

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE**

In the Matter of: Proposed adoption or amendment of the Insurance Commissioner's regulations pertaining to the Workers' Compensation Insurance Claims Cost Benchmark and pure premium rates. These regulations will be effective on **July 1, 2015**.

FILE NUMBER REG-2015-00005

DECISION AND ORDER

California's workers' compensation insurance system is unique when compared to other states. Insurance companies are largely free to set prices as they see fit and competition between those companies is intended to control pricing. The purpose of the pure premium benchmark rate process is to review the costs in the workers' compensation insurance system and to determine a set of advisory pure premium rates that are reasonably predictive of the cost projections for the next year. The Department of Insurance does not set workers' compensation insurance rates. The pure premium rate review is intended to confirm that rates filed by insurance companies are adequate to cover benefits for injured workers and to provide for reasonable claims adjustment expenses. The "pure premium rate" is the rate needed to cover the cost of benefits and adjustment expenses.

The Workers' Compensation Insurance Rating Bureau ("WCIRB") submitted its July 1, 2015 pure premium rate filing and indexed it to current insurance company rate filings and pricing for workers' compensation insurance. Without changing its process for analyzing workers' compensation costs, the WCIRB now provides additional important information not included previously with its pure premium rate filings, including insurers' own cost estimates in their rate filings and the average premiums insurers charge employers. As a result, we now have a better picture of the workers' compensation insurance market and are able to provide additional information about cost trends to employers, workers' compensation insurance companies, and the general public.

The Department of Insurance reviewed the data supplied by the WCIRB as well as testimony and information submitted as a part of the public hearing held on the WCIRB pure premium rate filing. The Department of Insurance analyzed both current costs and trends in the workers' compensation insurance system. The Department of Insurance analysis is set forth in the Proposed Decision and Order, which is attached. After reviewing the Proposed Decision, I make the following determination:

Approved Advisory Claims Cost Benchmark and Pure Premium Rates

The WCIRB is directed to adopt an Advisory Claims Cost Benchmark at \$2.46 per \$100 of employer payroll, and pure premium rates for individual classifications shall be adjusted based upon the classification relativities reflected in the WCIRB's filing in accordance with the adjustment of the Benchmark. The WCIRB, the Department of Insurance, and the Public Members of the WCIRB, all presented pure premium rate proposals that fall within a narrow range. These proposals are all within a reasonable actuarial range.

The WCIRB recommended a pure premium rate of \$2.46 per \$100 of employer payroll. The Public Members' actuary recommended as its middle range a rate of \$2.43 per \$100 of payroll. The Department of Insurance, after a full public hearing and review of the testimony and evidence submitted, recommends adoption of a pure premium rate of \$2.46 per \$100 of employer payroll. For the reasons set forth in the Proposed Decision, I agree with the Department of Insurance's proposed pure premium rate level recommendation, which equals the recommendation of the WCIRB and differs slightly from the recommendation of the Public Members' actuary.

Workers' Compensation Pricing

The WCIRB's filing for July 1, 2015 demonstrates that insurers continue to charge premiums that are close to the estimated cost of providing benefits and adjusting expenses. The rates actually charged to employers, however, are lower on average than the filed rates.

The fact that insurers are substantially discounting their manual rates has helped to keep workers' compensation insurance prices lower, despite increasing costs. Our review of the California workers' compensation insurance industry's profitability indicates that the pricing environment continues to benefit from substantial investment income relating to substantially higher premiums in prior years and associated reserves, resulting in an average market price level that is below what may be sustainable without this underlying level of support. However, the average charged rate in 2014 of \$2.93 appears much stronger relative to the WCIRB's July 1, 2015 indicated pure premium rate of \$2.46. If lower pure premium rates are maintained in future filings, it appears that charged rates may be approaching long-term sustainable levels.

Impact of SB 863

We are now observing medical loss experience that appears to be consistent with anticipated projections regarding savings under Independent Medical Review ("IMR"). Due to delays in the IMR process, however, we are uncertain whether indications will hold up in the long term. I have instructed the WCIRB to continue to study the effect of the IMR process on system costs in

California. I look forward to evaluating the WCIRB's findings as a result of this study and will carefully consider those findings when considering the impact of SB 863 in future pure premium decisions.

ORDER

I adopt the Proposed Decision and Order of Hearing Officer Patricia Hein dated May 7, 2015, and direct the WCIRB to adopt an average Advisory Claims Cost Benchmark of \$2.46 per \$100 of employer payroll and adjust pure premium rates for individual classifications based upon this Benchmark.

IT IS SO ORDERED THIS 7th DAY OF MAY, 2015.



