Department; and

3. The WCIRB collect data of aggregate premium charged for any rate component and/or rating plan that includes an adjustment for COVID-19.

IT IS SO ORDERED THIS 24th DAY OF NOVEMBER, 2020.

A handwritten signature in black ink, appearing to read "Ricardo Lara". The signature is stylized with a large "R" and "L".

RICARDO LARA
Insurance Commissioner

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

PROPOSED DECISION AND ORDER

**JANUARY 1, 2021 WORKERS' COMPENSATION CLAIMS COST
BENCHMARK AND ADVISORY PURE PREMIUM RATES**

FILE NUMBER REG-2020-00014

In the Matter of: Proposed adoption or amendment of the Insurance Commissioner's ("Commissioner") regulations pertaining to the workers' compensation insurance claims cost benchmark and advisory pure premium rates. These regulations will be effective on January 1, 2021.

SUMMARY OF PROCEEDINGS

The California Department of Insurance ("Department") held a public hearing in the above captioned matter on October 5, 2020 at the time and place set forth in the Notice of Proposed Action and Notice of Public Hearing, File Number REG-2020-00014, dated September 4, 2020 ("Notice"). A copy of the Notice is included in the record. The record closed on October 26, 2020.

The Department distributed copies of the Notice to the persons and entities referenced in the record. The Notice included a summary of the proposed changes and instructions for interested persons who wanted to view a copy of the information submitted to the Commissioner in connection with the proposed changes. The filing letter dated August 26, 2020, submitted by the Workers' Compensation Insurance Rating Bureau of California ("WCIRB"), and related documents were available for inspection by the public at the Oakland office of the Department and were available online at the WCIRB's website, www.wcirb.com.

The WCIRB's filing proposes a change in the workers' compensation claims cost benchmark and advisory pure premium rates ("benchmark") in effect since January 1, 2020, that reflects insurer loss costs and loss adjustment expenses ("LAE").

In its filing, the WCIRB requested that the Commissioner adopt a set of pure premium rates for each classification to be effective January 1, 2021. The

WCIRB recommended an average pure premium rate of \$1.56 per \$100 of payroll, which is 2.6% more than the approved pure premium rates as of January 1, 2020.

The Department accepted testimony and written comments at a hearing in Oakland on October 5, 2020, and also received exhibits into the record. Members of the public submitted additional materials along with correspondence and documents prior to the hearing. The Commissioner announced that the record would remain open pending the receipt of additional information from the WCIRB. After the hearing and before the closure of the record, the Department received into the record additional comments from the WCIRB and Bickmore, the public members' actuary. The record closed at 5:00 p.m. on October 26, 2020. Having been duly heard and considered, the Department now presents the following review, analysis, Proposed Decision, and Proposed Order.

REVIEW OF WORKERS' COMPENSATION CLAIMS COST BENCHMARK AND ADVISORY PURE PREMIUM RATES FILING

Subdivision (b) of California Insurance Code Section 11750 states that the 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 a licensed rating organization, such as the WCIRB, shall collect and tabulate information and statistics for the purpose of developing pure premium rates for its insurance company members to be submitted to the Commissioner. Pure premium rates are the cost of workers' compensation benefits and the expense to provide those benefits.

The pure premium rates approved in this process by the Commissioner are only advisory. Insurers are permitted under California law to make their own determinations as to the pure premium rates each insurer will use, as long as the ultimate rates charged do not threaten the insurer's financial solvency, are not unfairly discriminatory, and do not tend to create a monopoly in the marketplace.

The Department's actuary, Mitra Sanandajifar, provides below in the Actuarial Evaluation a review and analysis based upon the filing information presented by the WCIRB and the public's comments about the filing. The pure premium rate process serves as an important gauge or benchmark of the costs in the workers'

compensation system, but must also reflect the reality of insurer rate filings and the premiums insurers charge to employers.

The pure premium rate process does not reflect an employer's final paid insurance rate or premium. Instead, the pure premium process is narrowly tailored to project a specific sub-component of an overall rate. For example, the pure premium rate does not include the costs associated with underwriting expenses, profit, or a return on an insurer's investments. The analysis of pure premium in California projects the cost of benefits and LAE for the upcoming policy period beginning January 1, 2021. The term "rate" can be confusing in the pure premium context since it is a measurement of average claim cost per \$100 of employer payroll rather than the rates insurers may charge.

These figures are not predictive of an individual employer's insurance premium. That premium may fluctuate greatly from these figures based upon an employer's business, the mix of employees and operations, and the employer's actual claims experience. It is not possible to determine an individual employer's premium from these figures or from the Commissioner's pure premium determination because the review of pure premium rates represents just one component of insurance pricing.

ACTUARIAL RECOMMENDATION

The WCIRB has proposed an average advisory pure premium rate level of \$1.56 per \$100 of payroll in its January 1, 2021 filing for policies incepting during January 1st and August 31st 2021 (PY21). The \$1.56 average pure premium rate includes an adjustment for the estimate of the cost of COVID-19 claims during PY21. The WCIRB's proposed average pure premium rate excluding the COVID-19 adjustment is \$1.50 per \$100 of payroll. The Department's staff actuaries' analysis, as set forth in the following Actuarial Evaluation section, results in an average pure premium rate level of \$1.45 per \$100 of payroll, excluding the COVID-19 adjustment, and an average of \$0.05 per \$100 of payroll as an additive adjustment for the projected cost of COVID-19 claims. The most recently available industry average level of pure premium rates filed by insurers with the Department is \$1.80 per \$100 of payroll as of July 1, 2020. While the indicated pure premium rate level represents our central estimate, and thus our recommendation, we note that both the WCIRB's estimate of \$1.56 (\$1.50 excluding COVID-19) and the middle estimate of \$1.49 (\$1.44 excluding COVID-19) from the Public Members' Actuary (Bickmore) are within reasonable actuarial range.

Due to differences in the nature of exposure to risk underlying the non-COVID-19 portion of the pure premium rates by classification, and the COVID-19 adjustment, as discussed in more detail in Section 5, the Department's staff believe that the non-COVID-19 advisory pure premium rates by classification, and COVID-19 adjustment by classification, should be kept separate and not promulgated on a combined basis.

Moreover, given the temporary nature of the adjustment for the cost of the COVID-19 pandemic, the Department's staff recommends that the advisory pure premium rates be kept on a non-COVID-19 basis to avoid distorting the pure premium rates for temporary non-recurring and rare events similar to terrorism and the global pandemic. The adjustment for the cost of COVID-19 claims would be recommended as a separate provision for the periods affected by the pandemic, and not as part of the advisory pure premium rates.

In order to preserve separation of the non-COVID-19 pure premium rates from the COVID-19 loss costs, the Department's staff recommends that starting with January 1, 2021 policies, the premiums collected to cover COVID-19 claims costs be separately accounted for, to allow for an undistorted determination of the non-COVID-19 pure premium rates, and facilitate potential loss cost analyses for COVID-19 claims.

The WCIRB's proposed pure premium rate level of \$1.50, excluding the COVID-19 adjustment, is based on data evaluated as of March 31, 2020. While the WCIRB reviewed the data available as of June 30, 2020, the review did not result in changes in the proposed average pure premium rate in the amended filing due to consideration of the distorting impact of the pandemic and resultant stay-at-home orders on the 2nd quarter 2020 experience. However, as discussed in the COVID-19 section, the amended filing proposed changes to the distribution of the COVID-19 costs to various NAICS industry sectors.

The WCIRB's filing compares its proposed average pure premium rate level to the average industry-filed pure premium rate level. We believe this comparison is useful. It provides an appropriate basis for assessing both the industry's ability to adapt to the proposed pure premium rate level and the size of the potential market impact of such an adjustment. We note that under California law, the Insurance Commissioner's adopted pure premium rates are advisory, and insurers are free to make their own decisions as to what pure premium rates they will use in their rate filings and what rates to charge. The most recently filed pure premium rates by insurers are higher than the Insurance Commissioner's most recently adopted pure premium advisory rates.

The California workers' compensation market appears to be competitive and financially healthy. Collected premiums in the first quarter of 2020 produced an average charged rate of \$1.90¹, which compares to \$1.96² and \$2.21³ observed in 2019 and 2018 respectively, showing a continuation of a downward trend in charged market rates that has been in progress since the first half of 2015 when the average charged rate was \$3.01. The average charged rate of \$1.90 for the first quarter of 2020 (which reflects all insurer expenses) was approximately 25% more than the Insurance Commissioner's adopted January 1, 2020 average advisory pure premium rate of \$1.52, which reflects loss and loss adjustment expense only. It was also approximately 25.5% less than the industry average filed manual rate of \$2.55, thus indicating the average effect of schedule rating and other rating plan credits.

