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

PROPOSED DECISION AND ORDER

SEPTEMBER 1, 2023 WORKERS' COMPENSATION CLAIMS COST BENCHMARK AND ADVISORY PURE PREMIUM RATES

FILE NUMBER REG-2023-00006

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, 2023.

SUMMARY OF PROCEEDINGS

The California Department of Insurance ("Department") held a public hearing in the above-captioned matter on June 7, 2023, at the time and place set forth in the Notice of Proposed Action and Notice of Public Hearing, File Number REG-2023-00006, dated May 5, 2023 ("Notice"). A copy of the Notice is included in the record. The record closed on June 12, 2023.

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 28, 2023, 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 September 1, 2022, 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, 2023. The

WCIRB recommended September 1, 2023 advisory pure premium rates that are, on average, 0.3% above the advisory pure premium rates adopted by the Insurance Commissioner effective September 1, 2022. These proposed advisory pure premium rates average $1.50 per $100 of payroll.

The Department accepted testimony and written comments at a hearing held on a virtual platform on June 7, 2023, 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 June 12, 2023. 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 June 12, 2023. 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, 2023. 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

In its September 1, 2023 filing, the WCIRB has proposed an increase of +0.3% in the approved September 1, 2022 average advisory pure premium rate of $1.50[1] per $100 of payroll. The average of the September 1, 2023 advisory pure premium rates proposed by the WCIRB is $1.50 per $100 of payroll, and does not include any provision for the estimated cost of the COVID-19 claims that will incur during the September 1, 2023 policy period, as both the proportion of indemnity COVID-19 claims, and the average severity of indemnity COVID-19 claims have significantly declined, and therefore the WCIRB does not recommend including a provision for COVID-19 claims for policies incepting between September 1, 2023 and August 31, 2024.

Analyses by the Department's staff actuaries, as set forth in the following Actuarial Evaluation section, results in an indicated average pure premium rate decrease of 2.6%, or equivalently, an average pure premium rate level of $1.46 per $100 of

[1] Revised from the Insurance Commissioner's adopted September 1, 2022 Pure Premium Rate of $1.45 based on updated exposure weights by classification.

payroll. The most recently available industry average level of pure premium rates filed by insurers with the Department is $1.71 per $100 of payroll as of January 1, 2023. While the indicated average pure premium rate change represents our central estimate, and thus our recommendation, we note that both the WCIRB's estimated increase of +0.3% and the estimated decrease of 7.3% from the middle scenario of 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 cover the estimated costs of the COVID-19 claims, and be accounted for and tracked separately.

In this filing, the WCIRB utilizes the data excluding COVID-19 claims, and the September 1, 2022 Commissioner approved advisory pure premium rates, which exclude 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.

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 California workers' compensation market appears to be competitive and financially healthy. Collected premiums in 2022 produced an average charged rate of $1.68, which compares to $1.81 and $1.94 observed in 2021 and 2020 respectively[2], showing a continuation of a downward trend in charged market rates that has been in progress since the first half of 2015. The 2022 average charged rate of $1.68 (which reflects all insurer expenses) was approximately 12% higher than the Insurance Commissioner's approved September 1, 2022 average advisory pure premium rate of $1.50[3], which reflect loss and loss adjustment expense only. It was also approximately 32.5% less than the industry average filed manual rate of $2.49 as of January 1, 2023, and about 34% less than the industry average filed manual rate of $2.55 as of January 1, 2022, thus indicating the average effect of schedule rating and other rating plan credits.

[2] The 2020 and 2021 average charged rates have not been adjusted for the updated exposure weights by classification

[3] Revised from the Insurance Commissioner's adopted September 1, 2022 Pure Premium Rate of $1.45 based on updated exposure weights by classification.

As of December 31, 2022, the WCIRB estimates overall industry combined ratios at or below 85% for accident years 2014 through 2018, and combined ratios of 95% for accident year 2019, 105% for accident year 2020, 112% for accident year 2021, and 107% for accident year 2022. While the combined ratio for accident year 2020 excluding COVID-19 would be lower at 100%, excluding COVID-19 losses will lower the combined ratios for 2021 and 2022 by about 1%. These combined ratios do not include the impact of investment income, federal income taxes or insurer profits. Moreover, the 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 expenses (“LAE”) provision, which includes allocated loss adjustment expenses (“ALAE”), unallocated loss adjustment expenses (“ULAE”) and medical cost containment programs (“MCCP”); and (4) impact of legislative, regulatory and judicial actions.

In this filing, analyses rely on loss and ALAE incurred in accident year 2022 and prior, evaluated as of December 31, 2022, and ULAE incurred in calendar year 2021 and prior. While the loss and ALAE data excludes COVID-19 claims, in the development of ULAE to loss ratio, ULAE on COVID-19 claims could not be separated.

Table 1 shows the components of the WCIRB’s pure premium rate indications over the past several years, separated into medical, indemnity, LAE, and when applicable the COVID-19 components, along with a comparison to Bickmore’s current indication based on its middle scenario projection. Table 2 displays the percentage impact of the differences in assumptions and methods between the WCIRB’s proposal, the Department’s analysis, and Bickmore’s middle projection.

Table 1													
						WCIRB Filed Rates							Bickmore
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
	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	9/1/22	9/1/23	9/1/23	9/1/22
Medical $	1.00	0.95	0.87	0.84	0.76	0.70	0.65	0.62	0.60	0.61	0.58	0.52	0.54
Indemnity $	0.70	0.67	0.64	0.63	0.58	0.54	0.51	0.50	0.53	0.57	0.56	0.52	0.53
LAE $	0.61	0.60	0.51	0.49	0.46	0.46	0.42	0.38	0.37	0.38	0.36	0.35	0.36
COVID-19 $	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.06	-	0.01	-	-	0.01
Total $	$ 2.30	$ 2.22	$ 2.02	$ 1.96	$ 1.80	$ 1.70	$ 1.58	$ 1.56	$ 1.50	$ 1.56	$ 1.50	$ 1.39	$ 1.44
Industry Avg Filed PP Rate								$ 1.86	$ 1.77	$ 1.71			
Industry Avg Filed Manual Rate (with expenses)								$ 2.65	$ 2.55	$ 2.49			
Industry Avg Charged Rate (net discounts)								$ 1.86	$ 1.81	$ 1.68			

Table 2	Recommended 9/1/2023 Average Advisory Pure Premium Rate Change	Impact of Difference in Assumptions & Methods Between WCIRB and Alternative Recommendations: Total	Ultimate Medical	Indemnity Ultimate	Claim Frequency	Indemnity Severity Trend	Medical Severity Trend
WCIRB	+0.3%						
CDI	-2.6%	-2.9%	-1.9%	-0.8%	+1.0%	-0.6%	-0.6%
Bickmore (Middle)*	-7.3%	-7.6%	-2.3%	-1.0%	-2.8%	-0.6%	-1.2%

*Bickmore percentage impacts is based on the information provided in May 26, 2023 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 of these basic methods. At the same time, Bickmore has incorporated both the paid and incurred development methods in its analysis of ultimate medical and indemnity losses.