DAVE JONES
Insurance Commissioner

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

PROPOSED DECISION

**JULY 1, 2015 WORKERS' COMPENSATION CLAIMS COST BENCHMARK
AND PURE PREMIUM RATES**

FILE NUMBER REG-2015-00005

In the Matter of: Proposed adoption or amendment of the Insurance Commissioner's regulations pertaining to the Workers' Compensation Insurance Claims Cost Benchmark and pure premium rates. These regulations will be effective on July 1, 2015.

SUMMARY OF PROCEEDINGS

The California Department of Insurance ("CDI") held a public hearing in the above captioned matter on April 30, 2015, at the time and place set forth in the Notice of Proposed Action and Notice of Public Hearing, File Number REG 2015-00005, dated April 6, 2015 and sent on April 7, 2015 ("Notice"). A copy of the Notice is included in the record. The record closed on May 1, 2015, at 5:00 p.m.

The CDI 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 Insurance Commissioner in connection with the proposed changes. The "Filing Letter" dated April 6, 2015, submitted by the Workers' Compensation Insurance Rating Bureau of California ("WCIRB") and related documents were available for inspection by the public at the Sacramento office of the CDI and were available online at the WCIRB website, www.wcirb.com.

The WCIRB's filing proposes a change in the Workers' Compensation Claims Cost Benchmark and Pure Premium Rates ("Benchmark") in effect since January 1, 2015, that reflects insurer loss costs and loss adjustment expenses ("LAE").

The filing of the WCIRB requested the Commissioner adopt a set of pure premium rates for each classification to be effective July 1, 2015, due to loss and loss adjustment expense experience. In its filing, the WCIRB recommended an average pure premium rate of \$2.46 per \$100 of payroll, which is 5% less than the average pure premium rates California insurers filed as of January 1, 2015.

The CDI accepted testimony and written comments at a hearing in San Francisco on April 30, 2014, 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 the record would close on May 1, 2015. After the hearing and before closure of the record on May 1, 2015, CDI received into the record additional comments from the California Applicants' Attorneys Association and Pacific Compensation Insurance Company. The matter was submitted for decision at 5:00 p.m. on May 1, 2015. Having been duly heard and considered, the CDI now presents the following review, analysis, and Proposed Decision and Proposed Order.

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

Subdivision (b) of California Insurance Code Section 11750 states the Insurance Commissioner shall hold a public hearing within 60 days of receiving an advisory pure premium rate filing made by a rating organization pursuant to subdivision (b) of Insurance Code Section 11750.3 and either approve, disapprove, or modify the proposed rate. Subdivision (b) of Section 11750.3 states 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 are not inadequate to maintain the financial solvency of the insurer.

CDI Actuaries Ron Dahlquist and Giovanni Muzzarelli provide below in the Actuarial Evaluation a review and analysis based upon the new filing information presented by the WCIRB and the public's comments about the filing. The CDI's actuarial review essentially follows the same approach used for prior pure premium rate filings, but the CDI is now able to review the proposed pure premium rates based upon insurers' actual 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 purpose of the pure premium process is narrowly tailored to project a specific sub-component of the overall rate. Specifically, the analysis of pure premium in California projects the cost of benefits and LAE for the upcoming policy period beginning July 1, 2015. The term "rate" can be confusing in the pure premium rate context since it is a measurement of claim cost per hundred dollars of employer payroll rather than the rates insurers may charge. The information provided in the current filing shows the following:

- Based upon a review of insurance company rate filings made with the CDI, as of January 1, 2015, insurers are using an average pure premium rate level that is \$2.59 per \$100 of employer payroll. This figure is higher than the WCIRB's recommended pure premium rate level of \$2.46.
- 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 pure premium rate level of \$2.46 per \$100 of payroll in its July 1, 2015 rate filing. CDI staff actuaries' analysis also results in an average pure premium rate level of \$2.46 per \$100 of payroll for reasons set forth in the "Actuarial Evaluation" section that follows. The current industry average level of pure premium rates filed by insurers with the Department is currently \$2.59 per \$100 of payroll as of January 1, 2015. While the indicated pure premium rate level represents our central estimate, and thus our recommendation, we note that both the WCIRB pure premium rate proposal and the middle estimate of \$2.43 from the Public Actuary ("Bickmore") are within a reasonable actuarial range.

This WCIRB filing compares its proposed average pure premium rate level to the average industry filed pure premium 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 the WCIRB proposed 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. Insurers have proven their willingness over time to exercise their own independent judgment, and we cannot predict the decisions insurers will make with respect to their rate and price levels.