As of March 31, 2020, the WCIRB estimates overall industry combined ratios at or below 87% for accident years 2014 through 2018, and a combined ratio of 95% for accident year 2019. After a period of combined ratios in excess of 100% over the 2008 through 2012 accident years, the 2019 accident year is the seventh consecutive year for the industry with a projected combined ratio at or below 95%. However, current charged rate levels are somewhat lower than the charged rates that underlay the combined ratios for accident years 2015 through 2019.

Actuarial Evaluation

The actuarial evaluation will focus on the following main components of the analysis: (1) loss development; (2) loss trends; (3) loss adjustment expense ("LAE") provision, which include allocated loss adjustment expense ("ALAE"), unallocated loss adjustment expense ("ULAE") and medical cost containment programs ("MCCP"); (4) the impact of reform legislation contained in Senate Bill 863 ("SB 863"), Senate Bill 1160 ("SB 1160"), Assembly Bill 1244 ("AB 1244"), and Assembly Bill 1124 ("AB 1124"); and (5) the estimated cost and distribution of the costs of the COVID-19 claims.

Table 1 shows the components of the WCIRB's pure premium rate indications over the past several years, separated into medical, indemnity, LAE, and for this filing, COVID-19 components, along with a comparison to Bickmore's current

¹ Includes adjustment for new payroll limitations effective in 2020 applicable to five classifications.

² \$2.06 if adjusted for new payroll limitations effective in 2020, to make it comparable to the \$1.90 for the first quarter of 2020

³ \$2.32 if adjusted for new payroll limitations effective in 2020, to make it comparable to the \$1.90 for the first quarter of 2020

indication based on its middle scenario. Table 2 displays advisory average pure premium rates and the COVID-19 average cost per \$100 of payroll from the WCIRB's recommendation, as compared to those of both the Department's staff recommendation, and Bickmore's middle projection.

Table 1	WCIRB Filed Rates										Bickmore	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	7/1/15	1/1/16	7/1/16	1/1/17	7/1/17	1/1/18	7/1/18	1/1/19	1/1/20	1/1/21	1/1/21	1/1/2020
Medical \$	1.14	1.10	1.00	0.95	0.87	0.84	0.76	0.70	0.65	0.62	0.56	0.59
Indemnity \$	0.72	0.69	0.70	0.67	0.64	0.63	0.58	0.54	0.51	0.50	0.50	0.48
LAE \$	0.61	0.63	0.61	0.60	0.51	0.49	0.46	0.46	0.42	0.38	0.38	0.45
COVID-19 \$	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.06	0.05	N/A
Total \$	\$ 2.47	\$ 2.42	\$ 2.30	\$ 2.22	\$ 2.02	\$ 1.96	\$ 1.80	\$ 1.70	\$ 1.58	\$ 1.56	\$ 1.49	\$ 1.52
Industry Avg Filed PP Rate							\$ 2.13	\$ 1.99	\$ 1.80			
Industry Avg Filed Manual Rate (with expenses)							\$ 3.10	\$ 2.82	\$ 2.55			
Industry Avg Charged Rate (net discounts)							\$ 2.38	\$ 2.04	\$ 1.90			

Table 2	Excluding COVID-19 Adjustment		Including COVID-19 Adjustment		Average COVID-19 Adjustment per \$100 of Payroll
	Recommended 1/1/2021 Average Pure Premium Rate	% Difference from the WCIRB Recommendation	Recommended 1/1/2021 Average Pure Premium Rate	% Difference from the WCIRB Recommendation	
WCIRB	\$1.50		\$1.56		\$0.06
CDI	\$1.45	-3.3%	\$1.50	-3.8%	\$0.05
Bickmore (Middle)	\$1.44	-4.0%	\$1.49	-4.5%	\$0.05

1. Loss Development

Some form of the paid loss development method has consistently served as the basis for determining ultimate loss estimates for both indemnity and medical losses in the WCIRB's advisory pure premium rate filings for many years. While focusing on the paid method, the WCIRB has also reviewed the results of other methods, particularly the incurred development method, along with multiple variations on these basic methods. At the same time, Bickmore has been giving equal weight to both the paid and incurred development methods in its analysis of ultimate medical losses. The WCIRB's final selection, however, has always been based on the paid development method.

In recent years, particularly after the implementation of SB 863 in 2013, it has become increasingly apparent that claims are closing more quickly than in years

past. This phenomenon is very likely to cause the paid development method to overestimate ultimate losses. In order to try to prevent such overstatement, the WCIRB has incorporated a Berquist-Sherman adjustment for changes in claim settlement rates to the historical paid loss triangles for both indemnity and medical losses in its filings.

In addition, the WCIRB has incorporated the impact of various reforms in the paid development factors. Similar to the January 1, 2020 filing, the cumulative paid medical development factors have been adjusted for the impact of SB 1160 and AB 1244 lien-related provisions, assuming a 60% decline in liens compared to the 2nd quarter of 2016.

Based on a study performed in 2019, and similar to the January 1, 2020 filing, the WCIRB has also made an adjustment to the paid losses underlying the paid medical development factors for the impact of the significant decline in pharmaceutical costs, which represent a much larger proportion of later period development compared to earlier periods (i.e. varies widely by maturity) and, if left unadjusted, would distort projected age-to-age medical development factors.

Earlier this year, the WCIRB conducted two studies that resulted in the implementation of changes in methodology and additional adjustments to late-term development factors and development tail for both indemnity and medical loss development, which are incorporated in this filing.

While the WCIRB has for the most part relied on paid losses for the determination of both indemnity and medical loss development factors, following a comprehensive study in 2014, for later maturities, and corresponding to accident years 1997 and prior, development factors had been determined based on incurred losses.

A retrospective study on late-term loss development conducted by the WCIRB this year showed that compared to the incurred method, the paid loss development method after 267 months was significantly more accurate at projecting recent emerging loss development for these late periods, and produced more stable tail factors.

The WCIRB also performed an analysis of the impact of acceleration in claim settlement rates on later period loss development, which showed that there is a strong correlation between changes in the proportion of ultimate claims open at a point in time, and changes in later period loss development.

The results of the above-mentioned studies have been incorporated in indemnity and medical loss development factors, in that the loss development factors for 267 months and later are based on the paid loss development method, adjusted for the impact of acceleration in claim settlement rates.

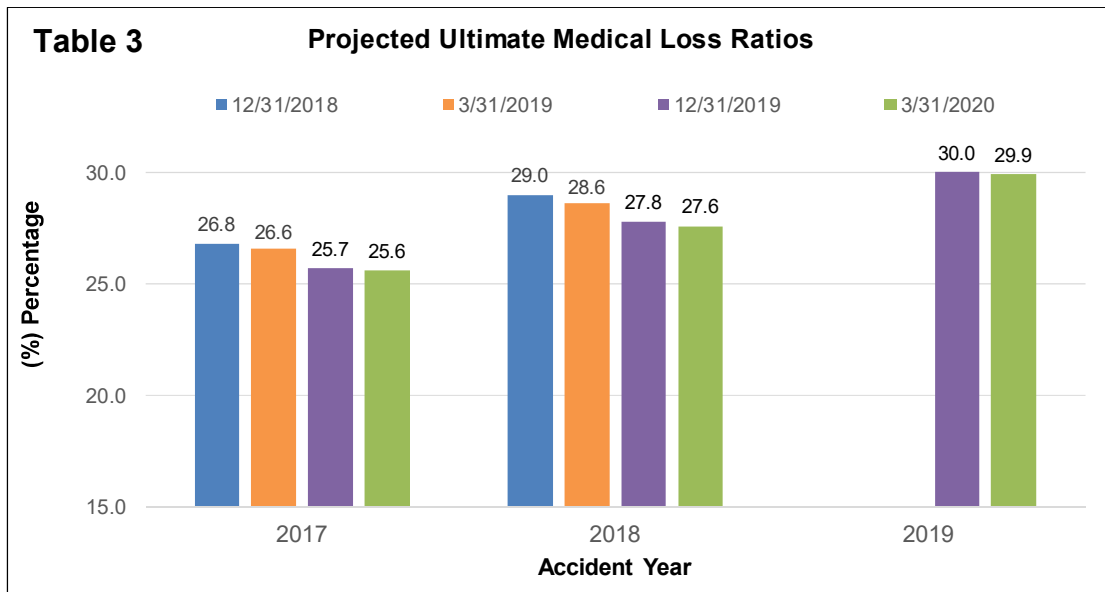
The Department appreciates the WCIRB's continued efforts to re-evaluate the impact of various reforms and the suitability of the methods underlying the projections, as well as conducting studies to monitor appropriateness of the projections and proper implementation of adjustments to improve the accuracy of the estimates.

