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

DECISION AND ORDER

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

FILE NUMBER REG-2021-00003

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-2021-00003. The benchmark will be effective on **September 1, 2021**.

DECISION AND ORDER

I adopt the Proposed Decision and Order of Yvonne Hauscarriague dated July 21, 2021, and direct the WCIRB to adopt an average advisory claims cost benchmark of $1.41 per $100 of employer payroll and adjust the pure premium rates for individual classifications based upon this benchmark.

IT IS SO ORDERED THIS 21 DAY OF JULY, 2021.

RICARDO LARA
Insurance Commissioner

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

PROPOSED DECISION AND ORDER

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

FILE NUMBER REG-2021-00003

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 September 1, 2021.

SUMMARY OF PROCEEDINGS

The California Department of Insurance ("Department") held a public hearing in the above-captioned matter on June 7, 2021 at the time and place set forth in the Notice of Proposed Action and Notice of Public Hearing, File Number REG-2021-00003, dated May 7, 2021 ("Notice"). A copy of the Notice is included in the record. The record closed on July 6, 2021.

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 April 29, 2021, 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, 2021, that reflects insurer loss costs and loss adjustment expenses ("LAE").

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

The WCIRB recommended an average pure premium rate of $1.50 per $100 of payroll, which is 2.7% more than the approved average pure premium rate as of January 1, 2021.

The Department accepted testimony and written comments at a hearing held on a virtual platform on June 7, 2021, 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 and Bickmore Actuarial, the actuary representing the Public Members of the Workers' Compensation Insurance Rating Bureau's Governing Committee. The record closed on July 6, 2021. After the hearing and before the closure of the record, the Department received into the record additional comments from the WCIRB and Bickmore. The matter was submitted for decision at 5:00 p.m. on July 6, 2021. 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 Department's actuarial review is consistent with the approach used for prior pure premium rate filings. 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 September 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 $1.50 per $100 of payroll in its September 1, 2021 filing. The $1.50 average pure premium rate does not include any provision for the estimated cost of the COVID-19 claims that will incur during the September 1, 2021 policy period, as the WCIRB has determined that in light of the current success of the COVID-19 vaccines and the research published by the sources that the WCIRB has relied on, inclusion of such a provision was not recommended for policies incepting on September 1, 2021 and later. The Department's staff actuaries' analysis, as set forth in the following Actuarial Evaluation section, results in an average pure premium rate level of $1.41 per $100 of payroll. The most recently available industry average level of pure premium rates filed by insurers with the Department is $1.86 per $100 of payroll as of January 1, 2021. While the indicated pure premium rate level represents our central estimate, and thus our recommendation, we note that both the WCIRB's estimate of $1.50 and the middle estimate of $1.34 from the Public Members' Actuary (Bickmore) are within reasonable actuarial range.

With his decision on the January 1, 2021 advisory pure premium rates, the Commissioner approved pure premium rates that did not include a provision for COVID-19 estimated claims costs, and ordered that any provision in the rates filed by the insurers to cover the estimated costs of the COVID-19 claims, be accounted for and tracked separately.

In this filing, the WCIRB utilizes the data excluding COVID-19 claims, and January 1, 2021 industry filed pure premium rates excluding any provision for the estimated cost of the COVID-19 claims, as the basis for the determination of the proposed change in the average pure premium rate level.

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 2020 produced an average charged rate of $1.86, which compares to $1.95[1] and $2.20[2] 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 $1.86 (which reflects all insurer expenses) was approximately 22% higher than the Insurance Commissioner's adopted January 1, 2020 average advisory pure premium rate of $1.52, and 27% more than the Insurance Commissioner's adopted January 1, 2021 average advisory pure premium rate of $1.46[3], which reflect loss and loss adjustment expense only. It was also approximately 30% less than the industry

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[1] $2.05 if adjusted for new payroll limitations effective in 2020, to make it comparable to the $1.86 for 2020

[2] $2.31 if adjusted for new payroll limitations effective in 2020, to make it comparable to the $1.86 for 2020

[3] Revised from the Insurance Commissioner's adopted January 1, 2021 Pure Premium Rate of $1.45 based on updated exposure weights by classification.

average filed manual rate of $2.65, thus indicating the average effect of schedule rating and other rating plan credits.

As of December 31, 2020, the WCIRB estimates overall industry combined ratios at or below 86% for accident years 2014 through 2018, and a combined ratio of 95% for accident year 2019. For accident year 2020, the WCIRB projects a combined ratio of 102%, including the cost of COVID-19 claims, of which about six points are estimated for the COVID-19 costs, suggesting a preliminary estimate of the accident year 2020 combined ratio of about 96% excluding COVID-19, and comparable to 95% for 2019 accident year combined ratio. 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%, and the higher accident year 2020 combined ratio is due to an extraordinary event, and is not expected to continue. However, current charged rate levels are somewhat lower than the charged rates that underlay the combined ratios for accident years 2015 through 2020.

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 includes allocated loss adjustment expense ("ALAE"), unallocated loss adjustment expense ("ULAE") and medical cost containment programs ("MCCP"); (4) impact of changes to the official medical fee and medical-legal fee schedules; and (5) 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").

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 the January 1, 2021 filing, the COVID-19 components, along with a comparison to Bickmore's current indication based on its middle scenario. Table 2 displays the percentage impact of the various differences in assumptions and methods for both the Department's staff and the Public Members' Actuary, based on Bickmore's middle projection, as compared to the WCIRB's recommendation.

Table 1	WCIRB Filed Rates											Bickmore
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
	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	9/1/21	9/1/21	1/1/21
Medical $	1.14	1.10	1.00	0.95	0.87	0.84	0.76	0.70	0.65	0.62	0.60	0.50	0.56
Indemnity $	0.72	0.69	0.70	0.67	0.64	0.63	0.58	0.54	0.51	0.50	0.53	0.49	0.50
LAE $	0.61	0.63	0.61	0.60	0.51	0.49	0.46	0.46	0.42	0.38	0.37	0.35	0.38
COVID-19 $	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.06	-	-	0.05
Total $	$ 2.47	$ 2.42	$ 2.30	$ 2.22	$ 2.02	$ 1.96	$ 1.80	$ 1.70	$ 1.58	$ 1.56	$ 1.50	$ 1.34	$ 1.49
Industry Avg Filed PP Rate								$ 1.99	$ 1.80	$ 1.86			
Industry Avg Filed Manual Rate (with expenses)								$ 2.82	$ 2.55	$ 2.65			
Industry Avg Charged Rate (net discounts)								$ 2.04	$ 1.90	$ 1.86			

Table 2		Impact of Difference in Assumptions & Methods Between WCIRB and Alternative Recommendations					
	Recommended 9/1/2021 Pure Premium Rates	Total	Ultimate Medical	Claim Frequency	Indemnity Severity Trend	Medical Severity Trend	Inclusion of 2020 Year
WCIRB	$1.50						
CDI	$1.41	-6.0%	-2.0%	-3.4%	-0.7%	0.0%	0.0%
Bickmore (Middle)*	$1.34	-10.4%	-2.8%	-4.6%	-1.2%	-1.3%	-0.5%

*Bickmore percentage impacts is based on the information provided in May 21, 2021 written testimony.

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 the last several years, particularly after the implementation of SB 863 in 2013, 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. While the claim settlement rates had been mostly increasing during the pre-pandemic period, following the COVID-19 pandemic, and especially during the second quarter of 2020, claims settlement rates for more recent accident years have decreased sharply. If left unadjusted, development factors will be overstated during periods of increase in claim settlement rates, and understated during periods of decrease in claim settlement rates.

In addition, the WCIRB has incorporated the impact of various reforms in the paid development factors. Similar to the January 1, 2021 filing, the cumulative paid medical development factors have been adjusted for the impact of SB 1160 and AB 1244 lien-related provisions, assuming a 70% decline in liens compared to the 2nd quarter of 2016, based on updated information and reflecting continued decline in the lien filings from the 60% level, utilized in the January 1, 2021 filing.

Based on a study performed in 2019, and similar to the latest two filings, 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.

In 2020, the WCIRB conducted two studies that led to the implementation of changes in methodology and additional adjustments to late-term development factors and development tail for both indemnity and medical loss development. The results of these studies, discussed below, have been incorporated in the indemnity and medical loss development factors since the January 1, 2021 filing.

One of these studies was the WCIRB's retrospective study on late-term loss development, which 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. This study resulted in a change from the incurred method to the paid method for development after 267 months.

The second study involved 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. This study resulted in an adjustment to the paid loss development being applied after 276 months for the post-SB 863 increases in claim settlement rates impacting later period loss development.

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 this filing, the WCIRB reviewed the impact of the distortions caused by the COVID-19 pandemic on the paid loss development, and determined that the use of the Berquist-Sherman adjustment, which adjusts for the decline in claim settlement rates caused by the pandemic, substantially corrects for the impact of the distortions in the second quarter of 2020. In addition, in consideration of the recent volatility in loss development patterns emerging during the pandemic period, the WCIRB has relied on the two-year average claim settlement rate and reform adjusted paid method, compared to the latest year adjusted paid method used in prior filings. The estimated ultimate indemnity and medical loss ratios for 2019 are respectively about 1.3% and 1.9% higher based on the two-year adjusted paid method, compared to the latest year adjusted paid method.

In our review 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 had been overestimating ultimate medical losses 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.