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 decreased. Subsequent to the pandemic period, the claim settlement rates have started to increase again to approximately the pre-pandemic levels for the 2021 and 2022 accident years. 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 recent prior filings, the cumulative paid medical development factors have been adjusted for the impact of SB 1160 and AB 1244 lien-related provisions.

Moreover, paid medical development factors for accident years 2013 and later have been adjusted for the impact of changes in the Evaluation & Management (E&M) section of the OMFS related to office visits, and the Medical-Legal Fee Schedule (MLFS), adopted by the DWC effective March 1st and April 1st of 2021.

Based on a study performed in 2019, and similar to the recent 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, the WCIRB's retrospective study on late-term loss development, 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 late-term loss development.

The second study involved an analysis of the impact of acceleration in claim settlement rates on later period loss development. The study showed 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. On the basis of this study, the WCIRB has adjusted paid loss development applied after 300 months for the post-SB 863 increases in claim settlement rates impacting later period loss development, in this filing.

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 to implement proper adjustments, in order to improve the accuracy of the estimates.

Consistent with the previous filing, the WCIRB's projected ultimate loss utilizes the paid loss development method based on adjusted data. Loss development factors were selected based on the latest year for the 12-to-24 month through 96-to-108 month factors and three-year averages for the subsequent age-to-age factors from 108 months through 456 months. The Ultimate/456 tail factor was calculated based on an inverse power curve fit to a four-year average of the 108-to-120 through 348-to-360 factors and extrapolated to 80 development years.

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 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 adjusting 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 could be utilized as an offset to moderate the overstatement in projected ultimate medical losses by the paid method.

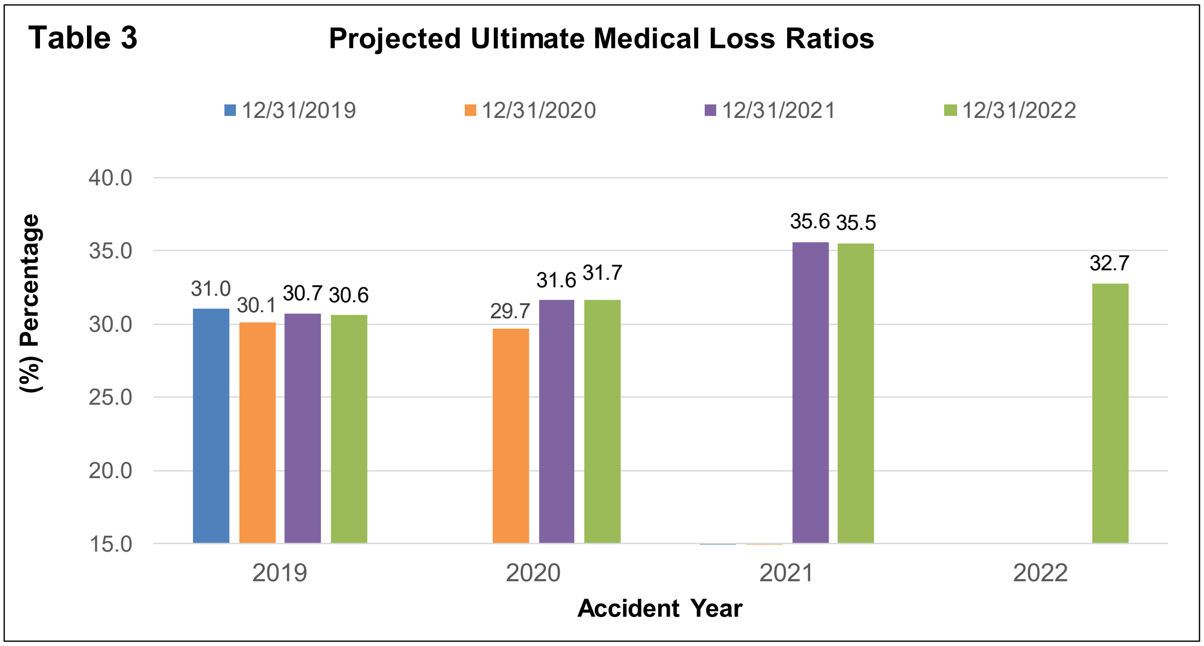
The drawbacks with the use of the incurred method lie in the challenges associated with formulating the proper adjustments to make the incurred method more accurate, which include the difficulty of adjusting incurred losses for the impacts of the various reforms that have affected the historical data. 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 nearly 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 incurred loss development method is a standard and widely used methodology, and based on various retrospective evaluations performed by the WCIRB, including the most recent evaluation performed this year, the unadjusted latest year incurred development method has performed well for both indemnity and medical ultimate loss projections.

Moreover, the WCIRB has noted in this filing that the estimated proportion of claims involving permanent disability has steadily declined over the last several years and has reached a twenty-year low in 2021, and that the shift toward more claims involving temporary disability only, which tend to be less costly and quicker settling than claims involving permanent disability, may impact loss development patterns as well as ultimate claim severities.

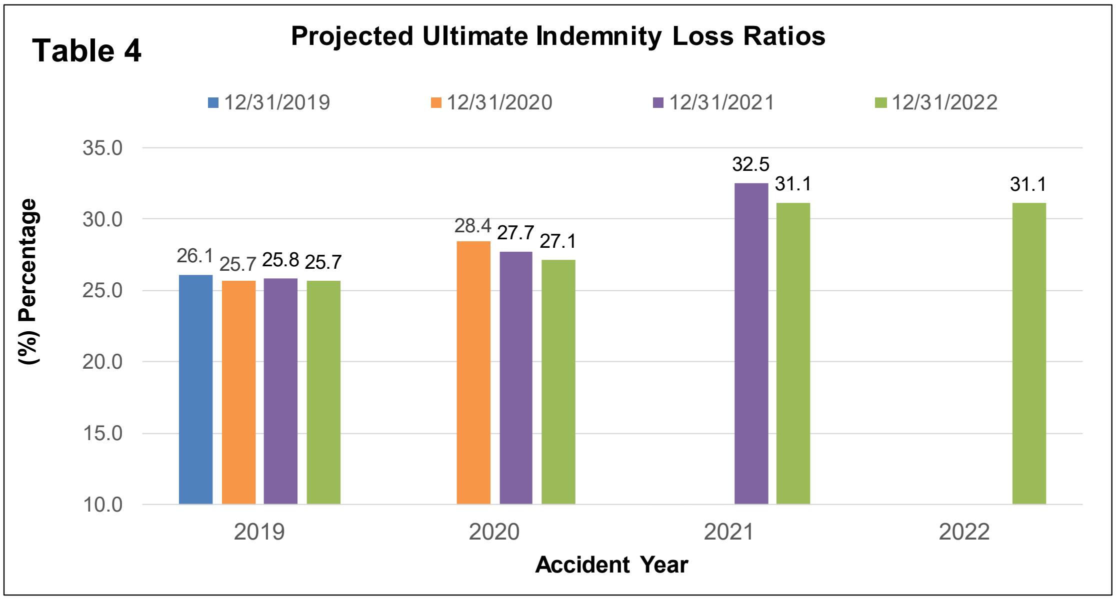
Table 3, below, shows successive evaluations of the accident year ultimate medical loss ratios. Accident years 2019 and 2020 show an increase in the loss ratios between 12/31/2020 and 12/31/2021 evaluations, potentially due to the distortions caused by the pandemic, and slowdown in claim closure rates. As mentioned below, for 2019 and 2020 accident years the level of claim closure rates has not yet caught up with the pre-pandemic levels. Both the 2019 and 2020 accident years, and the less mature 2021 accident year, have been stable between 12/31/2021 and 12/31/2022 evaluations.