In our reviews of filings prior to July 1, 2018, we had declined to give any weight to the incurred loss development method, noting that there were several drawbacks with the use of this method, especially on an industrywide basis for the workers' compensation line of insurance. While we had outlined the range of estimates produced by the various actuarial methods utilized by the WCIRB, and provided our commentary on the relative merits of the alternatives, we eventually concluded that the WCIRB's reliance on the paid development method, after adjustment for changes in settlement rates and for the effects of reforms, was appropriate.

However, in the review of the July 1, 2018 WCIRB proposed pure premium rate filing, we found it appropriate to give some weight to the incurred loss development method for projecting ultimate medical losses, despite the impediments to properly adjust the incurred method. Given the shortcomings identified with the incurred method stated below, we chose to give 75% weight to the WCIRB's paid development method, which included the adjustments for reforms and changes in claim settlement rates, and 25% weight to the unadjusted incurred development method. Our selection was made in consideration of the strong evidence that the paid development method has been overestimating ultimate medical losses—and can be expected to continue to do so—and that the lower projections based on the incurred method—despite its shortcomings and distortions—could be utilized as an offset to moderate the overstatement in projected ultimate medical losses by the paid method. The drawbacks with the use of the incurred method lie in the challenges associated with formulating the proper adjustments to make the incurred method more accurate, which include the difficulty of adjusting incurred losses for the impacts of the various reforms that have affected the historical data. Making such adjustments to historical paid loss data is relatively straightforward, but knowing how much the reforms have influenced the setting of case reserves across the entire insurance industry would seem to be well-nigh impossible.

There is also difficulty in adjusting historical case reserve data to the current level of case reserve adequacy when there are likely to have been different claims handling procedures and case reserving philosophies across the industry, as well as a changing mix of insurers over time. Sorting these effects out would also be quite difficult.

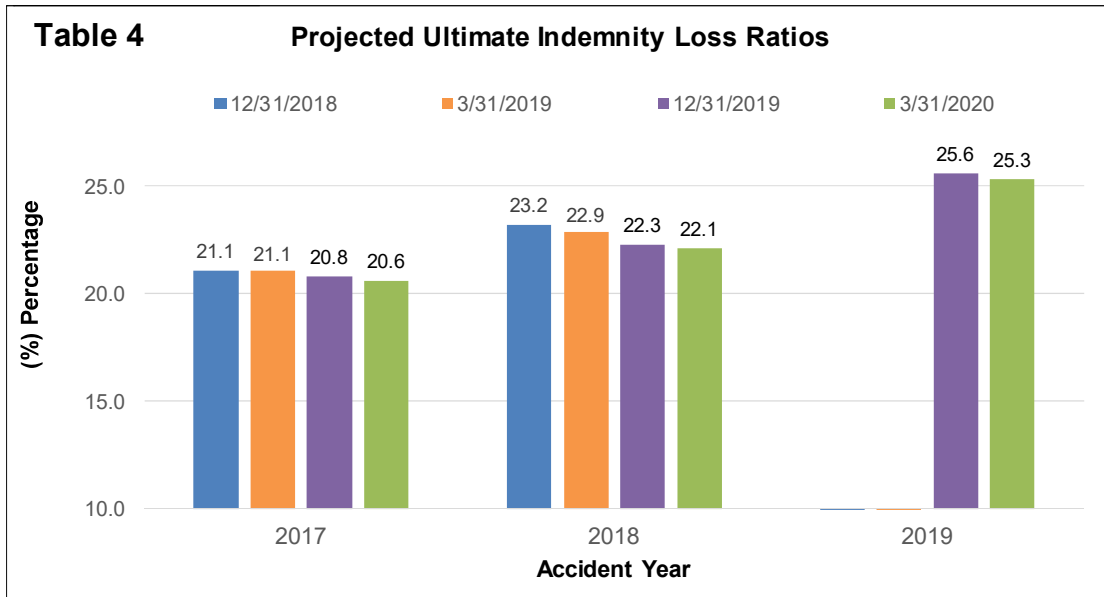
On the other hand, despite the use of the Berquist-Sherman adjustment, estimated ultimate medical loss ratios have continued to decline. Information provided in the hearing and in the Executive Summary of the filing demonstrate that the successive evaluations of the accident year ultimate medical losses have shown continued downward development since December 2018 (see Table 3), and while the decline has moderated, the accident year 2018 loss ratio has declined by about 3.5% between March 31, 2019 and March 31, 2020, and during the same period, the loss ratio for the more mature accident year 2017 also declined by about 3.8%. These loss ratios have been adjusted for changing claim settlement rates, the impact of pharmaceutical cost reductions to bring the historical payments to the current pharmaceutical cost level, as well as the impact of SB 1160, and AB 1244 provisions, and include changes in methodology and adjustments for the late-term loss development discussed above.



Note: All loss ratios are adjusted to the loss development methodology presented in the WCIRB 1/1/2021 filing.

Similarly, the successive estimates for indemnity loss ratios show that the accident year 2018 loss ratio has declined by about 3.5% between March 31, 2019 and March 31, 2020, and the loss ratio for the more mature accident year 2017 declined

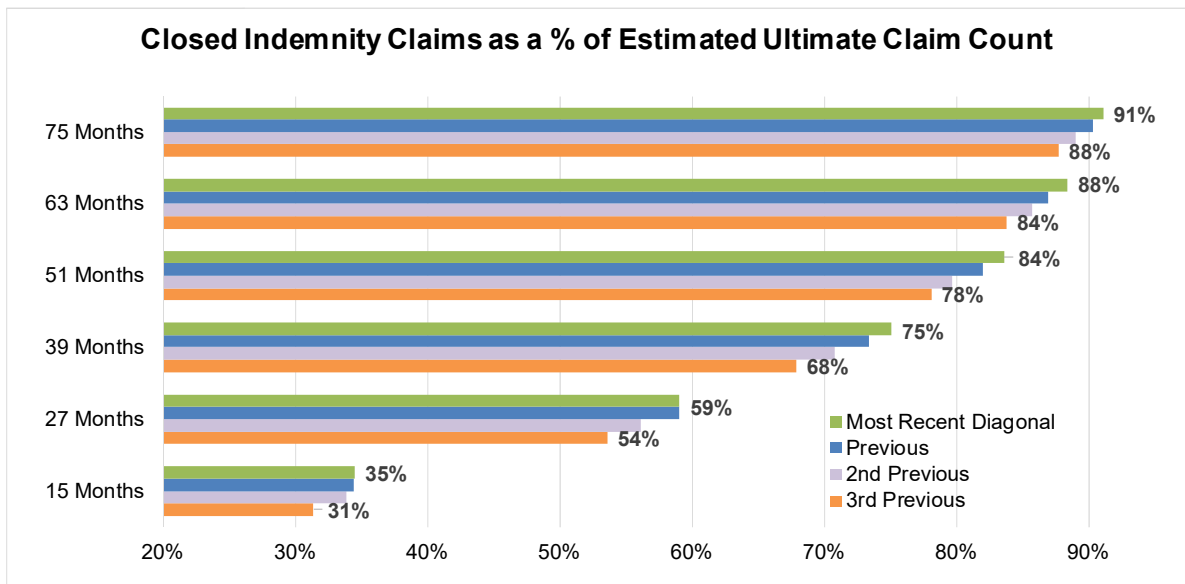
by about 2.4% during the same period, despite utilization of a common more refined loss development methodology.



Note: All loss ratios are adjusted to the loss development methodology presented in the WCIRB 1/1/2021 filing.

While the acceleration in claim settlement rates has plateaued for early evaluation of less mature accident years, as shown in Table 5, the trend continues for 39-months-plus maturities, and despite the utilization of the Berquist-Sherman adjustment for changes in claim settlement rates in recent filings, the improvement in loss development has continued, although at a more moderate level.

Table 5



Moreover, there are several factors that can be expected to have an impact on shortening the payout pattern for medical losses. Bickmore has provided some commentary in its review of this current filing. Bickmore cites three reasons for believing future medical paid loss development patterns will be less than what is indicated from historical patterns. These are: first, permanent disability claims are closing more quickly, while the closing rates for temporary disability claims appear to be increasing at a much slower pace; second, the change in the medical fee schedule to a resource-based relative value scale (“RBRVS”) and the utilization of the Independent Medical Review (IMR) could have sped up payments for medical benefits; and third, substantial declines in pharmaceutical costs could lead to lower loss development in later stages, as these costs were particularly heavy in the mature development periods.