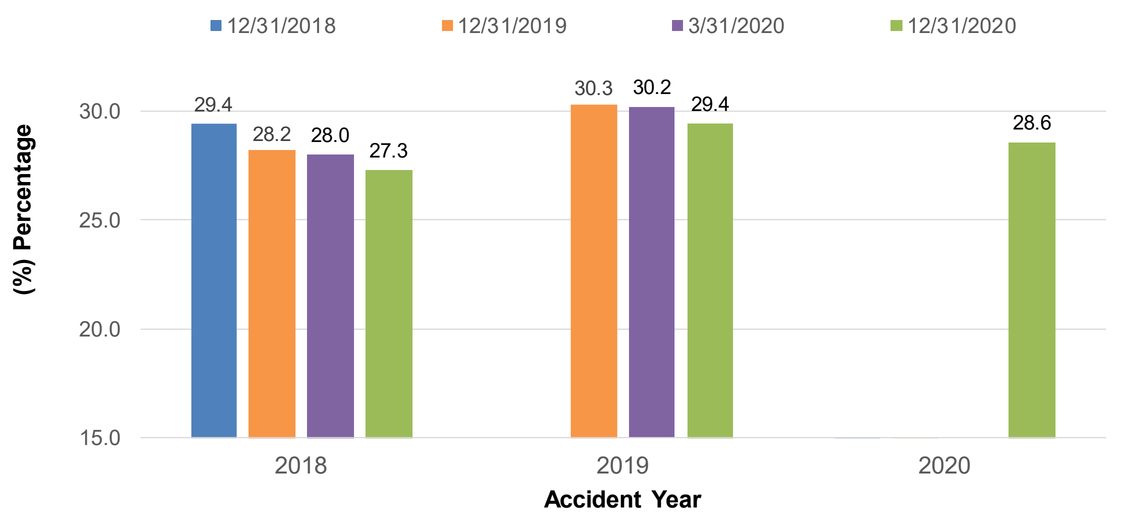
There is also difficulty in adjusting historical case reserve data to the current level of case reserve adequacy when there are likely to have been different claims handling procedures and case reserving philosophies across the industry, as well as a changing mix of insurers over time. Sorting these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

On the other hand, as noted in Bickmore's written testimony, the WCIRB's retrospective evaluation of the performance of alternative loss development methodologies indicate that while the claims settlement and reform adjusted paid development method outperforms other methods, the latest-year incurred method has performed relatively well and significantly better than all other alternative methods for accident years 2014 through 2018 included in the study.

Moreover, the WCIRB's analysis of the distortions in loss development caused by the pandemic, especially during the second quarter of 2020, showed that while the paid loss development that emerged during the pandemic-affected periods was significantly distorted, the incurred development pattern was more stable and consistent with the pre-pandemic period.

Table 3, below, shows successive evaluations of the accident year ultimate medical loss ratios, which have shown continued downward development since December 2018. The accident year 2019 loss ratio has declined by about 2.9% between December 31, 2019 and December 31, 2020, and during the same period, the loss ratio for the more mature accident year 2018 also declined by about 3.2%. These loss ratios are all based on the 2-year average claim-settlement adjusted method utilized by the WCIRB in this filing, have been adjusted for 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.

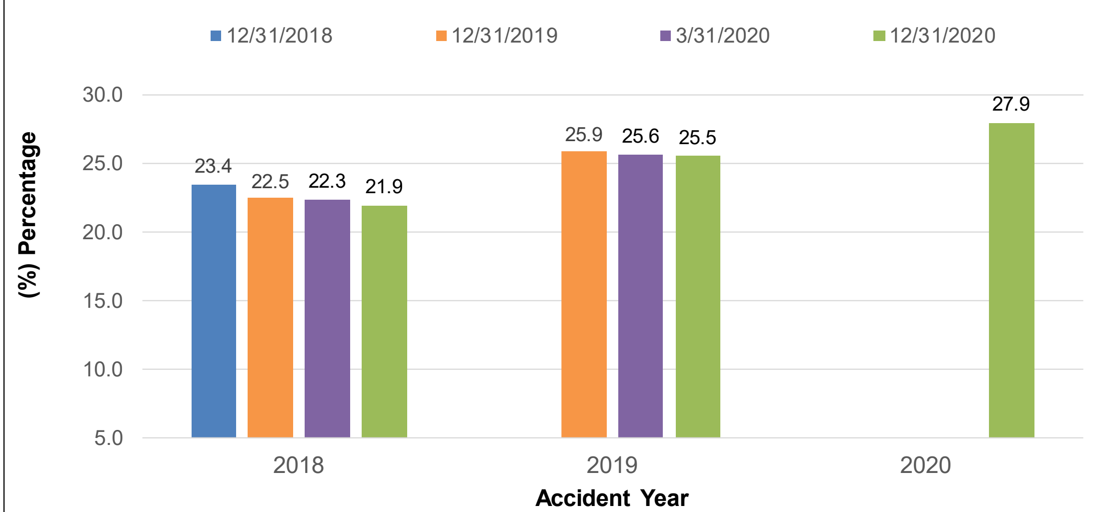
Table 3 **Projected Ultimate Medical Loss Ratios**



Note: All loss ratios are based on the loss development methodology presented in the WCIRB 9/1/2021 Filing, i.e. the 2-Year Average Claim Settlement-Adjusted Method

Similarly, as shown in Table 4, the successive estimates for indemnity loss ratios show that while the downward trend has moderated, the accident year 2019 loss ratio has declined by about 1.6% between December 31, 2019 and December 31, 2020, and the loss ratio for the more mature accident year 2018 declined by about 2.7% during the same period, despite utilization of a common more refined loss development methodology.

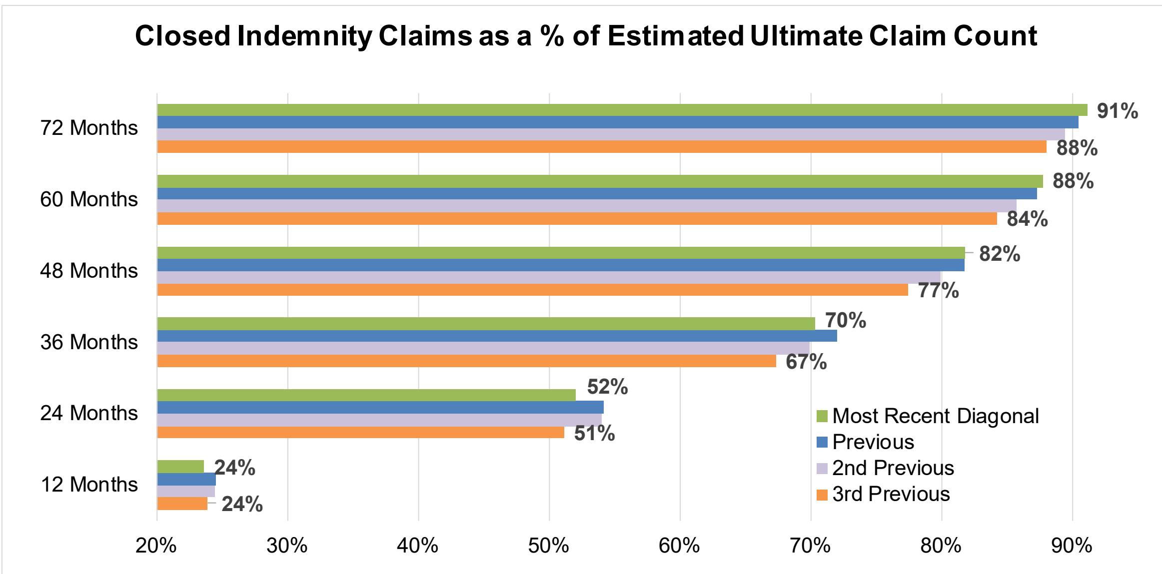
Table 4 **Projected Ultimate Indemnity Loss Ratios**



Note: All loss ratios are based on the loss development methodology presented in the WCIRB 9/1/2021 Filing, i.e. the 2-Year Average Claim Settlement-Adjusted Method

As shown in Table 5, claim settlement rates have declined in 2020 for the three least mature accident years. While prior to the onset of the pandemic the claim settlement rates for these accident years had plateaued, the decline in claim settlement rates appear to be due to a temporary slowdown affected by the COVID-19 pandemic, and are expected to return to the pre-pandemic levels once the operations return to a normal level. However, even with the pandemic, the trend of increase in claim settlement rates following the SB 863 has continued for 60-months-plus maturities.

Table 5



As noted above, the WCIRB has adjusted the development factors for the change in claim settlement rates to bring the historical claim settlement rates to the current level. The WCIRB does not forecast changes in the claim settlement rates, and makes adjustment to the development factors for known changes in claim settlement rates, as mentioned during the hearing.

Moreover, the WCIRB has adjusted the development factors for measurable impacts of the reforms such as the reduction in liens and the decline in pharmaceutical costs.

The continued decline in loss ratios, however, seem to be driven by the indirect impacts of the reforms such as the significant reduction in opioid use and other narcotics on future development of indemnity and medical losses, which have been difficult to quantify and are being allowed to work their way through the indications over time.