Note: All loss ratios are based on the loss development methodology presented in the WCIRB 9/1/2023 Filing.

On the other hand, as shown in Table 4, the indemnity loss ratios have declined between successive evaluations for the 2020 and 2021 accident years. While the 2019 accident year remained stable between 12/31/2020 and 12/31/2022 evaluations, the accident year 2020 loss ratio has declined by about 4.6% between December 31, 2020 and December 31, 2022, and the loss ratio for 2021 accident year declined by more than 4% between the December 31, 2021 and December 31, 2022 evaluations, despite utilization of a common loss development methodology. Historical changes for the 2017 and 2018 accident years, not shown in the below table, show similar levels of decline in indemnity loss ratios based on the same development methodology.

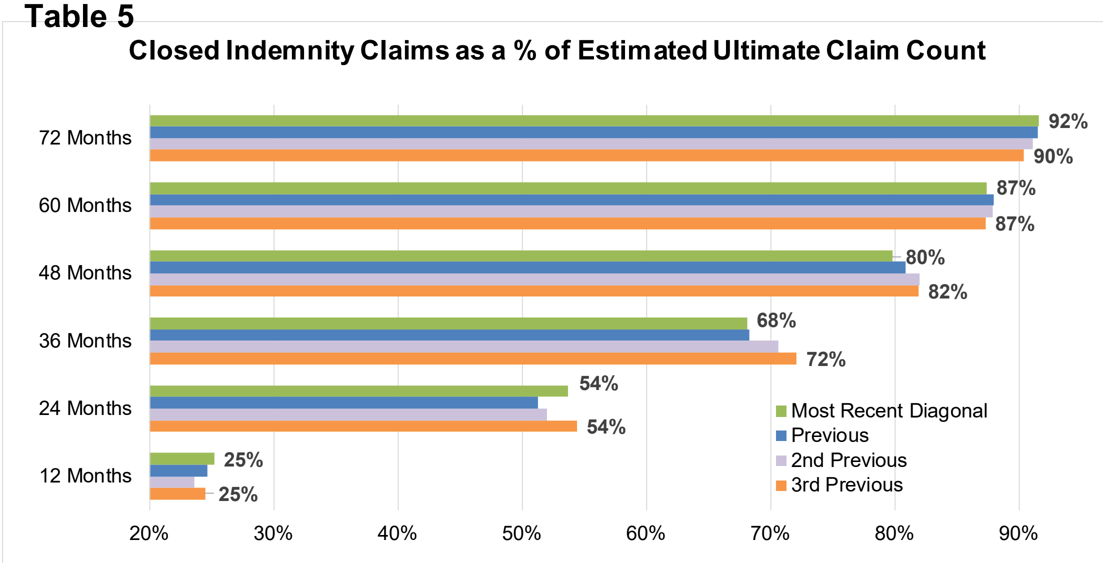
These loss ratios are all based on the latest year paid method on adjusted data, including the application of the Berquist-Sherman adjustment for changes in claim settlement rates, as utilized by the WCIRB in this filing.



Note: All loss ratios are based on the loss development methodology presented in the WCIRB 9/1/2023 Filing.

As shown in Table 5, claim settlement rates declined in the 2020 and 2021 calendar years for the 2018 through 2020 accident years. While prior to the onset of the pandemic the claim settlement rates for the 2018 and 2019 accident years had plateaued, the decline in claim settlement rates were a temporary slowdown affected by the COVID-19 pandemic, and although accident years 2019 and 2020 are still not caught up in their level of claim closure rate to the pre-pandemic levels, the acceleration in claim settlement rates have almost caught up to and occasionally exceeded pre-pandemic levels for most other accident years during the 2022 calendar year.

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.

While 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, other factors contributing to the decline in projected ultimate losses including 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), the decline in the share of permanent disability claims since 2015, and the increase in telecommuting following the pandemic, have not been adjusted for, partly as they may have been difficult to quantify.

The decline in the percentage of the permanent disability claims' share has been attributed[4] to dramatic reductions in opioid usage, improvement in medical procedures designed to return injured workers to work, and a different mix of injuries arising during the pandemic and endemic periods, with a much higher level of telecommuting. While the shift may not continue at the same pace, or become stationary, reverting back to the historical levels may require essential changes to the workers' compensation benefit system or the classification mix.

[4] WCIRB Pure Premium Rate Hearing Testimony on June 7, 2023

This shift, which has not been adjusted for, can distort both the incurred and paid development methods and may result in an overstatement of projected ultimate losses, as the development factors from older accident years represent a higher percentage of permanent disability claims compared to more recent accident years.

In addition, as noted by Bickmore during the Hearing, while such a shift affects both paid and incurred loss development methods, the incurred development method may be slightly more responsive to the shift by considering appropriate case reserves, in combination with development factors that are less leveraged, as compared to the paid method.

In consideration of the above, we believe it is appropriate to give some weight to the incurred loss development method for projecting ultimate indemnity losses in addition to medical losses in this filing. The Department has selected to give 60% weight to the WCIRB's adjusted paid development method, and 40% weight to the unadjusted latest year incurred development method for both indemnity and medical projections to ultimate. The 60/40% weight selection is consistent with the Department's recommendation in the last filing for medical development, and reflects the Department's continued higher reliance on the adjusted paid method.

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.

Similar to the WCIRB, Bickmore has selected trends separately for frequency and severity. This practice started with the January 1, 2021 filing, prior to which Bickmore had used a loss ratio trend in its indications.