Our evaluation would add to this list the significant reduction in opioid use and the effectiveness of recent lien reforms. While the WCIRB has been able to make an adjustment for the lien reforms, the decline in liens has continued beyond the level of the adjustment incorporated by the WCIRB, and the indirect impacts of IMR, RBRVS, and the significant reduction in opioid use and other narcotics on future development of indemnity and medical losses have been difficult to quantify and are being allowed to work their way through the indications over time.

As an example, claims that involve high-risk opioid use are about two to three times costlier, both on the medical and the indemnity side, and are almost twice as likely to remain open after four years, compared to similar lower-dose opioid use claims that are essentially identical in all aspects, except for the level of opioid use. Given that the differences in cost and proportion of permanent disability for claims subject to high-risk opioid usage appear to be more pronounced beyond four years since injury date⁴, the impact of reduced opioid use, and more appropriate courses of treatment for injured workers (which may have shifted the cost to earlier development periods), on future development of indemnity and medical losses for these accident years may not have been fully realized.

Accordingly, we believe it is appropriate to continue to give some weight to the incurred loss development method for projecting ultimate medical losses in this filing. Hence, we choose to give 75% weight to the WCIRB’s paid development method, which includes adjustments for the impact of pharmaceutical cost reductions to bring the historical payments to the current pharmaceutical cost

⁴ WCIRB Study, “Early Indicators of High-Risk Opioid Use and Potential Alternative Treatments.”

level, change in claim settlement rates, and SB 1160 and AB 1244 provisions, and 25% weight to the unadjusted incurred development method. However, given the sharp decline in the medical case reserves in recent calendar periods, consistent with the approach in the review of the January 1, 2020 filing, we use the projected ultimate incurred losses based on the 3-year average incurred development factors for this purpose. This weighting approach should recognize the continuing tendency of the paid development method to overstate ultimate medical losses while still preserving an element of caution that we believe is necessary when estimating future medical costs in California's uncertain workers' compensation environment.

2. Loss Trends

The WCIRB analyzes a range of trending assumptions to roll forward the estimates of ultimate losses developed above to the future time period during which the filing's proposed pure premium rates will be in effect.

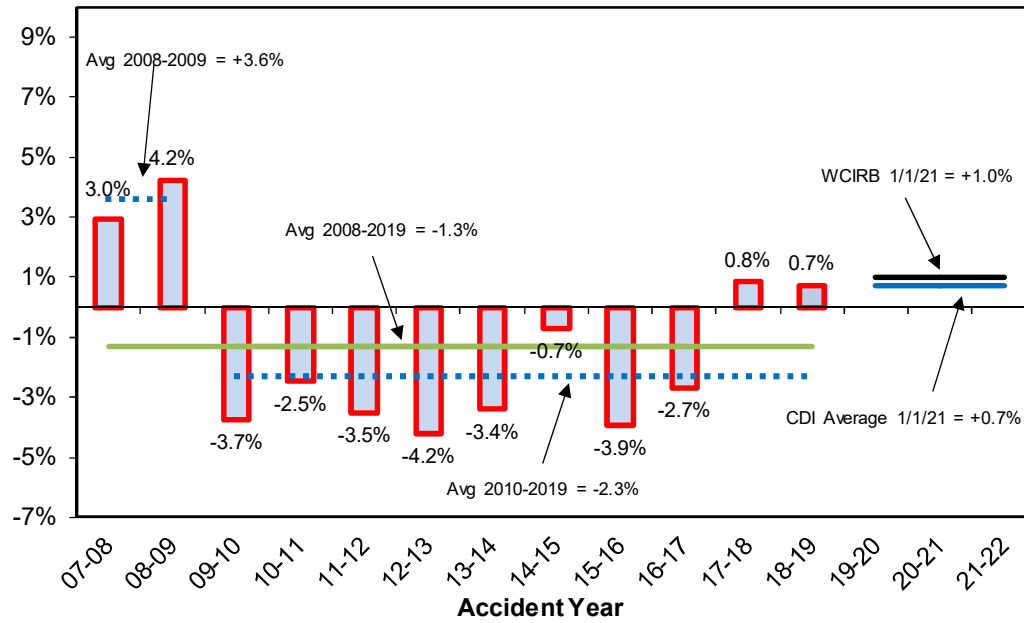
The various trend assumptions differ in terms of (1) the particular historical time period used to determine severity and frequency trends, and (2) the experience period that these trends are applied to, in order to roll forward to the future time period of the filing.

The preferred method utilized by the WCIRB has been the use of separate trends for frequency and severity and the application of these trends to the latest two years of experience. The WCIRB has conducted studies to determine the merits of alternative assumptions about trends in various environments such as reform, transition, and recession periods, and used the results to guide its selections based on the perceived current state of the environment.

As shown in Tables 6 and 7, indemnity and medical severities over the time period 2010-2019 have decreased relative to historical averages prior to 2010, discussed further following the severity and frequency charts.

Table 6

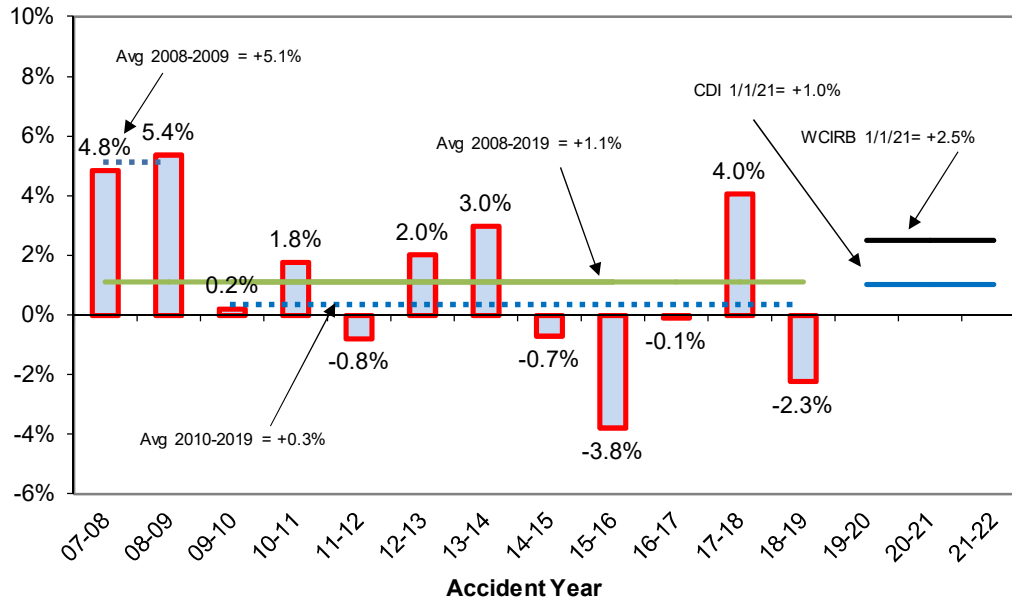
On-Level Indemnity Severity Annual % Change*



*Ultimate Indemnity Loss Projections are Based on the Paid Method, and Data Evaluated as of March 31, 2020

Table 7

On-Level Medical Severity Annual % Change*

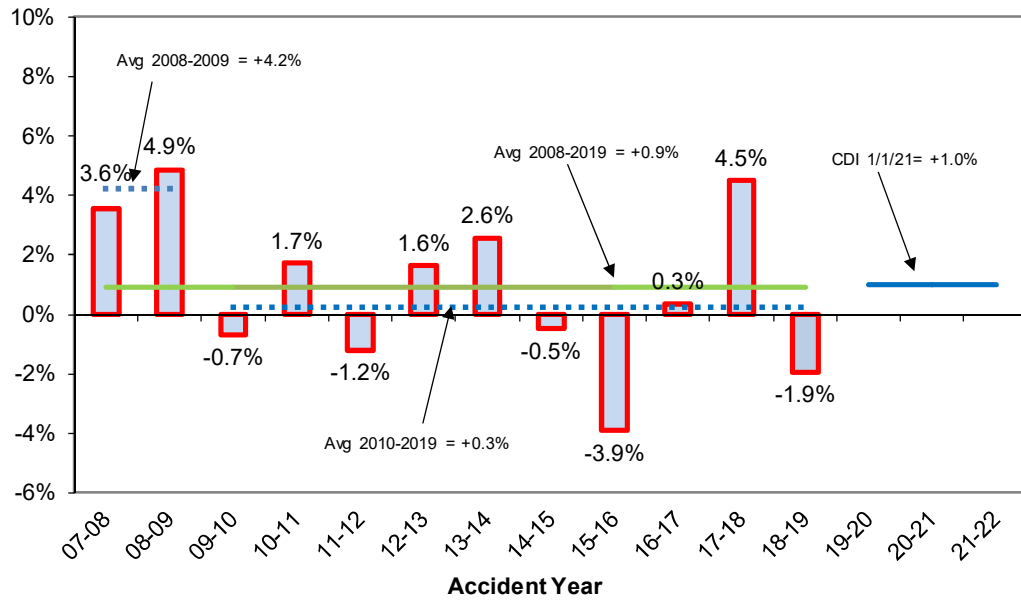


*Ultimate Medical Loss Projections are Based on the Paid Method, and Data Evaluated as of March 31, 2020

The changes in average medical severities in Table 7, as mentioned in the footnote, are based on ultimate medical losses that use the paid loss development method to project losses to ultimate. Table 8 shows the changes in average medical severities based on the Department-selected development method, discussed above, which relies on a combination of the paid and incurred development methods. While the individual data points may differ between Tables 7 and 8, the averages remain similar, especially for 2010 onward.