Consistent with the methodology used in the review of recent WCIRB pure premium rate filings since the July 1, 2018 filing, 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. However, given the fact that the incurred method has been proven to be more stable, and not affected by the distortions caused by the pandemic and rapid changes in the claim settlement patterns, for this filing, we choose to give 60% 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 level, change in claim settlement rates, and SB 1160 and AB 1244 provisions, and 40% weight to the unadjusted incurred development method. The 60/40% weight selection reflects the Department staff's continued higher reliance on the paid method compared to the incurred method. Furthermore, although the latest-year incurred development method has performed better than the 3-year average incurred development method based on the WCIRB retrospective study, in consideration of stability, and consistent with the methodology utilized in the review of recent filings, the projected ultimate incurred losses based on the 3-year average incurred development factors is used for this purpose.

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, giving 50% weight to the projections based on each of the latest two years. However, in this filing, the WCIRB has not found the experience for accident year 2020 appropriate to be used as the basis of projection of the September 1, 2021 pure premium rates, given significant and likely temporary impacts in various cost components, caused by the COVID-19 pandemic, affecting the 2020 accident year.

In contrast, Bickmore has selected to assign 25% weight to the 2020 accident year, based on the belief that despite the fact that the COVID-19 pandemic has resulted in distortions in the reported loss data, the 2020 accident year has some predictive value.

In terms of methodology, Bickmore has opted to make trend selections separately for frequency and severity, similar to the WCIRB, starting with the January 1, 2021 filing, prior to which Bickmore had used a loss ratio trend in past recent filings.

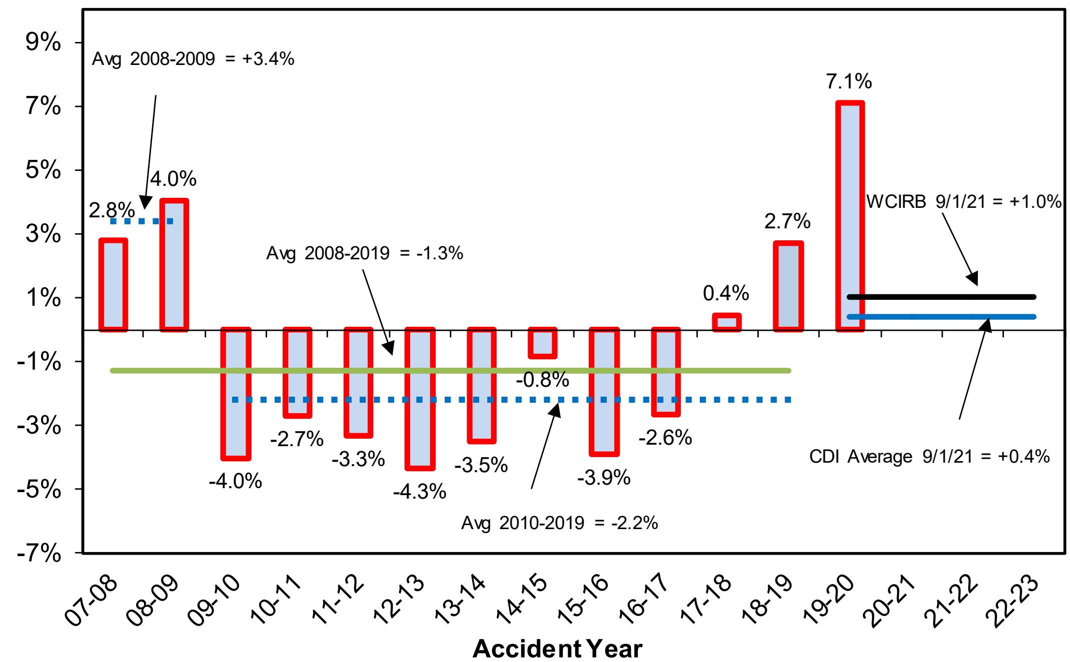
We agree with the WCIRB and Bickmore that the use of two years of experience for the application of the trend in general is appropriate, as it has also outperformed alternative assumptions based on the WCIRB's most recent study. In examining the merits of the loss ratio trend versus separate frequency and severity trends in various environments, we recognize that separate severity and frequency trends may better reflect the underlying causes in this changing environment. Furthermore, we agree with the WCIRB regarding not assigning any weight to the 2020 accident year as the basis for projecting the September 1, 2021 pure premium rates, given that known and unknown distortions caused by the pandemic, that may not be possible to adjust for, have been affecting the experience for this accident year.

Indemnity and Medical Severity Trend

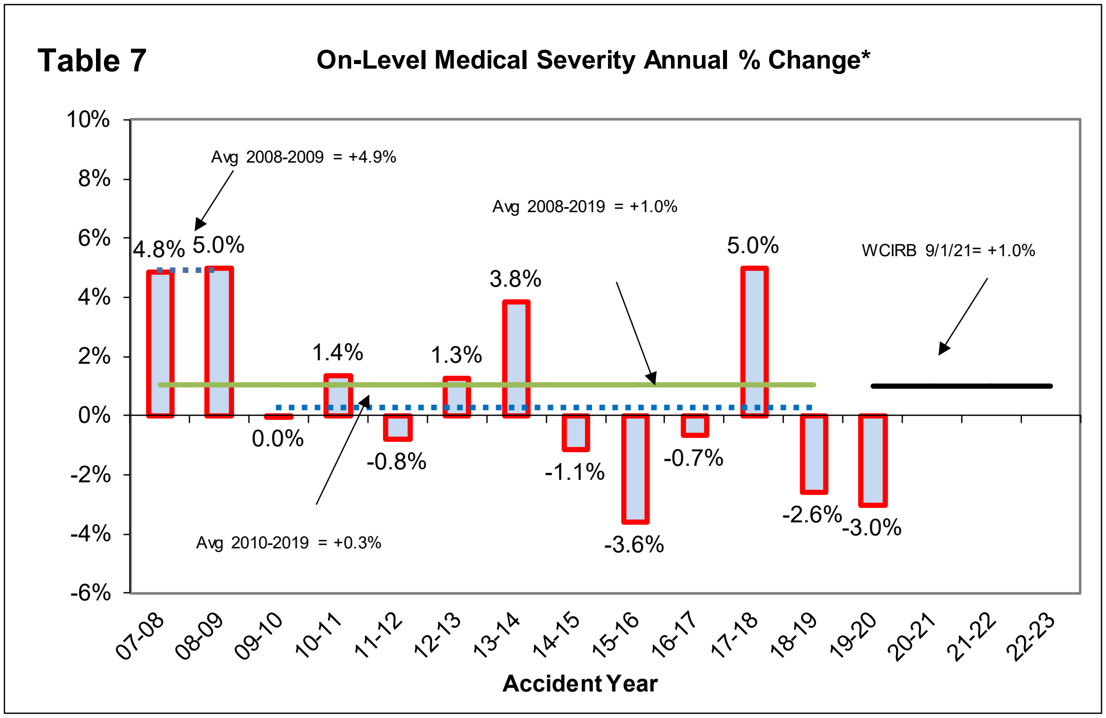
As shown in Tables 6 and 7, indemnity and medical severities over the time period 2010-2019 have decreased relative to historical averages prior to 2010, discussed further following the charts.

Table 6

On-Level Indemnity Severity Annual % Change*

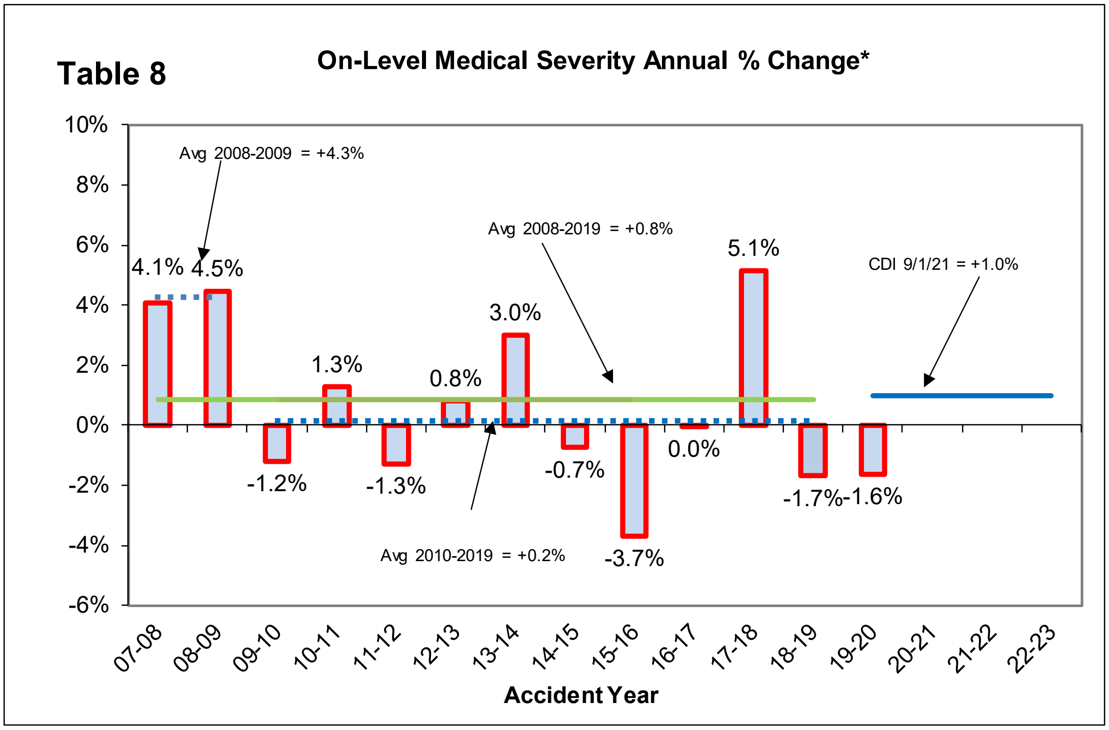


*Ultimate Indemnity Loss Projections are Based on the Paid Method, and Data Evaluated as of December 31, 2020



*Ultimate Medical Loss Projections are Based on the Paid Method, and Data Evaluated as of December 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.