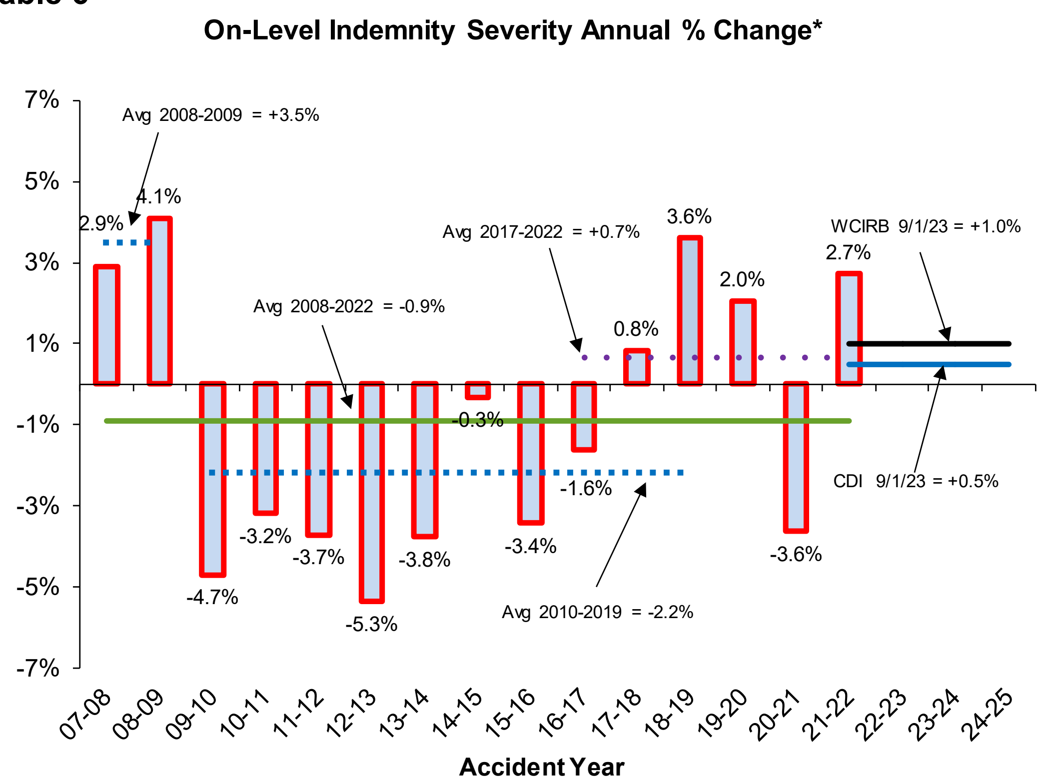
We agree with the WCIRB and Bickmore that the use of two years of experience for the application of the trend in general is appropriate, as it has outperformed alternative assumptions based on the WCIRB's most recent study.

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.

Indemnity and Medical Severity Trend

As shown in Tables 6 and 7, indemnity and medical severities experienced a high growth period prior to accident year 2010, followed by a mostly declining or low growth period over accident years 2010 through 2017. The severities after 2018 are more volatile, partly due to the distortions caused by the pandemic in more recent years, and higher than the usual proportion of large claims for 2018 and 2019 accident years.

Table 6



*Ultimate Indemnity Loss Projections are Based on Mix of Paid and Incurred Methods, and Data Evaluated as of December 31, 2022

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, 2022. The 2020 increase, which is affected by the distortions caused by the economic downturn due to the pandemic, is followed by another decrease in 2021. The 2022 accident year shows modest increase as of twelve months.

Consistent with the September 1, 2022 filing, the WCIRB-selected annual indemnity severity trend in this filing is +1.0%. Bickmore's selected annual indemnity severity trend is +0.5%, compared to the +1.0% selected in the prior filing. In his testimony during the Hearing, the public members' actuary noted the following considerations for his selection:

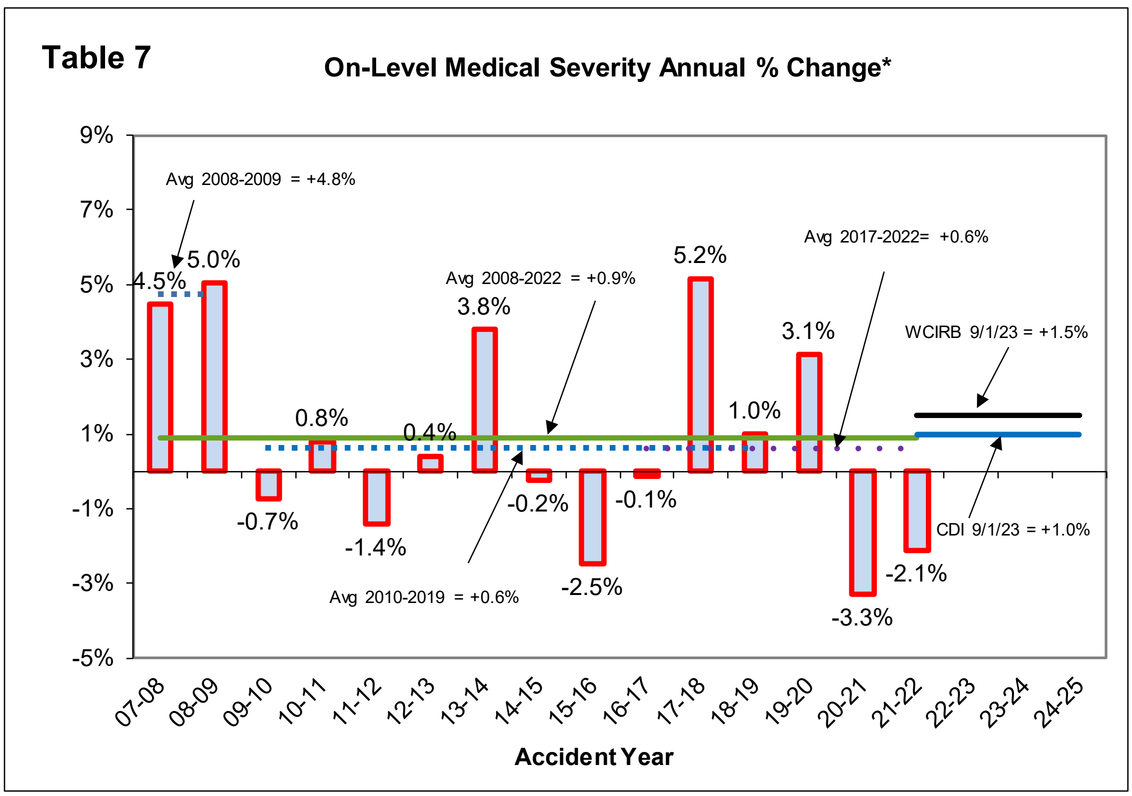
- The weekly maximum permanent disability benefits are capped at a level that is below the full-time minimum wage, which would make it highly unlikely to see any inflation on permanent disability.
- For the temporary disability, inflation above and beyond wage inflation would have to be due to an increase in temporary disability duration.