Table 8

On-Level Medical Severity Annual % Change*

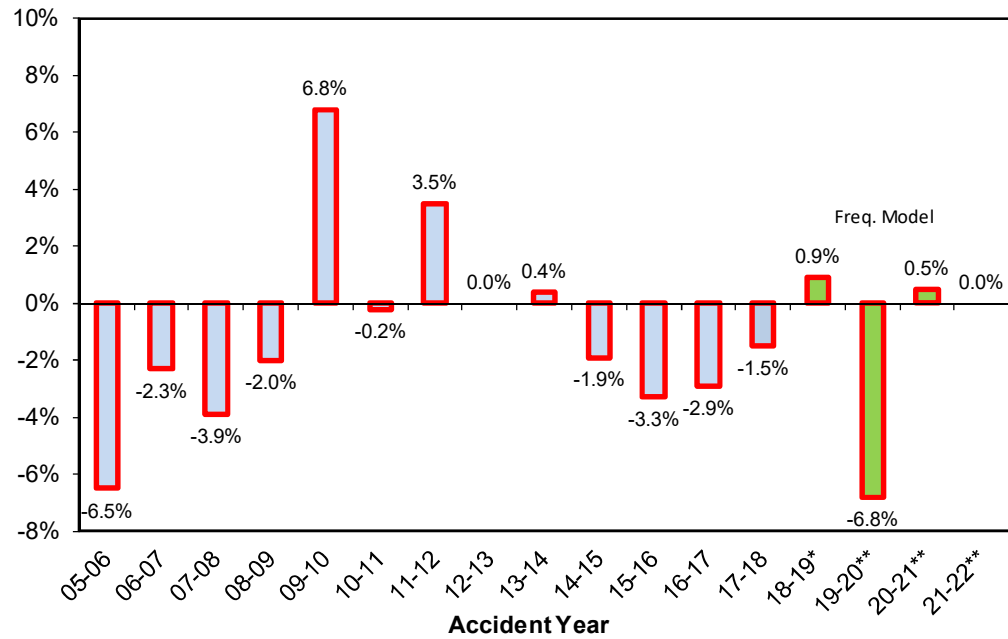


*Ultimate Medical Loss Projections are Based on Mix of Paid and Incurred Methods, and Data Evaluated as of March 31, 2020

Table 9

Indemnity Claim Frequency Annual % Change

As of March 31, 2020



*The 2018-2019 estimate is based on comparison of claim counts based on WCIRB accident year experience as of March 31, 2020 relative to the estimated change in statewide employment. Prior years are based on unit statistical data.

**Projections based on Frequency Model.

While the estimated changes shown in Table 9 are based on unit statistical plan data for 2018 and earlier periods, for 2019, the estimates also rely on proxies for changes in frequency (i.e. changes in reported aggregate indemnity claim counts compared to changes in statewide employment).

The WCIRB attributes the frequency increases since 2011 to cumulative trauma (“CT”) claims, where claims are much more likely to involve multiple body parts, often include a psychiatric component, and are more concentrated to the Los Angeles Basin area. A significant portion of CT claims are filed post-termination of the employee, and had been initially denied. The WCIRB has published an in-depth study of the cumulative injury claim patterns in 2018 to provide detailed information on the characteristics of these types of claims, and in its continued efforts to analyze the driver(s) of the frequency pattern.

Earlier this year, the WCIRB published a study of the historical impact of prior economic slowdowns on claim frequency, which showed that during periods of

economic slowdown, the accelerated decline in indemnity claim frequency is accompanied by an increase in the proportion of indemnity claims involving CT. Given the significant economic slowdown, caused abruptly by the pandemic, there is concern that the situation will give rise to an increase in CT claims, especially in 2020.

The green bars in Table 9 reflect the WCIRB's forecast of changes in frequency, which are based on an econometric model developed using a long-term history of frequency changes in relation to changes in economic and other claims-related factors, including the proportion of CT claims. In this filing, a projected increase in the proportion of CT claims, consistent with that of the last two economic recessions, has been incorporated in the WCIRB's frequency forecast model, and the 6.8% projected decline in indemnity frequency for accident year 2020 reflects this adjustment. Prior to adjustment for the impact of CT claims, the projected indemnity claim frequency decline would have been 11.1%. The indemnity frequency projections include an adjustment for a shift in industrial mix, consistent with the methodology used in prior filings.

In terms of methodology, in contrast to prior filings, there is no difference in this filing between the public members' actuary, Bickmore, and the WCIRB, in the application of trend methodology. In recent prior filings, Bickmore used a loss ratio trend applied to the latest two years, while the WCIRB uses separate frequency and severity trends. However, for this filing, Bickmore has also opted to make trend selections separately for frequency and severity. Moreover, for its middle scenario, Bickmore is also in agreement with the WCIRB in regard to the selected annual frequency trends, and therefore, any distinctions between the public members' actuary and the WCIRB in regards to trend is due to differences in selected indemnity and medical severity trends.

We agree with the WCIRB and Bickmore that the use of two years of experience for the application of the trend is appropriate, as it has also outperformed alternative assumptions based on the WCIRB's most recent study. In examining the merits of the loss ratio trend versus separate frequency and severity trends in various environments, we recognize that separate severity and frequency trends may better reflect the underlying causes in this changing environment. While there is not yet a full understanding of the changes that are happening, the separate analyses of frequency and severity provide information that the combined trend may smooth or mask.

Following a period of year-over-year decreases in on-leveled indemnity severity between 2010 and 2017, sometimes with sharp declines, the 2018 and 2019 accident years show a modest increase in indemnity severity based on data as of

March 31, 2020. The 2018 increase may be associated with a higher than usual proportion of large claims, similar to the medical severity for this period, and the 2019 increase is preliminary, given that at this stage in maturity, the underlying losses are mostly from temporary disability claims, which have higher indemnity benefits, but comprise about fifty percent of the indemnity claim counts. As an example, the increase in indemnity severity for 2018 has moderated from +3.0% as of March 31, 2019 to +0.8% as of the current valuation.

The WCIRB-selected annual severity trend for indemnity in this filing is +1.0%, compared to -0.5% selected in the January 1, 2020 filing. The average change in indemnity severities between accident years 2008 through 2019, which provides a longer term view, is -1.3%, and the short term average since 2015 is about the same.

The WCIRB's selection of indemnity severity trend is based on considering several factors related to the impact of the environment caused by the COVID-19 pandemic, and the resulting economic downturn on the indemnity severity. Specifically, the filing mentions that the following factors may result in increases in on-leveled indemnity severities in the near future: increases in temporary disability duration during a recession as injured workers may have fewer employment opportunities to return to; an upward shift in average indemnity costs due to increase in CT claims; and a shift towards larger claims, as the economic-driven sharp decrease in indemnity frequency projected for 2020, may be disproportionately geared towards smaller claims being not filed.

Bickmore's selection of indemnity severity trend, as noted in the public members' actuary's hearing testimony, takes into consideration the factors mentioned by the WCIRB, and while Bickmore selects separate annual trends for 2019 through 2022 accident years, the impact of the trend selections, on average, resemble a uniform annual indemnity severity trend of +1.0%.

The Department's staff also agrees with considerations regarding the impact of the economic downturn on the indemnity severity for non-COVID-19 claims, cited by the WCIRB and Bickmore, and based on separate selections for 2019 through 2022, which are similar to the annual trends selected by Bickmore, except for 2019, project indemnity severity trends that on average resemble a uniform annual indemnity severity trend of +0.7%. The Department's staff's selections for 2019 through 2022 are -1.0%, +2.5%, +0.5%, and -1.0% respectively. The -1.0% selection for 2019 and 2022 reflect consideration for the pattern of indemnity severity trend for 2008 through 2019, as discussed above.