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

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 modest increases in indemnity severity based on data as of December 31, 2020. The 2020 increase is affected by mix shifts caused by the economic downturn due to the pandemic. In fact, if adjusted for class mix, the change in the indemnity severity for 2020 would have been about 1.5% lower at 5.6%. Both 2019 and 2020 increases are 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 +0.4% as of the current valuation.

Consistent with the January 1, 2021 filing, the WCIRB-selected annual severity trend for indemnity in this filing is +1.0%. 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 -0.9%.

The WCIRB's selection of indemnity severity trend is based on consideration of the general growth in on-level indemnity severities over the most recent three years, as well as increased temporary disability duration and a slower claim settlement process in the short-term as a result of the gradual economic recovery in the post-pandemic period.

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, as well as the effects of the economy downturn and recovery, and selects separate annual trends of +3.5%, -0.2%, -2.5%, and -0.9%, for 2020 through 2023 accident years respectively, assuming return to more historical levels in 2023.

The Department’s staff also agrees with considerations regarding the impact of the economic downturn and recovery on the indemnity severity, cited by the WCIRB and Bickmore, and based on separate selections for 2020 through 2023, which are similar to the annual trends selected by Bickmore, project indemnity severity trends that on average resemble a uniform annual indemnity severity trend of +0.4%. The Department’s staff’s selections for 2020 through 2023 are +3.5%, 0.0%, -2.0%, and -1.0% respectively.

The Department’s staff notes that the medical severity trend of +1.0% selected by the WCIRB in this filing has been selected in consideration for both long-term and short-term trends, and is somewhat lower than the +2.5% selected by the WCIRB in the January 1, 2021 filing. The WCIRB also cites sharp growth of average medical costs in California absent of reforms, in combination with the length of time since implementation of the reforms that led to the decrease in medical costs, uncertainty in the impact of transition to the post-pandemic environment on medical costs, and inflationary pressures and advancements in new and improved medical technologies and processes, as the basis for the selected medical severity trend. As shown in Table 7, the ten-year average change in medical severities during the 2010-2019 period evaluated as of December 31, 2020 is +0.3.

Bickmore’s selected annual medical severity trend is 0.0%, compared to the selected medical severity trend of +1.0% in the January 1, 2021 filing. Bickmore’s selection is based on the average changes in medical severity for 2012-2020, which is -0.2%.

While the Department shares Bickmore’s view that the observed trend in the recent ten years is on average flat, the Department is also sensitive to the WCIRB’s concerns about the uncertainty in the impact of transition to the post-pandemic environment on medical costs.

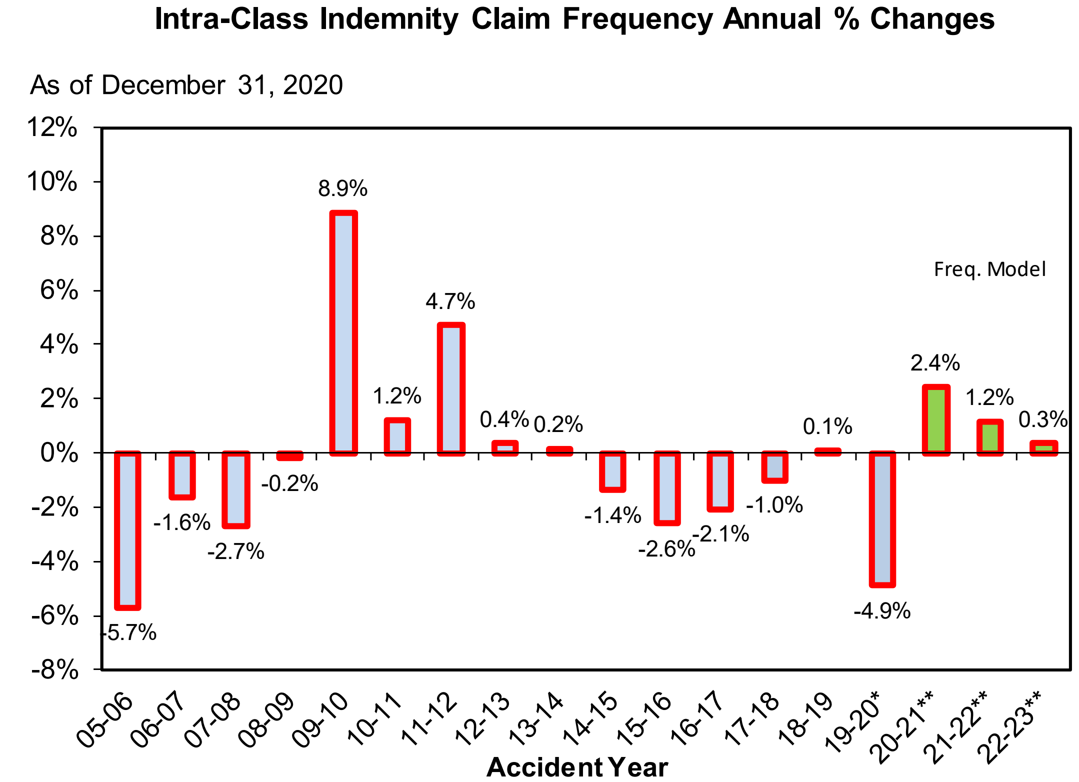
The Department's actuarial staff believe that it is important to keep in mind that the workers' compensation system is an adaptive system where the various service providers respond to changes in the environment brought on by reform or court decisions. We recognize that particular attention needs to be paid to medical trends, as the belated recognition of increasing medical costs has been a major problem in the not-too-distant past. The average change in medical severities during the 2008-2019 period evaluated as of December 31, 2020, is about +1.0%, and the accident years included in this period strike a balance between pre- and post-SB 863 phases. The Department does not give any credence to the severity change observed for accident year 2020, due to existing distortions embedded in the data for this period. In consideration of the factors stated above, and consistent with the January 1, 2021 filing, the Department is selecting a +1.0% medical severity trend, as shown in Table 8, for this filing, which reflects considerations for both long-term and short-term changes in the average medical severity, as well as the uncertainty in the impact of current and prospective environments on the medical costs.

Frequency Trend

For many years, the WCIRB's econometric claim frequency model has been the primary source that the WCIRB has relied upon to project future changes in indemnity claim frequency. In addition, consistent with pure premium rate filings since January 1, 2014, the WCIRB relies on the preliminary estimate of the indicated frequency change for the most recent completed accident year as of twelve months (12-month frequency measure), based on preliminary measure of changes in actual reported claim counts compared to changes in statewide employment levels.

Table 9 below, shows the historical changes in indemnity claim frequency since 2005, as well as the WCIRB projected frequency changes based on the WCIRB econometric indemnity claim frequency model. The historical annual frequency changes shown in this table are based on unit statistical plan data for 2019 and earlier periods. For 2020, which is the latest complete accident year, the estimate relies on proxies for changes in frequency (i.e., changes in reported aggregate indemnity claim counts compared to changes in statewide employment).

Table 9



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

The green bars in Table 9 reflect the WCIRB's forecast of changes in frequency, which are based on the WCIRB's 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 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.

Last 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.

Due to the significant economic slowdown, caused abruptly by the pandemic, there was concern that the situation will give rise to an increase in CT claims, especially in 2020. Therefore, in the January 1, 2021 filing, the WCIRB had incorporated a projected increase in the proportion of CT claims, consistent with that of the last two economic recessions, in the WCIRB's frequency forecast model.

The preliminary information for accident year 2020 suggests that an increase in the proportion of cumulative trauma claims has not occurred. Consequently, the WCIRB has not reflected any increase in the proportion of cumulative trauma claims either in the model frequency change forecasts, or as an adjustment to the 12-month frequency measure.

The projected frequency decline for accident year 2020 based on the WCIRB's econometric claim frequency model is 11.1%, which is consistent with the projection of the model in the January 1, 2021 filing, prior to the adjustment for the impact of the CT claims. On the other hand, the estimated frequency decline for accident year 2020 based on the 12-month frequency measure is 4.9%.

The WCIRB has used the 12-month frequency measure in its pure premium rate filings since 2014. Between 2014 and 2019, there has been a relatively modest difference between the 12-month frequency measure based on actual reported claim count and the initial estimate of indemnity frequency change based on the model at December 31 evaluation. The maximum absolute difference between the two was 2%. However, for accident year 2020, there is a significant difference between the results of the model which estimates a -11.1% change in the indemnity frequency, and the 12-month frequency measure, which reflects an estimate of 4.9% - both assessments adjusted for the estimated shifts in industrial mix.