The average increase in the indemnity severity for the 2017 through 2022 period based on the Department-selected development method, which as discussed above, relies on a combination of the paid and incurred development methods, is +0.7%. The Department's selection of a +0.5% annual indemnity severity trend reflects consideration of more stable[5], or potentially decreasing, temporary disability duration that the Department's staff expects to emerge as a result of the economic rebound and recent speed up in claim closure rates, as well as the cap on the weekly maximum permanent disability benefits, noted by Bickmore.

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. The Department-selected development method, as discussed above, relies on a combination of the paid and incurred development methods. While the individual data points may differ between severity changes based on the Department-selected development and the WCIRB-selected development methods, the averages remain similar, especially for 2012 onward.

[5] The Workers Compensation Research Institute's most recent summary of California benchmarks with data through March 31, 2022 shows that temporary disability duration was relatively flat in the most current year after a sharp increase in the prior year.

The WCIRB's medical severity trend of +1.5% has been selected in consideration of both long-term and short-term trends, and is consistent with the WCIRB's selection in the September 1, 2022 filing. The WCIRB also cites the sharp growth of average medical costs in California absent reforms, in combination with the length of time since implementation of the reforms that led to the decrease in medical costs, uncertainty in whether reductions in medical utilization observed in the past and the shift toward fewer permanent disability indemnity claims will continue to offset increases in the average cost per medical service, and inflationary pressures in 2021 and 2022, which have not been fully reflected in workers' compensation medical costs due to the lag in reflecting these cost impacts in the Medicare-based fee schedules, as the basis for the selected medical severity trend.



*Ultimate Medical Loss Projections are Based on the Paid Method, and Data Evaluated as of December 31, 2022

As shown in Table 7, the ten-year average change in medical severities during the 2010-2019 period, prior to the distortions caused by the pandemic, and evaluated as of December 31, 2022, is +0.6%. Similarly, the more recent period of 2017-2022, reflects a +0.6% average change in medical severities.

Bickmore's selected annual medical severity trend is +0.5%, compared to the selected trend of +1.0% in the September 1, 2022 filing. Bickmore has noted in its written testimony that the average changes observed in medical severity for 2014-2022 of +0.5%, as well as 2018-2022 average changes of +0.8%, have been considered in its selection of annual medical severity trend.

While the Department appreciates Bickmore's view, which has also been noted by the WCIRB in the filing, that the observed medical severity trend in recent years has been on average relatively flat, the Department is also sensitive to the WCIRB's concerns about the increase in the Medicare-based fee schedules, which have not been on-leveled for.

The average change in medical severities during the 2008-2022 period evaluated as of December 31, 2022, is about +1.0%, and the accident years included in this period reflect both the pre-and post-SB 863 phases. Moreover, while the 2018 and 2020 accident years reflect relatively higher level of increases in the medical severity during the more recent period, they do not reflect a turning point in the medical cost level, as 2018 exhibits higher than usual large claims, and 2020 is distorted by the pandemic environment. In consideration of the factors stated above, and consistent with the September 1, 2022 filing, the Department is selecting a +1.0% annual medical severity trend, as shown in Table 7, for this filing.

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.

The WCIRB undertook a comprehensive review of the econometric indemnity claim frequency model in 2021, and the Department's staff appreciate the WCIRB's efforts to validate and improve the model, and the accuracy of its projections.

Table 8, 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 Table 8 are based on unit statistical plan data for 2021 and earlier periods. For 2022, 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).

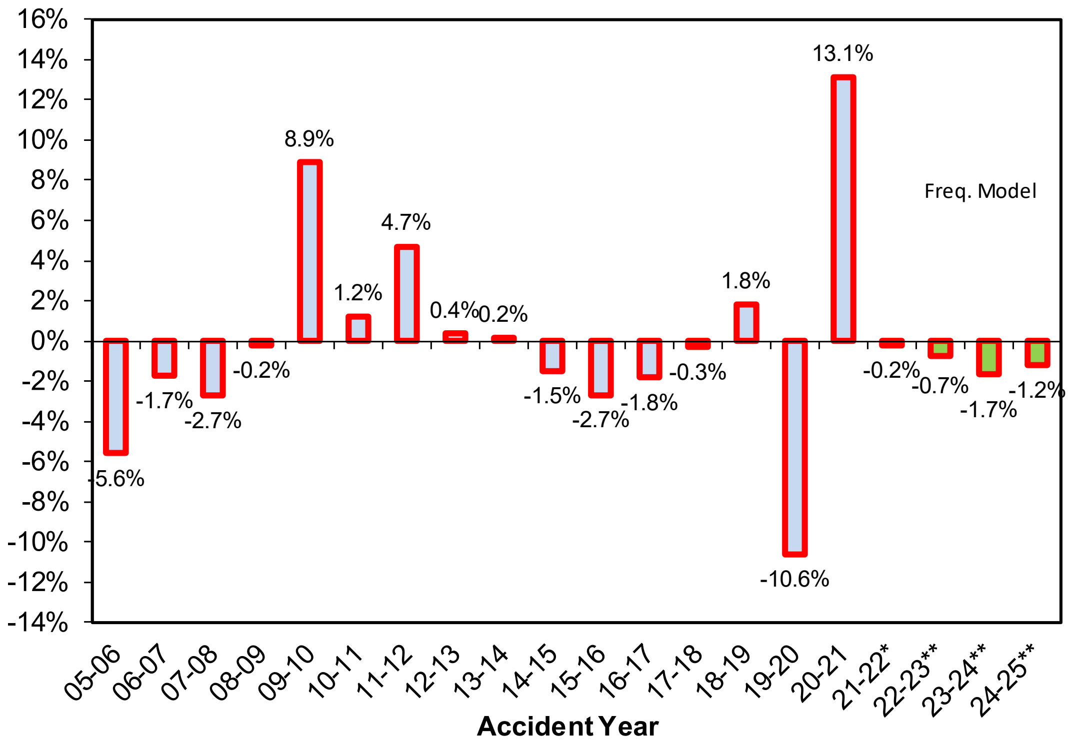
Historical indemnity frequency was generally declining for more than a decade with two exceptions. The first was the post-recession recovery period from 2010 through 2012. Such an increase could be expected during an economic recovery. The second exception was in 2021 after a sharp decline in accident year 2020. Considering the 2020 and 2021 years in combination, frequency has increased from 2019 to 2021. This is not unexpected, as the workers who had lost their jobs during the pandemic ended up in new jobs, potentially, as the economy was evolving, performing different types of work, and consequently were more likely to become injured.

The green bars in Table 8 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.

Table 8

Intra-Class Indemnity Claim Frequency Annual % Changes

As of December 31, 2022



*The 2021-2022 estimate is based on comparison of claim counts based on WCIRB accident year experience as of December 31, 2022 relative to the estimated change in statewide employment. Prior years are based on unit statistical data.
**Projections based on Frequency Model.