The Department's staff notes that the medical severity trend of +2.5% selected by the WCIRB in this filing is comparable to the average of the long-term rate of growth since 1990 of +5.5% per year, and five-year rate of growth of -0.1% per year. As shown in Table 7, the ten-year average change in medical severities during the 2010-2019 period evaluated as of March 31, 2020 is +0.3%, and the five-year average change is -0.6%. As with indemnity, the WCIRB cites potential changes in average severities from the pandemic and the resulting economic downturn, in addition to the review of historical trends in medical severity, as the basis for the selected medical severity trend. During the hearing, the WCIRB presented four considerations for the selection of a +2.5% annual trend for medical severity, namely: impact of economic slowdown on return to work; delays in medical treatment during pandemic; growth in very large claims; and reduction in filing of smaller claims during slowdown.

Bickmore's selected annual severity trend is +1.0%, based on long-term average of changes in medical severity, which is +0.3% for 2011-2019.

While the Department is sensitive to the WCIRB's concerns about the impact of the pandemic and the economic downturn on future medical severity, the Department's actuarial staff believes that some of the concerns raised, such as the impact of delays in medical treatment, may be more relevant to the 2020 accident year. In addition, as noted by the WCIRB, the spike in the average severity for accident year 2018 is driven by a greater than usual number of large claims for this period, and based on the reference study provided as a follow-up to the hearing, the growth in very large claims has been a byproduct of economic expansion since 2013. Therefore, the historical pattern of changes in the average severities already include the impact of growth in large claims. Moreover, as the WCIRB has noted in the selection of its frequency trend, one of the potential consequences of the economic downturn is the rise in proportion of CT claims, and while the average indemnity cost on post-termination CT claims is somewhat higher than the overall average indemnity, the average medical cost on post-termination CT claims is to a larger extent lower than the overall average medical severity.

Furthermore, while the Department agrees with the WCIRB that the COVID-19 pandemic has sent a significant shock through the California workers' compensation system, generating additional uncertainty in projecting the future cost of medical severity, the essential structure of utilization of medical services following the enactment of SB 863 and the subsequent legislation continues to impact the California workers' compensation system, and has the potential to further the realization of the reduction in medical costs, and postponing of the return to the long term medical inflation trends.

During the past several years, a sequence of reforms has impacted the California workers' compensation system, starting with the SB 863 reforms in 2013, and continuing with SB 1160, AB 1244, and AB 1124, the latter of which became effective in January 2018. Given the timing of these reforms and the interaction between the elements of these reforms, it is reasonable to assume that various elements of these reforms, in conjunction with anti-fraud efforts, are continuing to combine to lower medical costs.

And while the WCIRB has incorporated several aspects of the reforms in determining the costs, the reforms interact with the drivers of the system in multifaceted ways that are difficult to adjust for. As an example, the lower level of lien filings and higher rate of lien dismissals could possibly have an impact on speeding up the claim closure rates, as well as reducing costs. Another example is reduction in opioid use, which may facilitate earlier return to work, and result in lower indemnity and medical costs. Moreover, as discussed in the development section, the significant reduction in opioid use, and the increased utilization of alternative medical services, appears to have the effect of shifting the cost to earlier development periods, where alternative treatments such as physical medicine, along with evaluation and management, comprise a significant portion of payments for medical services.

The Department appreciates the balance that the WCIRB is trying to achieve in considering both the long-term and the more recent trend indications, in recognition of the inherent volatility of severities at early evaluations, the long-term medical severity growth rates, the long period over which the medical payments are made, and the implications of the COVID-19 pandemic. However, while we share the concerns that the WCIRB has raised, we note that there are offsetting effects, as discussed above, that require consideration.

The Department's actuarial staff believe that it is important to keep in mind that the workers' compensation system is an adaptive system where the various service providers respond to changes in the environment brought on by reform or court decisions. We recognize that particular attention needs to be paid to medical trends, as belated recognition of increasing medical costs has been a major problem in the not-too-distant past. However, the average change in medical severities during the 2008-2019 period evaluated as of March 31, 2020, is about +1.1%, and the accident years included in this period strike a balance between pre- and post-SB 863 phases. In consideration of the factors stated above, the Department is selecting a +1.0% medical severity trend, as shown in Tables 7 and 8, for this filing, which reflects considerations for both long-term and

short-term changes in the average medical severity, as well as the current and prospective environments.

3. Loss Adjustment Expenses

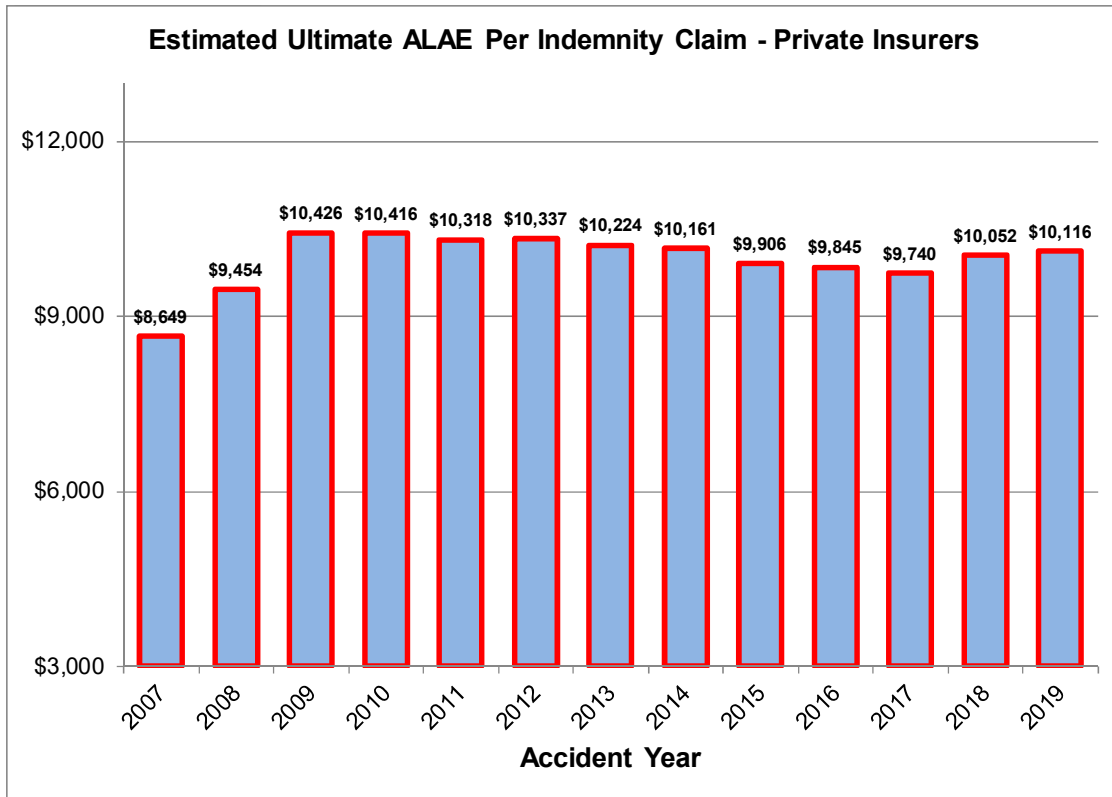
In its determination of the provision for LAE in the proposed rates, the WCIRB developed separate indications for the ALAE and ULAE, and medical cost containment programs (“MCCP”).

Starting with the January 1, 2015 filing, the WCIRB adopted a change in its methodology to reflect only private carrier data in its evaluation of ALAE and ULAE to avoid distortion due to the impact of the higher expenses of the State Compensation Insurance Fund. The WCIRB has continued to apply this methodology in this current filing. The Department’s staff concur with this methodology.

ALAE

Several evaluations underlying the past filings had shown that the estimated ultimate ALAE per indemnity claim increased steadily following the implementation of SB 863. Since the prior filing, this pattern has changed, and the estimated ultimate ALAE per indemnity claim shows relatively flat ALAE per indemnity claim between 2009 and 2019 (Table 10). While there is an expectation that ALAE costs decrease after the immediate periods following the reforms have elapsed, the ultimate ALAE per indemnity claim for 2018 and 2019 reverses the pattern of slight decline observed between the 2014 and 2017 accident years in the March 31, 2020 evaluation.

Table 10



Based on Data as of March 31, 2020.