Department's staff agrees with the WCIRB's comment during the hearing, that forecasting indemnity claim frequency during a major economic slowdown is incredibly challenging. Various distortions that have led to the WCIRB's finding that the accident year 2020 changes in severity are unreliable, such as the shift from medical-only to indemnity claims, have also had an effect on the preliminary indicated indemnity frequency change based on the 12-month frequency measure. Given that in calendar year 2020, the filing of medical-only claims declined by about 28%, compared to the indemnity claims, which declined by about 12.5%, the WCIRB believes that some of the medical-only claims have been actually filed as smaller indemnity claims, as workers with no job to return to may be more inclined to file an indemnity claim rather than a medical-only claim, where they would have to return to work right away. Such a shift in the type of claims filed would result in an overstatement of the reported indemnity claim count underlying the preliminary indicated frequency change for accident year 2020 for the purpose of projections. However, as the WCIRB has explained in the hearing, the impact of such a shift could not be determined and accounted for, as measuring the impact would involve analysis of the characteristics of individual claims, as the claims mature.

As the WCIRB has noted in the filing, job losses in 2020 have disproportionately impacted lower wage industries, and lower wage workers within industries. The WCIRB has determined that the shifts in the industry mix have contributed by about 1.9% to the observed increase in the average wage level for 2020. In addition, the impact of the wage level shift within industries on the 2020 average wage level is about a 4.3% increase in the observed average wage for 2020. Therefore, the WCIRB has adjusted the 2020 average wage level for both the shifts in the industry mix and the shift in wage levels within industries. Given that the frequency is measured in relationship to payroll, both of these shifts have an impact on the accident year 2020 change in frequency.

The WCIRB, consistent with the methodology used in prior filings, has adjusted the preliminary indicated accident year 2020 indemnity claim frequency change for the impact of changes in the industrial mix. Furthermore, the WCIRB has also recognized that there may be several other factors that impact the ultimate 2020 claim frequency change such as shifts in wage levels within industries, potential future cumulative trauma claim filings, or other mix shifts. The WCIRB has not made adjustments for the impact of distortions due to known additional shifts in the underlying data, induced by the pandemic, given that they are not as well understood, and there is not a reliable basis to make these adjustments to the 12-month 2020 claim frequency measure. However, it appears that some of these shifts that could not be adjusted for, such as the shift in filed 2020 type of claims from medical-only claims to indemnity claims, result in an understatement of the frequency decline for accident year 2020, for the purposes of projection into future.

Information provided in the course of follow-up to the hearing discussions and in regards to the retrospective evaluation of the frequency projections, show that the 12-month frequency measure has performed better compared to the frequency change projected by the WCIRB's frequency model based on the three measures shown in the exhibit, i.e., Correlation with Actual Frequency, Mean Squared Error, and Directional Accuracy Percentage, and especially on the basis of Correlation with Actual Frequency. It is worth noting here that taking an average of the two estimates of frequency change, improves both the Directional Accuracy Percentage and the Mean Squared Error, while resulting in slightly lower Correlation with Actual Frequency, compared to the performance measures based on the 12-month frequency estimate.

Despite uncertainties around the accident year 2020 data, the WCIRB has found it appropriate to use the reported claim count for this period to determine the 12-month frequency measure, on the basis of not expecting the number of claims for 2020 to change dramatically as the year matures, and concluded that the preliminary frequency change based on 12 months continues to be a more reliable predictor of the actual accident year 2020 claim frequency than the WCIRB's frequency model projection.

While the WCIRB relies on the frequency model projections for 2021 through 2023 frequency changes, the WCIRB does not utilize the model's projection for accident year 2020 frequency change, given that the sharp unprecedented decrease in the economic variable for 2020 in the WCIRB's frequency model is well below that of any of the 40 years of economic information used to fit the model and results in a decrease significantly lower than any change experienced in the last 15 years as well as the preliminary actual 2020 change.

Bickmore has raised concerns regarding the disparity of using the results of the model for future years, while the indicated 12-month frequency measure for 2020 is significantly different from the model, stating that "If the recession in 2020 resulted in a frequency drop that was much less dramatic than projected (i.e., an actual drop of only 4.9% vs. the model predicted drop of 11.1%), then it stands to reason that frequency bouncing back up during the recovery will also be less dramatic than predicted." To that end, Bickmore is projecting frequency decreases for 2021 through 2023 of 0.6%, 1.0% and 0.1%, compared to frequency increases of 2.4%, 1.2%, and 0.3% projected by the WCIRB econometric claim frequency model. Bickmore's analysis assumes an annual 2% decline in frequency as the expected decline in frequency in a normal year (model's constant), and applies a formulaic adjustment based on the difference between the model prediction and the observed frequency change for AY 2020, to the model prediction for AYs 2021 through 2023 to determine the revised frequency change projection for these accident years.

Department's staff is also concerned about complete disregard of the model's projected 2020 decline in frequency on the basis that the results of the model for this period is significantly lower than any decrease in the last 15 years, especially as the WCIRB had noted in the January 1, 2021 filing, the WCIRB's review of indemnity claim frequency changes during prior recessions indicated that the economic variable in the WCIRB's frequency model was generally predictive of frequency decreases during these periods.

In addition, in view of the variety of unadjusted mix shifts and distortions embedded in the 2020 accident year data, the Department's staff does not find it appropriate to rely solely on the 12-month frequency measure for accident year 2020. However, we agree with the WCIRB, that the number of claims may not dramatically change for the 2020 period, and therefore this preliminary estimate should be given some weight.

Given the challenges associated with the projection of the frequency change for accident year 2020, the Department's staff believes that an average of the two estimates of frequency based on the model and the 12-month frequency measure would be more appropriate as a basis for projections.

Department staff's selection is based on concerns regarding the plausible distortions present in the 2020 preliminary indicated indemnity claim frequency, and in consideration of the fact that while the current WCIRB econometric model may need some enhancements, and the changes in the economic variable for accident years 2020 and 2021 are outside the usual range of observations that are the basis of the regression analysis, given the significant sudden increase in unemployment in 2020, the results of the model for accident year 2020 are within reasonable range, and as such, it would be appropriate to partially rely on those results. This approach will result in a projected frequency decline for accident year 2020 of about 8%.

Furthermore, the Department's staff finds the results of the model projections for 2021 through 2023 appropriate, as they can also be supported by the notion of the expected increase in frequency during economic rebound, as younger and less experienced workers that had become unemployed during the pandemic would enter the workforce again, and potentially start a different job.

The WCIRB is undertaking a comprehensive review of the econometric indemnity claim frequency model to determine potential enhancements to the model and the Department's staff appreciate the WCIRB's efforts to improve the model and the accuracy of its projections. In addition, the WCIRB has begun a study of wage inflation and frequency by wage levels, and plans to expand that study to look at differences between medical-only and indemnity claims to the extent reliable injured worker wage information on medical-only claims is available.

3. Loss Adjustment Expenses

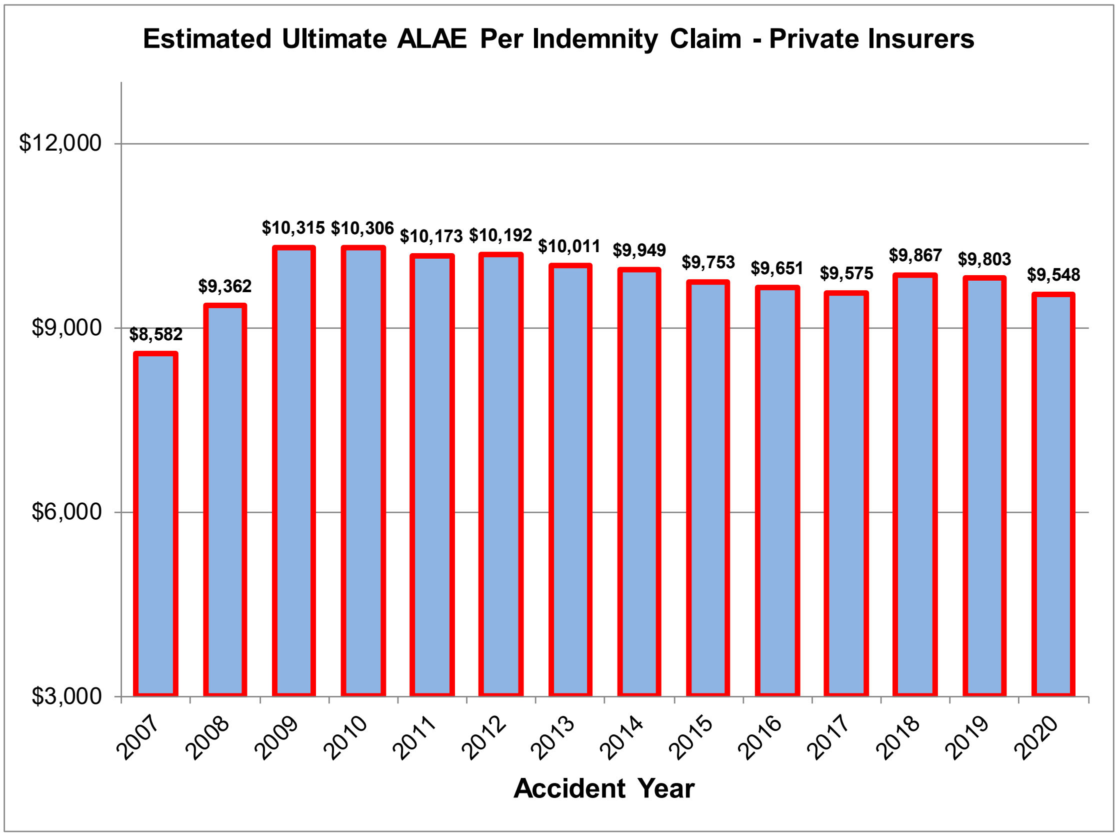
In its determination of the provision for LAE in the proposed rates, the WCIRB developed separate indications for the ALAE and ULAE, and medical cost containment programs (“MCCP”).