The WCIRB has used the 12-month frequency measure in its pure premium rate filings since 2014. Between 2014 and 2019, there had 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, due to significant differences between the model projections and the 12-month frequency measure for accident year 2020, in review of the 9/1/2021 filing, the Department staff looked into the performance of the average of the two methods compared to each of the methods. The analysis showed that although the 12-month frequency measure had performed better compared to the frequency change projected by the WCIRB's frequency model, taking an average of the two estimates of frequency change improved 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.

An update of the above analysis performed in the review of this filing shows that taking an average of the two estimates of frequency change improves all measures of performance stated above. Consequently, the Department continues to rely on the average of the two methods to determine the frequency for the 2022 accident year.

The projected frequency change for accident year 2022 based on the WCIRB's econometric claim frequency model is +4.1%. On the other hand, the estimated frequency change for accident year 2022 based on the 12-month frequency measure is -0.2%. The Department-selected frequency change for accident year 2022 is about +2.0%. For the 2023 through 2025 accident years, the Department relies on the WCIRB's econometric indemnity claim frequency model, which projects an average decline in frequency of about 1.2% per year.

Like the WCIRB, Bickmore uses the 12-month frequency measure for the 2022 accident year frequency change projection of -0.2%. For the projections of the 2023 through 2025 frequency changes based on the WCIRB econometric model, consistent with the 9/1/2022 filing, Bickmore utilizes the full constant determined by the model of -3.1%, as opposed to the tempered constant of -2.0% utilized by the WCIRB during the last decade or so. Consequently, Bickmore's projected annual frequency changes reflect higher level of decline by about 1.1% for each of the 2023 through 2025 accident years.

3. Loss Adjustment Expenses

In its determination of the provision for LAE in the proposed rates, the WCIRB develops 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.

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 9. Compared to the

September 1, 2022 filing, ALAE and MCCP have decreased as a percentage of losses, while ULAE has increased.

Table 9 LAE Provision Underlying WCIRB Pure Premium Rate Filings

	9/1/22 Filing		9/1/23 Filing	
(ALAE ex/MCCP)/Loss	14.3%		14.0%	
MCCP/Loss	3.9%		3.3%	
Total ALE/Loss	18.2%	$0.21	17.3%	$0.20
ULAE/Loss	14.2%	$0.16	14.4%	$0.16
Total LAE/Loss	32.4%	$0.37	31.7%	$0.36
Indicated Pure Premium Rate*		$1.55		$1.50

*Excluding COVID-19 Adjustment

The projected LAE as a percentage of losses in the Department's analysis is 32.8%, compared to the WCIRB's selection of 31.7%. The higher LAE ratio is partially attributable to lower ultimate loss in the denominator. The Department's selection of a higher frequency trend for the 2022 accident year also projects slightly higher overall expenses. Consequently, the Department's projected LAE-to-loss ratio is higher than the projection by the WCIRB.

Bickmore highlighted two main differences in its assumptions from the WCIRB's in its written testimony. First, Bickmore has lower projected losses which increase the ratio by impacting the denominator. Second, Bickmore projected a lower indemnity count based on a lower frequency trend. The combined impact is an LAE-to-loss ratio at 33.6%, which is higher than the WCIRB's.

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 LAE components provides comparable bases for a determination of the LAE-to-loss ratio, and the Department's staff agree with this approach.

The Department's staff believe 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.

ALAE

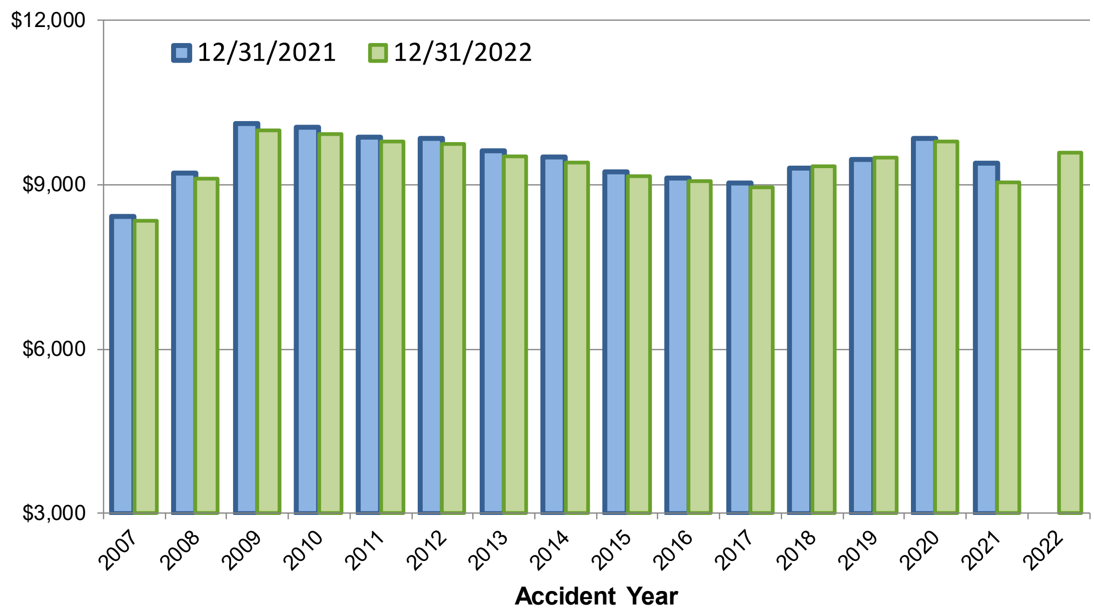
The WCIRB projects the ALAE-to-loss ratio using a methodology that projects future ALAE as the product of the anticipated future statewide number of indemnity claims and average private insurer ALAE per indemnity claim, which is consistent with the methodology reflected in the latest several pure premium rate filings.

The WCIRB's projection of ultimate ALAE follows a similar methodology to projection of ultimate loss. The paid method is used to develop ALAE to ultimate. Latest age-to-age factors are selected as loss development factors. Separate frequency and severity trends are applied to accident years 2021 and 2022 indemnity claim count and average ALAE per indemnity claim. The same frequency trend used in the loss projection is used in the ALAE projection. The WCIRB-selected annual ALAE severity trend in this filing is +0.5%, compared to +1.0% selected in the September 1, 2022 filing.

The Department's staff is selecting an average ALAE per indemnity claim 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 +0.5%, compared to +0.65% selected in the September 1, 2022 filing.

Table 10 below shows the ALAE per indemnity claim by accident year, as well as the comparison of Ultimate ALAE per indemnity claim evaluated at December 31, 2021 and December 31, 2022.

Table 10 Estimated Ultimate ALAE Per Indemnity Claim - Private Insurers



After a period of rapid increase, the estimated ultimate ALAE per indemnity claim showed a slight year-over-year decline from 2010 to 2017. The pattern was reversed in accident year 2018 and the estimated ultimate ALAE per indemnity claim seems to be increasing between 2018 and 2020 per the current evaluation. The 2021 accident year appears to revert back to the 2017 level, but the 2022 accident year shows another uptick, that based on the pattern that had become the norm prior to the pandemic, may decline as the accident year matures.