In the review of the January 1, 2019 WCIRB pure premium rate filing, the Department noted that the projected ultimate ALAE per indemnity claim at successive quarterly evaluations had shown a downward trend with increased maturity, suggesting a consistent overstatement of the ultimate ALAE, and questioned whether an adjustment due to the speed-up in claims settlement rates would be needed to more accurately project ultimate ALAE.

The WCIRB performed a study to explore the potential impact of claim settlement rate changes on paid ALAE development in 2019, and determined that while the changes in claim settlement rates do not appear to significantly impact paid ALAE age-to-age development factors during the period of the change in settlement rates, there is a negative correlation between changes in claim settlement rates in earlier periods and the ALAE development that emerges in later periods for a given accident year. On the basis of that study, the one-year change in settlement rate was compared to cumulative development patterns from that age to ultimate for a given accident year. This approach created inconsistency in adjustments to various accident years, when settlement rates do not change consistently over time, or within a calendar year. As an example, in the January 1, 2020 filing, the 2017 accident year age to ultimate ALAE

development factor had been adjusted for higher claim settlement rates as of 27 months, but no adjustment had been made to the 2018 age to ultimate development factor, creating an inconsistency in the application of the concept underlying the adjustment.

As a follow-up to that study, prior to this filing, the WCIRB refined its approach for adjustment of the ALAE development factors to reflect incremental adjustments to age-to-age factors based on indicated cumulative adjustment per one point of change in claim settlement rates. Consequently, in this filing the WCIRB has incorporated an adjustment to the ALAE age to ultimate development factor for the 2015 and 2016 accident years and based on age 39 to ultimate development factors for 2017 through 2019 accident years.

The Department appreciates the WCIRB's efforts in researching the impact of changes in settlement patterns on ALAE projections, and finding more appropriate ways to incorporate the results of the study. However, even after incorporating these adjustments, it appears that ALAE emergence is more favorable than considered in the adjusted ALAE development factors. As an example, the ALAE development factor to ultimate for 2017 accident year was adjusted by the same -2.7% in the prior filing and in this filing. Nonetheless, the 2017 accident year average ALAE declined by about 6.8% from \$10,446 to \$9,740 between the March 31, 2019 and March 31, 2020 evaluations. Similarly, the mature 2014 accident year average ALAE, which did not have any development factor adjustment in either of the evaluations, declined by about 3.1% during the same period. In fact, even after controlling for the adjustments incorporated in this filing, all of the accident years since 2007 had persistent downward development within the past 12 months, and the pattern reflects increasing magnitude of downward development for less mature accident years.

The persistent downward trend in successive evaluations of ALAE may signal a need for further investigation of the underlying causes of the ALAE downward development, especially since unresolved issues with the ALAE development factors could become magnified in future filings, for which the evaluation of the underlying data will be as of 12 months and the ALAE development factors to ultimate are more leveraged.

Moreover, the overstatement in the average ALAE per indemnity claim can also result in an overstatement of the implied annual trend, as the decline in average ALAE appears to be higher for less mature accident years.

In consideration of this effect, the Department's staff is selecting an average ALAE per indemnity annual trend of 1.0% based on the approximate average of

the rates of growth in (a) estimated ultimate ALAE per indemnity claim for private insurers, and (b) incremental paid ALAE per open indemnity claim for private insurers, since 2013. The WCIRB-selected annual ALAE severity trend in this filing is +1.5%, compared to +2.5% selected in the January 1, 2020 filing.

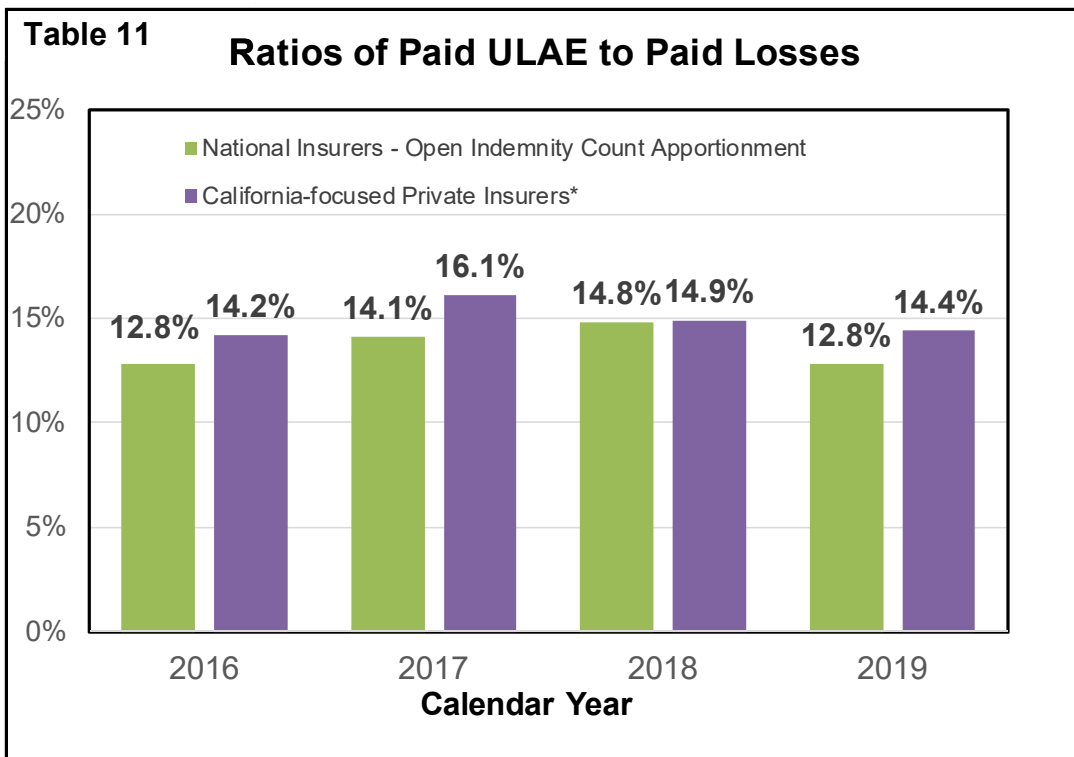
Similar to the January 1, 2020 filing, the WCIRB has adjusted the projected ALAE for the impact of the SB 1160 and AB 1244 reforms, based on an assumed 60% reduction in lien filings compared to the 3rd quarter of 2016. The full 9.6% estimate of the impact of the decline in liens is judgmentally tempered by 50% to reflect the impact of the reforms that is not yet reflected in the emerged ALAE data as of March 31, 2020.

As discussed in Section 4, the more recent level of lien filings reflects a higher reduction than the 60% assumed by the WCIRB. Further study of the impact of reduction in liens is needed to determine an appropriate adjustment to the projected ALAE.

While the projected ALAE has been adjusted for the impact of SB 1160 and AB 1244, the filing does not include any adjustment to the ULAE for the impact of these reforms, as medical bill disputes that would otherwise result in a filed lien are continuing to be pursued, and generate ULAE costs.

ULAE

Similar to the January 1, 2020 filing, the WCIRB has allocated national carriers' countrywide ULAE expenses on the basis of open indemnity claim count, in order to more completely reflect the additional complexity and duration of California workers' compensation claims. The allocation method uses the open indemnity claim count as a basis to apportion the ULAE, compared to the method utilized before the January 1, 2019 filing that had used paid losses to determine California's share of countrywide paid ULAE for national insurers. As shown in Table 11, using the open indemnity claim count as the basis of apportionment of the ULAE for national insurers' results in paid ULAE ratios that are comparable to the ULAE ratios for other private insurers that primarily write workers' compensation business in California. The rest of the difference could be attributed to economies of scale, as most of the national insurers tend to be much larger than the California-focused insurers.