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 January 1, 2020 filing, this pattern has changed, and the estimated ultimate ALAE per indemnity claim shows slight decline between 2013 and 2017 (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 decline observed between the 2013 and 2017 accident years in the December 31, 2020 evaluation.

Table 10



Based on Data as of December 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 the January 1, 2021 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, applied only if the absolute value of the change for that accident year at that evaluation is at least 1.5%.

While in the January 1, 2021 filing this adjustment was incorporated to reflect increases in claim settlement rates, as discussed in the development section, the pandemic environment has resulted in a temporary decline in claim settlement rates, and consequently, in this filing the WCIRB has incorporated an adjustment to the ALAE age to ultimate development factor for the 2018 and 2019 accident years, which have shown more than 1.5% decline in claim settlement rates. This adjustment increases the age to ultimate development factors for 2018 and 2019 by 1.1% and 3.1% respectively, and essentially corrects for the distortions in the development factors caused by the pandemic. However, similar to the considerations for indemnity and medical loss development, the WCIRB has selected the ALAE development factors based on 2-year average age-to-age factors to account for the volatility that may have emerged during the pandemic period.

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.

Given that the ALAE development factors to ultimate are highly leveraged, the Department's staff recommend continued evaluation of the development patterns for the ALAE, as it appears that the persistent downward trend in successive evaluations of ALAE have continued at least for 2007 and later accident years, despite the adjustments that the WCIRB has made.

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.

Consistent with the January 1, 2021 filing, the Department's staff is selecting an average ALAE per indemnity annual trend 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, which results in an annual trend of +0.8%, compared to +1.0% selected in the January 1, 2021 filing. The WCIRB-selected annual ALAE severity trend in this filing is +1.0%, compared to +1.5% selected in the January 1, 2021 filing.

While in prior filings the projections were based on the average of the recent two accident years, in this filing, the basis of the projection is the 2019 accident year, as the 2020 accident year projected ALAE may be distorted by the slowdown of the claim resolution process.

Similar to the January 1, 2021 filing, the WCIRB has adjusted the projected ALAE for the impact of the SB 1160 and AB 1244 reforms, based on an assumed 70% reduction in lien filings compared to the 3rd quarter of 2016. The full 11.2% estimate of the impact of the decline in liens is judgmentally tempered by 60% to 4.5% to reflect the impact of the reforms that is not yet reflected in the emerged ALAE data as of December 31, 2020.

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.

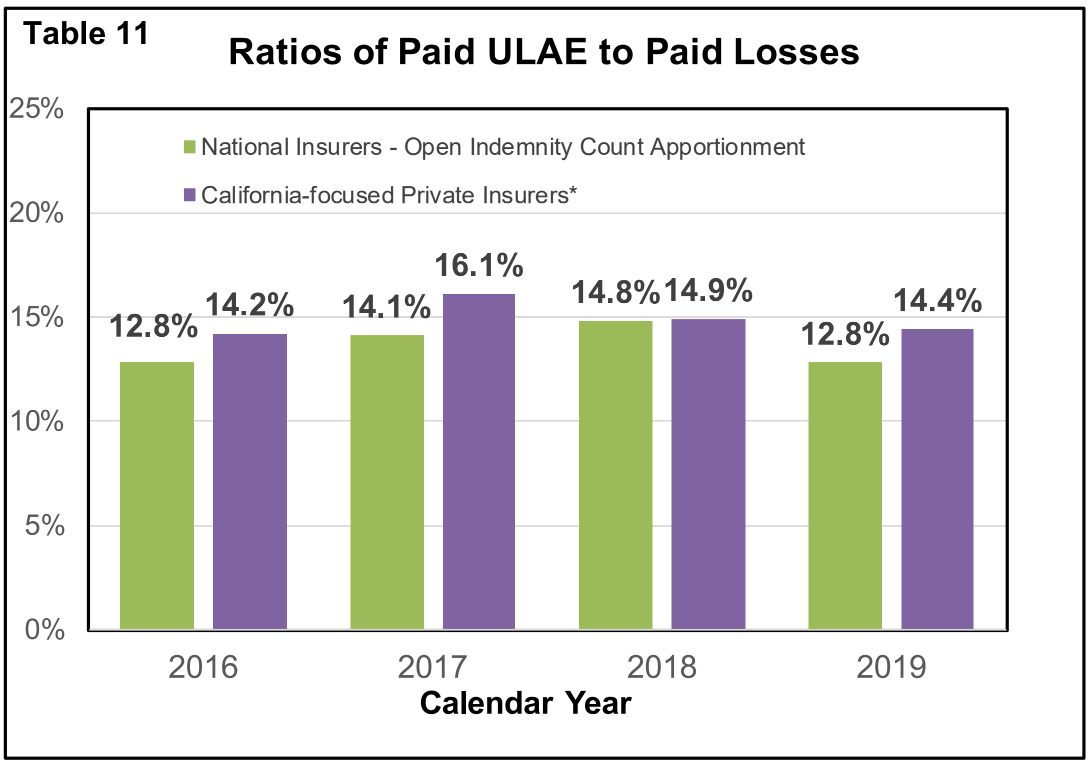
ULAE

Similar to the January 1, 2021 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.

Based on a study conducted by the WCIRB in 2020, starting with the January 1, 2021 filing, projections of open indemnity claim counts are based on incremental claim settlement rates, as opposed to estimated ultimate indemnity claim settlement rates used in prior filings. Given the impact of the COVID-19 on the claim settlement process in 2020, the incremental claim settlement rate from calendar year 2019 was utilized to determine the projections of open indemnity claim counts.

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.

Given that the 2020 calendar year information had not been available at the time of the filing, and even if available, it would have been impacted by the COVID-19 pandemic, the information used for this allocation is based on 12/31/2019 data.

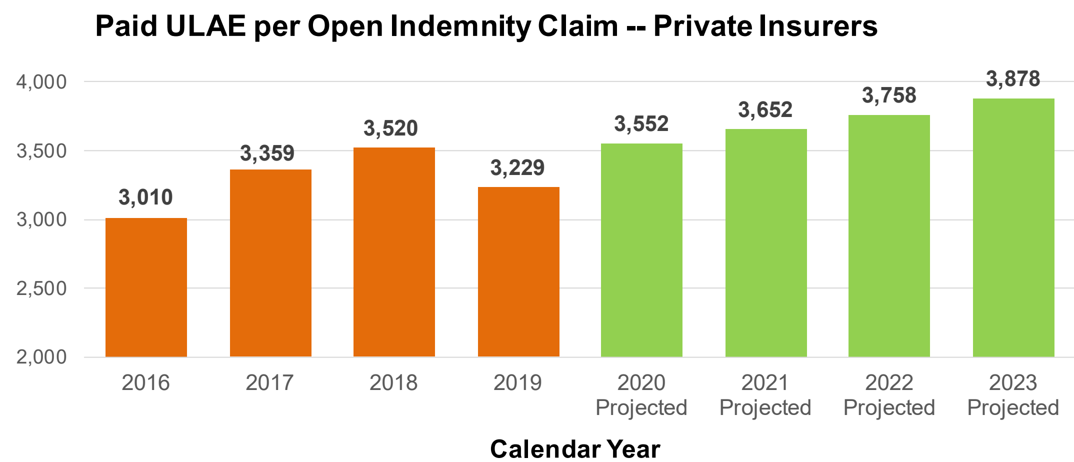


Source: WCIRB expense calls and quarterly calls for experience.
*California-focused Private Insurers are insurers with at least 80% of their workers' compensation writings in California.

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, with the assumption that the average ULAE costs grow at a rate comparable to that for statewide average wages. The ULAE costs have been trended to the prospective period by applying California average annual wage level changes based on UCLA and California Department of Finance forecasts, as adjusted for the impact of the pandemic-related slowdown on the mix of industries and mix of wage levels within industries. 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, and averaged to project average ULAE costs for calendar years 2021 through 2023.