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.

In 2019, the WCIRB studied the potential impact of claim settlement rate changes on paid ALAE development. It determined 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. For example, during a period of significant claim settlement increase, the WCIRB's study found that future paid ALAE development for that accident year emerged lower than otherwise projected. As a result, the WCIRB started to reflect an adjustment to paid ALAE development for the impact of claim settlement rate changes.

As a follow-up to that study, in 2020, 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%.

In this filing the WCIRB incorporated an adjustment to the ALAE age-to-age development factors for accident year 2021 because there was a more than 1.5% increase in claim settlement rates at 24 months.

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.

Similar to the recent filings, 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 84% to 1.8% to reflect the impact of the reforms that are not yet reflected in the emerged ALAE data as of December 31, 2022.

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.

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 (except for accident year 2020, which is distorted by the pandemic), despite the adjustments that the WCIRB has made.

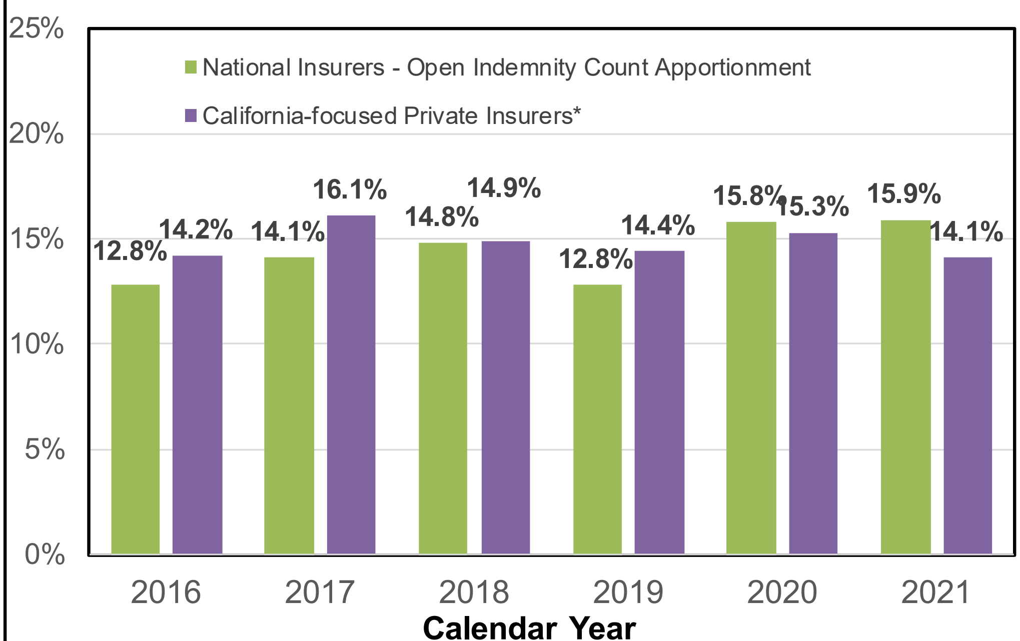
Moreover, the overstatement in the average ALAE per indemnity claim can also result in an overstatement of the implied annual trend, as the decline in average ALAE appears to be higher for less mature accident years. As an example, the 2021 accident year average ALAE declined by 3.8% between the 12/31/2021 and 12/31/2022 evaluations, and accident years 2014 through 2019 average ALAE estimates, declined by an average of about 5% between 12/31/2020 and 12/31/2021 evaluations.

ULAE

As in the last several pure premium rate filings, the WCIRB based the ratio of ULAE- to-paid loss on the average of (1) a method that relates ULAE to the number of open indemnity claims, and (2) a method that relates ULAE to paid losses. In 2020, the WCIRB conducted a study of these approaches and found that paid ULAE amounts continue to be correlated with both open indemnity claim counts and paid loss amounts.

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. While between 2016 and 2019, the ULAE ratios for national insurers were slightly below the California-focused insurers, in 2020 and especially 2021 calendar years this relationship has been reversed.

Table 11 **Ratios of Paid ULAE to Paid Losses**

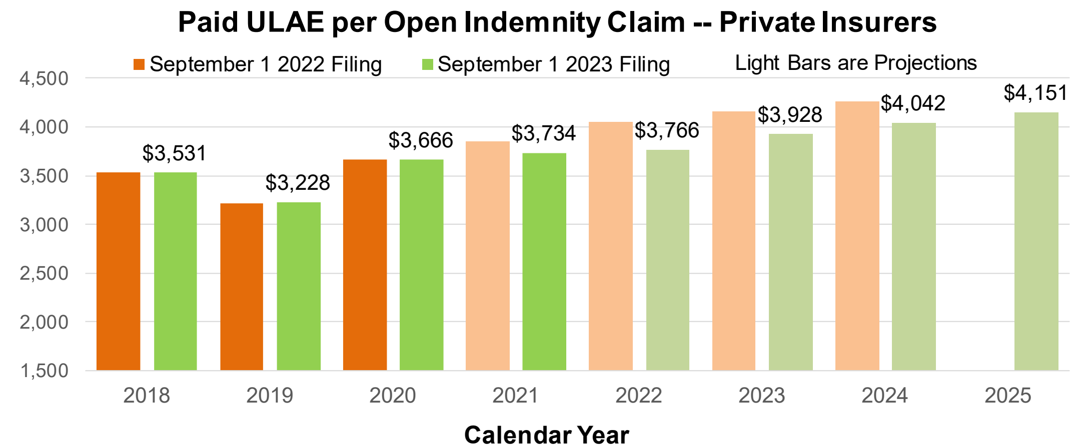


Source: WCIRB expense calls and quarterly calls for experience.
*California-focused Private Insurers are insurers with at least 80% of their workers' compensation writings in California.

The WCIRB's 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.

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 for the September 1, 2022 filing, and the ULAE severities for the 2019 and 2021 calendar years for the current filing. The light orange bars reflect projections for the September 1, 2022 filing, and the light green bars reflect projections for the current filing. The actual 2021 and the projected 2022 through 2024 paid ULAE per open indemnity claims are somewhat lower compared to the projections in the prior filing.

Table 12



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

Table 13, below, compares the WCIRB's ULAE projections based on the two methods utilized by the WCIRB for prior and current filings. The paid ULAE per indemnity claim method increased by one point between the September 1, 2021 and September 1, 2022 filings, but has remained stable between September 1, 2022 and the current filings. Given that ULAE on COVID-19 claims cannot be separated from other ULAE amounts, the 2020 ULAE is likely impacted by the pandemic. Consistent with the prior filing, the WCIRB is not using the 2020 data as the basis for the projections. As noted above, projections of future average ULAE per open indemnity claim are based on calendar years 2019 and 2021.