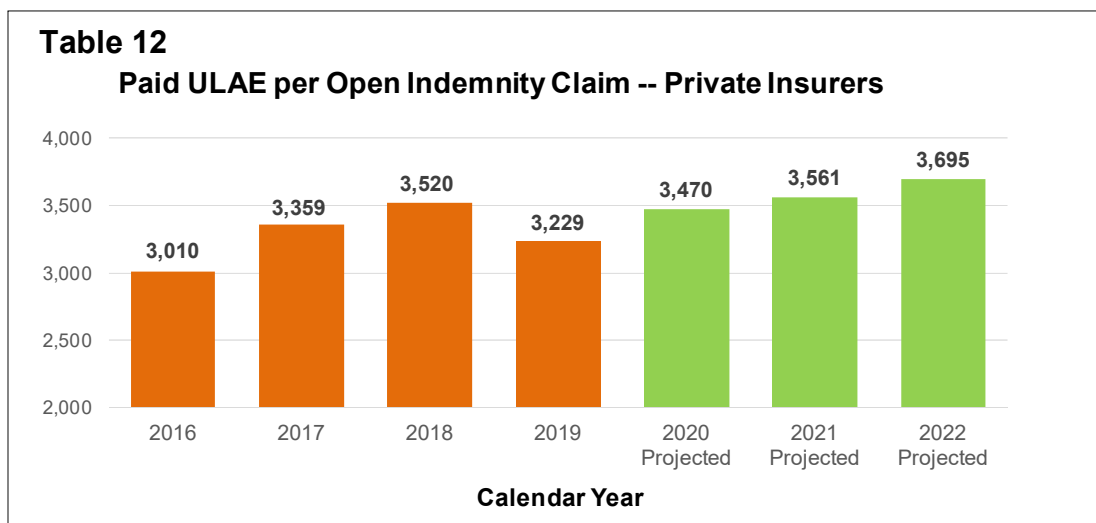


Source: WCIRB aggregate financial data as of December 31, 2019

*California-focused Private Insurers are insurers with at least 80% of their workers' compensation writings in California.

As shown in Table 12, following increases in the average paid ULAE per open indemnity claim in calendar years 2017 and 2018, the 2019 paid ULAE per open indemnity declined by about 8.3%. The WCIRB has attributed the decrease partly to the effort from insurers to settle larger and more complex claims faster over the last several years.

The WCIRB projections based on the paid ULAE per open indemnity claim method account for wage inflation, and trend the ULAE costs to the prospective period by applying California average annual wage level changes based on UCLA and California Department of Finance forecasts. The projected average paid ULAE per open indemnity claim shown in Table 12, is based on the application of the wage trends to the ULAE severities for the 2018 and 2019 calendar years.



Source: WCIRB aggregate financial data for private insurers only and projections.

The decline in average ULAE costs in 2019, along with lower projected wage inflation due to the economic downturn caused by the pandemic, has tempered the recent increase of this component of the LAE as a percentage of losses, as shown in Table 13 below.

Table 13

Method	January 1, 2019 Filing ULAE Projection	January 1, 2020 Filing ULAE Projection	January 1, 2021 Filing ULAE Projection
Paid ULAE per Open Indemnity Claim	14.9%	15.6%	14.1%
Paid ULAE to Paid Losses	12.2%	13.8%	13.2%
Average of Two Projection Methods	13.6%	14.7%	13.7%

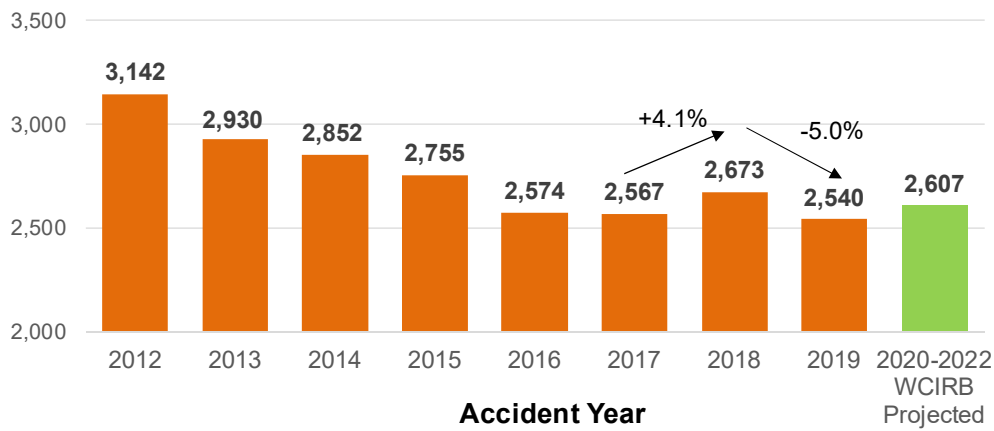
MCCP

The period between 2012 and 2019 shows a steady decline in ultimate MCCP per indemnity claim, except for an unusual spike for accident year 2018, as shown in Table 14.

Table 14

Ultimate MCCP per Indemnity Claim

As of March 31, 2020



Source: WCIRB aggregate financial data and projections. Excludes the cost of IMR and IBR from all years.

Although the increase in ultimate MCCP cost per indemnity claim for accident year 2018 has subsided from +8.0% evaluated as of March 31, 2019 to +4.1% as of March 31, 2020, the fact that MCCP costs increased in 2018 compared to 2017 is counterintuitive, given that SB 1160 has imposed some restrictions on utilization review (“UR”) within the first 30 days of a claim beginning with 2018 injuries, and the new drug formulary, implemented as of January 1st 2018, restricts UR on certain types of drugs, both of which were expected to lower the UR component of the MCCP costs.

The decline in ultimate MCCP cost per indemnity claim for accident year 2019, on the other hand, is in line with expectations, and while it is not clear what the drivers of the 2018 increase have been, continuation of that increase was not anticipated. Further research may be required to determine the underlying drivers of this unexpected increase.

The WCIRB’s projected MCCP per indemnity claim is based on the average of the 2018 and 2019 accident years, with 0.0% inflation going forward. In consideration of the recent pattern in the average MCCP per indemnity claim, the Department’s staff has selected an annual MCCP severity trend of -1.0%, based on the average of the annual rates of growth in (a) ultimate accident year MCCP costs per indemnity claim from 2015 through 2019 and (b) calendar year MCCP costs per open indemnity claim from 2013 through 2019. Consistent with the WCIRB’s method, the selected MCCP severity trend is applied to the latest two years.

A comparison of the components of LAE between the prior filing and the current filing based on WCIRB projections is shown below in Table 15, which shows that compared to the January 1, 2020 filing, all components of LAE have decreased as a percentage of losses.

Table 15

LAE Provision Underlying WCIRB Pure Premium Rate Filings				
	1/1/20 Filing		1/1/21 Filing	
(ALAE ex/MCCP)/Loss	17.2%		16.1%	
MCCP/Loss	4.5%		4.2%	
Total ALE/Loss	21.7%	\$0.25	20.3%	\$0.23
ULAE/Loss	14.7%	\$0.17	13.7%	\$0.15
Total LAE/Loss	36.4%	\$0.42	34.0%	\$0.38
Indicated Pure Premium Rate*		\$1.58		\$1.50

*Excluding COVID-19 Adjustment

The projected LAE as a percentage of losses considered in the Department's analysis is 35.0% compared to the WCIRB's selection of 34.0%. The higher LAE percentage reflects slightly lower ALAE-to-loss and MCCP-to-loss projections based on the CDI trend assumptions for these components, and an adjustment for the differences in projected losses in the denominator of the LAE-to-loss ratio.

In its projection of the LAE component for the middle scenario, Bickmore has assumed a slightly higher LAE-to-loss ratio compared to the WCIRB, although the LAE dollar-value after adjustment for the differences in projected losses in the denominator of the LAE-to-loss ratio matches the WCIRB's projection. Bickmore highlights differences in its assumptions from the WCIRB in the written testimony and in the exhibits provided as follow-up to the hearing testimony, as selection of lower ALAE severity trend based on the average change in ALAE per indemnity claim during the most recent three years, projection of lower ULAE per earned premium in consideration for how stable these ratios have been in the most recent three years, projection of lower MCCP severity trend, and projection of higher indemnity claim count by utilizing only the 2019 ultimate indemnity claim count as the basis for the indemnity claim count projection during the prospective period. The higher indemnity claim count partially offsets the lower average LAE per indemnity claim, and once normalized by the lower projected losses, results

in a projected LAE-to loss ratio of 35.0%, compared to 34.0% assumed by the WCIRB.

The WCIRB’s consistency in using the selected frequency trends, and the periods that the trends apply to in the projection of both the losses and the LAE components provides comparable bases for a determination of the LAE-to-loss ratio, and the Department’s staff agrees with this approach.

The Department believes that the continued monitoring of direct and indirect impacts of recent reforms and legislation on LAE costs require particular attention and appreciates the WCIRB’s and Bickmore’s efforts in this regard.

4. Impact of SB 863, SB 1160, AB 1244, and AB 1124

SB 863

In developing its actuarially-indicated pure premium rates, the WCIRB included its updated estimate of the effect of SB 863. In its October, 2019 SB 863 Cost Monitoring Report, the WCIRB has estimated that the various provisions of SB 863 have reduced annual system-wide costs by approximately \$2.3 billion, as shown in Table 16. This estimate is an update to the November 2016 estimate of \$1.3 billion, and an initial assessment of overall savings of \$200 million.