Table 12



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

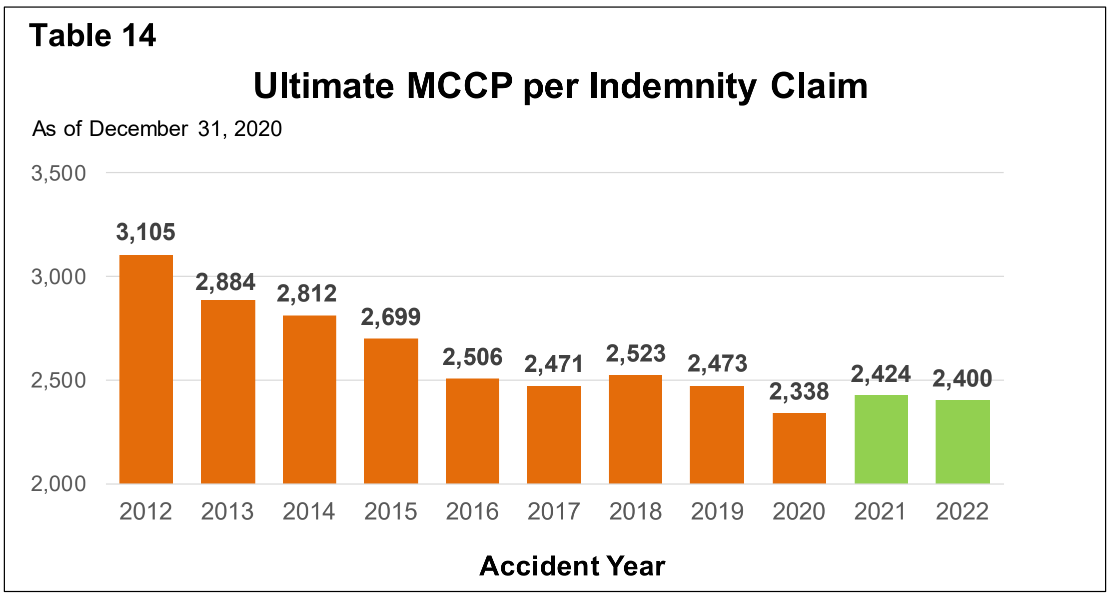
As shown in Table 13 below, the decline in average ULAE costs in 2019 has tempered the recent increase of this component of the LAE as a percentage of losses. In addition, while the results based on the individual methods have changed between the January 1, 2021 and the current filing, the average of the two methods utilized by the WCIRB remain the same. Given that the January 1, 2021 filing used the same calendar years (2018 and 2019) as the basis of the paid ULAE to paid loss ratio, the change in the calendar year paid ULAE to paid losses between the January 1, 2021 and the current filing, is due to utilization of a more simplified approach, which is also more stable, on the basis of a WCIRB review conducted in 2020, and implemented in this filing.

Table 13

Method	January 1, 2019 Filing ULAE Projection	January 1, 2020 Filing ULAE Projection	January 1, 2021 Filing ULAE Projection	September 1, 2021 Filing ULAE Projection
Paid ULAE per Open Indemnity Claim	14.9%	15.6%	14.1%	13.5%
Paid ULAE to Paid Losses	12.2%	13.8%	13.2%	14.0%
Average of Two Projection Methods	**13.6%**	**14.7%**	**13.7%**	**13.7%**

MCCP

The period between 2012 and 2019, as shown in Table 14, shows a steady decline in ultimate MCCP per indemnity claim, and the unusual spike for accident year 2018 has moderated as of the December 31, 2020 valuation.



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

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 +2.1% as of December 31, 2020. While it is not clear what the underlying driver of the initial significant increase has been, the subsequent moderations of the increase are reasonable, as an increase in MCCP costs 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 accident year 2020 may be distorted by the impact of the pandemic, a continued decline would have been expected.

Similar to the paid indemnity and medical loss development, the development factors to 108 months have been based on 2-year average development factors, to adjust for any distortions caused by the pandemic.

The WCIRB's projected MCCP per indemnity claim is based on the 2019 accident year, with -1.0% inflation going forward, which compares to 0.0% inflation assumed in the January 1, 2021 filing. Consistent with the January 1, 2021 filing, the Department's staff has selected an annual MCCP severity trend, 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. The selected MCCP annual severity trend of -1.3% is applied to the 2019 average MCCP per indemnity claim, as the basis for projections, disregarding the results for 2020.

A comparison of the components of LAE between the prior filing and the current filing based on the WCIRB projections is shown below in Table 15, which shows that compared to the January 1, 2021 filing, the ALAE and MCCP have decreased as a percentage of losses, while the ULAE has remained constant.

Table 15

LAE Provision Underlying WCIRB Pure Premium Rate Filings

	1/1/21 Filing		9/1/21 Filing	
(ALAE ex/MCCP)/Loss	16.1%		15.9%	
MCCP/Loss	4.2%		3.9%	
Total ALE/Loss	20.3%	$0.23	19.8%	$0.22
ULAE/Loss	13.7%	$0.15	13.7%	$0.15
Total LAE/Loss	34.0%	$0.38	33.5%	$0.37
Indicated Pure Premium Rate*		$1.50		$1.50

*Excluding COVID-19 Adjustment for 1/1/21 Filing

The projected LAE as a percentage of losses considered in the Department's analysis is 34.5% compared to the WCIRB's selection of 33.5%. 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. The Department's assumed frequency changes, as reflected in the Frequency Trend section, have been incorporated in the projected claim count underlying the LAE cost determination.

Bickmore highlights differences in its assumptions from the WCIRB in the written testimony, as selection of lower ALAE per indemnity count based on the most recent three years, projection of lower ULAE per earned premium in consideration for how stable these ratios have been since 2017, projection of lower MCCP severity trend based on a five-year average, and projection of lower indemnity claim counts based on differences in indemnity claim frequency assumptions. The projected LAE cost, once normalized by the lower projected losses, results in a projected LAE-to loss ratio of 35.5%, compared to 33.5% 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, as well as the economic environment, on LAE costs require particular attention and appreciates the WCIRB's and Bickmore's efforts in this regard.

4. Impact of changes to the Official Medical Fee and Medical-Legal Fee Schedules

In this filing the WCIRB has incorporated the cost impact of changes to the Evaluation and Management Section of the Official Medical Fee Schedule, as well as changes to the Medical-Legal Fee Schedule, adopted by the Division of Workers' Compensation effective March 1, 2021, and April 1, 2021 respectively, in the proposed pure premium rates.

The WCIRB has estimated the impact of the changes to these two Schedules, which have been incorporated in the September 1, 2021 advisory pure premium rates, to be an increase in the overall costs of +1.5%.

While the Schedule changes also impact the cost of medical and medical-legal services on open claims on policies incepting prior to September 1, 2021, the WCIRB has not proposed an adjustment to advisory pure premium rates applicable to the unexpired term of outstanding policies.

Official Medical Fee Schedule (OMFS)

The Division of Workers' Compensation (DWC) generally adopts regular updates made to the Medicare schedule values.

In 2021, the Centers for Medicare & Medicaid Services (CMS) made significant changes to reimbursement rules and rates in the Medicare payment system, including an increase in the reimbursement rates for Evaluation and Management (E&M) services, and effective March 1, 2021, the DWC made major changes to E&M billing, and posted new reimbursement rates for E&M services, to conform to relevant 2021 changes in the Medicare payment system.

The WCIRB has estimated the impact of the new DWC-adopted reimbursement rates for E&M services based on the distribution of the services in 2019 service year, and comparison of the March 1, 2021 OMFS values to the historical payments for those services, utilizing medical transaction data, and with a focus on the E&M office/outpatient visits which account for almost 90% of the payments for all E&M services.

Given that the E&M office/outpatient visits comprise about 15.9% of the overall medical costs, and based on an estimated 15% indicated increase in the E&M office/outpatient visits costs due to the implementation of the March 1, 2021 Schedule changes, the WCIRB has determined the impact of the Schedule change to be a +2.4% increase in overall medical costs. The 15% indicated increase is net of the typical Medicare inflationary increase of about 2.5% per year.

Medical-Legal Fee Schedule (ML)

Medical-Legal (ML) services which comprised about 6.5% of all medical costs in the California workers' compensation system in 2019, include services provided by a physician to resolve disputed issues in regards to evaluation of an injured worker, such as cause of injury, part of body injured, and temporary and permanent disability, which may be provided through a narrative medical report and/or expert testimony.

The new Medical-Legal Fee (ML) Schedule, adopted by the DWC effective April 1, 2021, reflects the first significant change to medical-legal reimbursement levels since 2006, and is intended to increase the reimbursement rate for medical-legal reports while eliminating the increased hourly billing provisions.

While in order to determine the cost impact of the ML Schedule change, the WCIRB essentially estimated the expected payments for ML services provided in 2018 and 2019 under the new Schedule and compared those to historical payments for those services based on medical transaction data, the estimation was more involved as there were changes in the ML codes, as well as additional modifiers for ML evaluations that have a primary focus of psychology/psychiatry, toxicology, and oncology, introduced with the new Schedule.

In addition, given that the new ML Schedule includes a provision that in lieu of billing for the time involved in conducting certain medical-legal evaluations, there is additional billing per page of records for reviewing records beyond the level specifically contemplated in the Schedule, evaluation of the cost impact of the new ML Schedule required estimation of the number of pages of records that physicians may review per hour.

Based on determination of the appropriate new code(s) to apply, the applicable fee(s) for the code(s), and application of the appropriate modifier and multipliers, as well as estimation of number of pages of records reviewed by physicians per hour, the WCIRB has estimated that the new ML Schedule increases the ML costs by about 22%, which translates to a 1.4% increase in overall medical costs, given that ML costs comprise approximately 6.5% of overall medical costs.