Table 13

Method	September 1, 2021 Filing ULAE Projection	September 1, 2022 Filing ULAE Projection	September 1, 2023 Filing ULAE Projection
Paid ULAE per Open Indemnity Claim	13.5%	14.5%	14.4%
Paid ULAE to Paid Losses	14.0%	13.9%	14.3%
Average of Two Projection Methods	**13.7%**	**14.2%**	**14.4%**

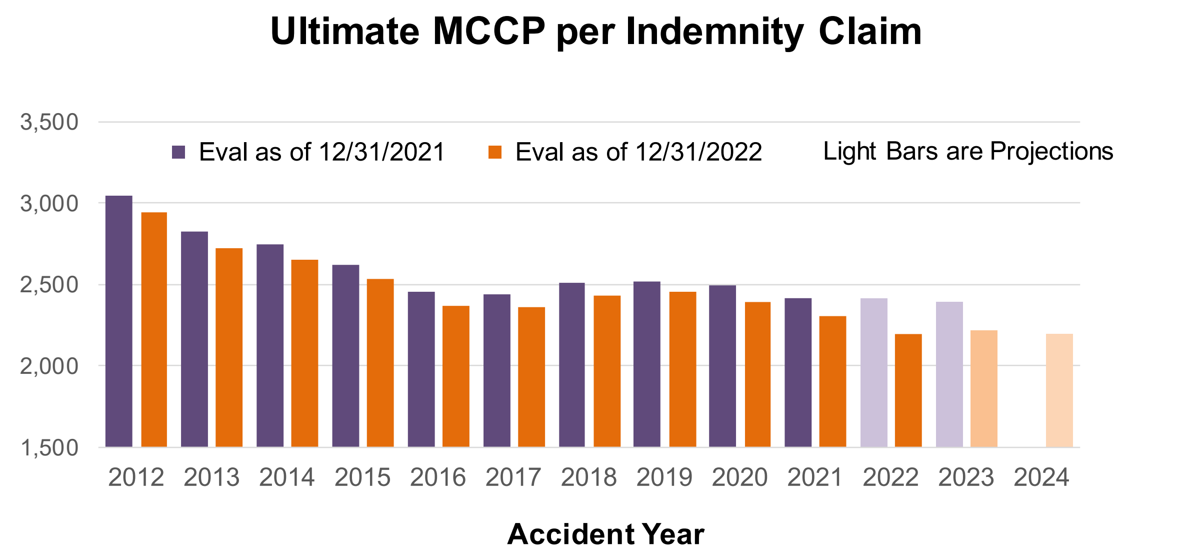
MCCP

The WCIRB's methodology used to project MCCP costs is very similar to its methodology used to project ALAE. It applies, to the accident years 2021 and 2022, (1) frequency trends to ultimate indemnity claim counts, and (2) severity trends to the ultimate MCCP per indemnity claim.

The WCIRB's selected MCCP severity annual trend is -1.0%, which is consistent with the prior filing and the CDI and Bickmore selected trend.

The period between 2012 and 2017, as shown in Table 14, shows a steady decline in ultimate MCCP per indemnity claim. Following the 2018 and 2019 increases, the average MCCP per indemnity claim is showing a declining pattern for the 2020 through 2022 accident years as of 12/31/2022. This decline has also led to lower projections compared to the prior filing as shown in comparison of the light bars in the graph.

Table 14



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

4. Impact of legislative, regulatory, and judicial actions

Official Medical Fee Schedule (OMFS)

Effective March 1, 2021, the DWC adopted significant changes to the Evaluation & Management (E&M) section of the OMFS related to office visits. These medical fee schedule changes impact medical services on a date-of-service basis rather than an accident date basis. In the September 1, 2021 Pure Premium Rate Filing, the WCIRB prospectively estimated that these changes would increase E&M office visit service costs by 15%.

The WCIRB performed a retrospective evaluation of the March 1, 2021 OMFS changes based on medical payments made subsequent to implementation of the changes in 2022. The review showed that E&M office visit service costs increased by 10% compared to the 15% reflected in the WCIRB's prospective estimate, resulting in an approximate 1.6% increase in total medical costs compared to the +2.4% in the initial estimate.

Given the date-of-service basis of these changes, the WCIRB is reflecting the impact of the most recent retrospective cost estimates for these fee schedule changes in adjustments to the medical loss development projection for accident years 2013 and later, and in on-level factors for accident years 2012 and prior.

Medical-Legal Fee Schedule (ML)

Effective April 1, 2021, the DWC adopted a significant update to the Medical- Legal Fee Schedule (MLFS). In the September 1, 2021 Pure Premium Rate Filing, the WCIRB prospectively estimated that the April 1, 2021 changes to the MLFS would increase medical-legal service costs by 22%.

The WCIRB performed a retrospective evaluation of the April 1, 2021 MLFS changes based on payments made during the first nine months the new MLFS was in effect, in 2022. The review showed that medical-legal costs increased by 39% compared to the 22% reflected in the WCIRB's prospective estimate, resulting in an approximate 2.5% increase in total medical costs, compared to the initial estimate of 1.4%.

Earlier this year the WCIRB performed an updated retrospective evaluation of the MLFS changes, which showed that medical-legal costs have increased by 50% since the implementation of the new fee schedule, which was higher than the earlier estimates and results in an approximate 3.2% increase in total medical costs. The sharp increase in medical-legal costs has been primarily driven by a significant increase in the costs for record review and, particularly within the last year, an increase in the utilization of medical-legal services per claim.

Given that the impact of these changes varies depending on the age of the claim, the WCIRB is reflecting the impact of the most recent retrospective cost estimates for these fee schedule changes in adjustments to the medical loss development projection for accident years 2013 and later, and in on-level factors for accident years 2012 and prior.

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

The WCIRB has been persistently evaluating impact from legislative changes and judicial actions. For details of the changes as well as the adjustments regarding these legislative changes, please reference pages 34-38 of the Proposed Decision and Order for the September 1, 2021 filing.

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 $1.46 per $100 of employer 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, 2023. 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 $1.46 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, 2023 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, 2023, 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 7, 2023

Yvonne Hauscarriague

Yvonne Hauscarriague
Attorney V

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

DECISION AND ORDER

SEPTEMBER 1, 2023 WORKERS' COMPENSATION CLAIMS COST BENCHMARK AND ADVISORY PURE PREMIUM RATES

FILE NUMBER REG-2023-00006

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-2023-00006. The benchmark will be effective on **September 1, 2023**.

DECISION AND ORDER

I adopt the Proposed Decision and Order of Yvonne Hauscarriague dated July 7, 2023, and direct the WCIRB to adopt an average advisory claims cost benchmark of $1.46 per $100 of employer payroll and adjust the pure premium rates for individual classifications based upon this benchmark.

IT IS SO ORDERED THIS 11th DAY OF JULY, 2023.

RICARDO LARA
Insurance Commissioner