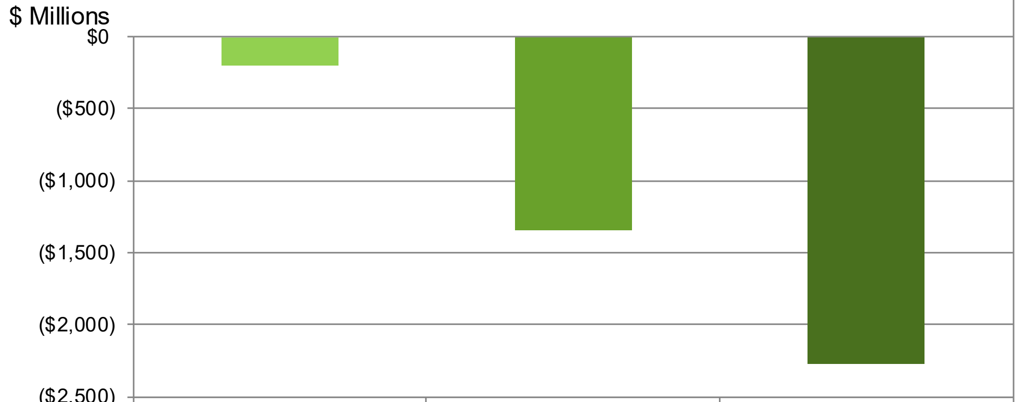
5. Impact of SB 863, SB 1160, AB 1244, and AB 1124

<u>SB 863</u>

The WCIRB issued its last retrospective evaluation of the effect of SB 863 in its October, 2019 SB 863 Cost Monitoring Report, where the WCIRB 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 has been an update to the November 2016 estimate of $1.3 billion, and an initial assessment of overall savings of $200 million.

Table 16

Evaluation of SB 863 Cost Impact



	WCIRB Initial Proposective Estimate (October 2012)	WCIRB November 2016 Estimate	WCIRB October 2019 Estimate
All SB 863 Components Including Indirect Impacts	**($200)**	**($1,340)**	**($2,270)**

The substantial decreases in medical cost projections, which have been noted and reflected in filings over the last couple of years, have, in large part, been attributed to SB 863. In particular, the impact of IMR on medical costs is thought to represent a substantial portion of the "indirect impact" component discussed in the October 2019 retrospective evaluation. Assuming this to be true, it far outweighs the increase in frictional costs due to IMRs.

With the exception of the 2018 year, for which the number of eligible IMRs filed reached a record level high, the number of eligible IMRs filed has been relatively stable, around 172,500, between 2016 and 2019. However, in 2020 as a result of the environment caused by the pandemic, the number of IMRs decreased by about 19% to 140,070. It is worth noting here that greater than 20% of the filed IMRs in each year are determined to be duplicates, which could be the consequence of the automatic filing of IMRs, and impose unnecessary frictional costs on the system.

We appreciate the WCIRB's continuous efforts in re-evaluating the impacts of various reforms, some of which are discussed below.

Based on the analysis of the indirect impact of SB 863 on overall indemnity cost levels reflected in the October 2019 "SB 863 Cost Monitoring Updated" report, the WCIRB estimated that the decline in the average temporary disability duration and the average permanent disability ratings since the full implementation of SB 863 have decreased the indemnity costs by about 4.5% on a combined basis. Given that several provisions of SB 863 impacted outstanding claims in addition to new claims, consistent with the approach employed since the January 1, 2020 filing, the WCIRB has distributed the 4.5% decrease in indemnity costs uniformly over the 2012 through 2015 accident years, and incorporated a 1.125% yearly decrease for these accident years in the calculation of indemnity on-level factors underlying the September 1, 2021 pure premium rate filing.

As mentioned in the Loss Development section, in 2019 the WCIRB studied the impact of the recent pharmaceutical cost declines on paid medical loss development factors, and since the January 1, 2020 filing, has reflected the results of this study in the adjustments made to the paid medical loss development.

SB 863 has also resulted in a significant reduction in the utilization of a number of types of medical services, particularly pharmaceuticals. In the January 1, 2019 pure premium rate filing, the WCIRB had reflected a 17% reduction in the utilization of medical services resulting from SB 863 in the medical on-level factors. The 17% decrease had been judgmentally spread to accident years 2011 through 2015, based on indications of the relative impact of SB 863 provisions impacting medical utilization on those years' medical costs.

Starting with the January 1, 2020 filing, given that the decline in pharmaceutical costs have been partially reflected in the adjustments to the paid medical losses underlying paid medical development factors, the WCIRB has judgmentally[4] reduced the total impact of SB 863 on medical utilization incorporated in the medical on-level factors from 17% to 13%, to avoid double counting for the portion of the decline that has been accounted for in adjustments to the paid medical development factors.

SB 1160, AB 1244, AB 1124

On September 30, 2016, SB 1160 and AB 1244 were signed into law. SB 1160 includes a number of provisions related to utilization review, while SB 1160 and AB 1244 include a number of provisions related to liens. In its January 1, 2017 filing, the WCIRB reviewed the impact of SB 1160 and AB 1244 on losses and loss adjustment expenses for policy year 2017 and estimated the impact at a 0.6% reduction in the indicated pure premium loss costs, which was an approximate savings of $135 million annually relative to the overall insured and

[4] Based on the differential in pharmaceutical cost declines in California compared to other states.

self-insured California workers' compensation system size of $22.5 billion. The 0.6% favorable impact was based on an estimated 10% reduction in number of liens filed.

Lien activity in 2017 and early 2018 indicated that the reduction in lien volume based on more recent data was in the ballpark of 40%. This reduction level assumed the 2nd quarter of 2016 to be the previous norm, before the transition period of late 2016 through early 2017 started, and the new environment was represented by the March 2017 through February 2018 period. The removal of the transition period from the calculations reflects the concern that the recent reform measures had resulted in many liens being filed before the January 1, 2017 reform effective date, potentially moving some of the 2017 volume into late 2016, and therefore the data for this period is distorted. Accordingly, in the July 1, 2018 pure premium rate filing, the WCIRB reflected a 40% reduction in lien volume in the adjustments applied to the medical loss development factors and the ALAE.

The number of liens filed continued to decline, and in the review of the January 1, 2019 pure premium rate filing, the Department incorporated a 50% reduction in its analysis, based on the comparison of lien filings in the 2nd quarter of 2018 to the 2nd quarter of 2016.

Due to a continued decline in the number of liens filed, the WCIRB incorporated a 60% reduction in lien volume in the January 1, 2020, and January 1, 2021 pure premium rate filings, on the basis of a comparison of the average number of liens filed during the July 2018 through June 2019 period, to the average level of filings shortly before the reforms.

However, the reduction in lien volume has continued, and reflect an approximate 70% decline based on the average number of liens filed during the July 2019 through June 2020 period. Consequently, in this filing, the WCIRB has made adjustments to the medical loss development factors and the ALAE reflecting the WCIRB's most recent review of lien filing information provided by the DWC, at a level of 70% reduction in liens.

A new medical treatment utilization schedule ("MTUS") drug formulary, as directed by AB 1124, was adopted by the Department of Industrial Relations, Division of Workers' Compensation, with an effective date of January 1, 2018. The primary goals of the formulary were to regulate the prescribing of opioids, reduce frictional costs from utilization review and IMR, and ensure medically necessary and timely medications for injured workers.

The prospective review of the MTUS drug formulary performed by the WCIRB estimated an overall reduction of 0.5% in loss and LAE costs, which were included in the WCIRB's July 1, 2018 and January 1, 2019 pure premium rate filings as an adjustment to the overall pure premium rate level. The 0.5% reduction was determined based on an estimated 10% decrease in pharmaceutical costs, amounting to 0.4% of total loss and LAE, and reduction in utilization review costs, estimated at 0.1% of total loss and LAE.

In 2019, the WCIRB performed its first retrospective analysis of the impact of the drug formulary based on pharmaceutical costs as of December 31, 2018, and found that the 10% reduction in pharmaceutical costs assumed in the prospective evaluation of the formulary has been reasonable in light of the emerged data, which showed that the pharmaceutical costs declined at an approximately 10% greater rate in 2018 compared to the rate of decrease observed in the immediate period before MTUS's implementation. Consistent with the filings since the January 1, 2020 filing, the WCIRB has reflected the -0.6% estimated impact of MTUS on medical costs, in the medical on-level factors applied to 2017 and prior accident years.

DETERMINATION OF WORKERS' COMPENSATION CLAIMS COST BENCHMARK BASED UPON CURRENT FILING

It is the determination of this Hearing Officer, based upon the current filing and public comments received, that the Commissioner should adopt an advisory pure premium rate of $1.41 per $100 of payroll. This recommended average pure premium rate is proposed to be effective with respect to new and renewal policies as of the first anniversary rating date of a risk on or after September 1, 2021. The change in the benchmark is based upon the hearing testimony and an examination of all materials submitted in the record as well as the Actuarial Recommendation and Evaluation set forth above by the Department's actuary, Mitra Sanandajifar.

ORDER

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 WCIRB's filed advisory workers' compensation pure premium rates and Sections, 2353.1 and 2318.6 of Title 10 of the California Code of Regulations shall be amended and modified in the respects specified in this Proposed Decision;

IT IS FURTHER ORDERED that the advisory pure premium rates for individual classifications shall change based upon the classification relativities reflected in the WCIRB's filing to reflect an average workers' compensation claims cost benchmark and advisory pure premium rate of $1.41 per $100 of employer payroll, to be adjusted to the relative classifications consistent with this Proposed Decision;

IT IS FURTHER ORDERED that these advisory pure premium rates shall be effective September 1, 2021 for all new and renewal policies.

I CERTIFY that this is my Proposed Decision and Order as a result of the hearing held on June 7, 2021, as well as additional written comments entered into the record, and I recommend its adoption as the Decision and Order of the Insurance Commissioner of the State of California.

Date: July 21, 2021

Yvonne Hauscarriague

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