We note that the market currently utilizes a substantial level of schedule credits, averaging something on the order of 20% of manual premium. Collected premiums at actual charged rates in 2014 of \$2.93 were on average only approximately 6% more than the WCIRB's January 1, 2015 recommended advisory pure premium rates of \$2.77, suggesting a high level of competition in the market since advisory pure premium rates make provision only for losses and loss adjustment expenses, and not for other company expenses. Our review of the California workers' compensation insurance industry's profitability indicates that the pricing environment continues to benefit from substantial investment income relating to substantially higher premiums in prior years and associated reserves, resulting in an average market price level that may be below what would be sustainable without this underlying level of support. However, the average charged rate in 2014 of \$2.93 appears much stronger relative to the WCIRB's July 1, 2015 indicated pure premium rate of \$2.46. If lower pure premium rates are maintained in future filings, it appears that charged rates may be approaching long-term sustainable levels.

Actuarial Evaluation

The actuarial evaluation will focus on four main components of the analysis: 1) Loss Development, 2) Loss trends, 3) LAE (Loss Adjustment Expense) provision, and 4) the impact of Senate Bill 863.

1. Loss Development

The WCIRB utilizes a range of actuarial methods to develop estimates of the medical and indemnity components of ultimate loss. For the July 1, 2015 filing, these various methodologies produced a range from \$2.39 per \$100 payroll to \$2.51 per \$100 payroll, relative to the WCIRB's actuarially indicated rate of \$2.46. We note the substantial reduction in this range versus the prior filing and discuss potential issues later in this section.

As shown in Table 1, these methods can be categorized into two main types: paid methods and incurred methods. The paid methods reflect historical payments by accident year, with the various alternative indications reflecting the latest year paid development

versus the most recent 3-year average, with and without adjustments for changes in insurer mix, and with and without adjustments for reform and for changes in claim settlement rate. Generally the paid methods have performed the best in terms of stability and accuracy.

Incurred methods reflect historical loss payments plus associated case reserves. Due to changes in case reserving practices over time within a given insurer and changes in insurer mix, the incurred methods generally do not produce results that are as stable or accurate as those produced by the paid methods, and thus are not given any weight in the selection process. These methods include a review of latest year versus the most recent 3-year average, and with and without adjustments for changes in insurer mix and changes in case reserve adequacy.

The CDI and the Public Members' actuaries agree with the indications developed by each of the methodologies. However, the Public Members' actuary's selected point estimate reflects a weighted average of the paid and incurred methods, whereas the WCIRB selected as its loss development assumption the "latest year paid, adjusted for reform" method.

While the CDI staff shares the Public Members' actuary's concern regarding the recent history of unstable loss development, we support the use of the paid methodology by the WCIRB due to the aforementioned relative historical stability and accuracy. Further, in this filing, the WCIRB adjusted its paid methodology to increase expected future medical loss development for more mature evaluation periods, which the WCIRB anticipates will reduce subsequent adverse loss development of medical loss ratios for more recent accident years.

Also shown in Table 1 is a comparison of the ranges of the various methods from the 1/1/15 filing versus the current filing. The range for both the paid indications and the incurred indications are much lower than in the prior filing. The reduction is primarily driven by continued improvement in medical loss ratio development as shown in Table 2. Further, the medical loss ratio for Accident Year ("AY") 2014 is emerging even lower than expected, which is important because the pure premium rate selected by the WCIRB is driven in large part by the loss ratios for AY's 2013 and 2014.

We do note one concern, however; the possibility that reported delays in the Independent Medical Review ("IMR") process could be slowing down the loss development process, thereby causing distortions in both the paid and incurred development methods. While there is little or no evidence in the form of an observed slowdown in claim settlement rates to support this hypothesis, it is quite possible that interim or partial payments could

be slowed down without claim closings being affected. It is also possible that establishment of more accurate case loss reserves could be delayed as IMR reviews were delayed; a slowdown in the overall process could be expected to slow down the flow of information as well as the flow of payments.

We do not think these concerns warrant explicit modification to the WCIRB’s methodologies at this time; but rather, they can be considered as supporting the use of the averages of the on-level medical loss ratios for Accident Years 2013 and 2014 as the basis for the selected medical loss ratio used in the determination of the filed pure premium rate.

If we had full confidence in the developed medical loss ratio for Accident Year 2014, we would give it 100% weight in our evaluation of the prospective medical loss ratio, since it provides us with our first look at experience after the full implementation of SB 863. Due to the issue mentioned above, as well as a more general concern that we have not seen enough experience post-SB 863, we believe it is more appropriate to rely on the averaging of 2013 and 2014, as the WCIRB has done.

Table 3 displays the relative impact of these issues.

Table 1

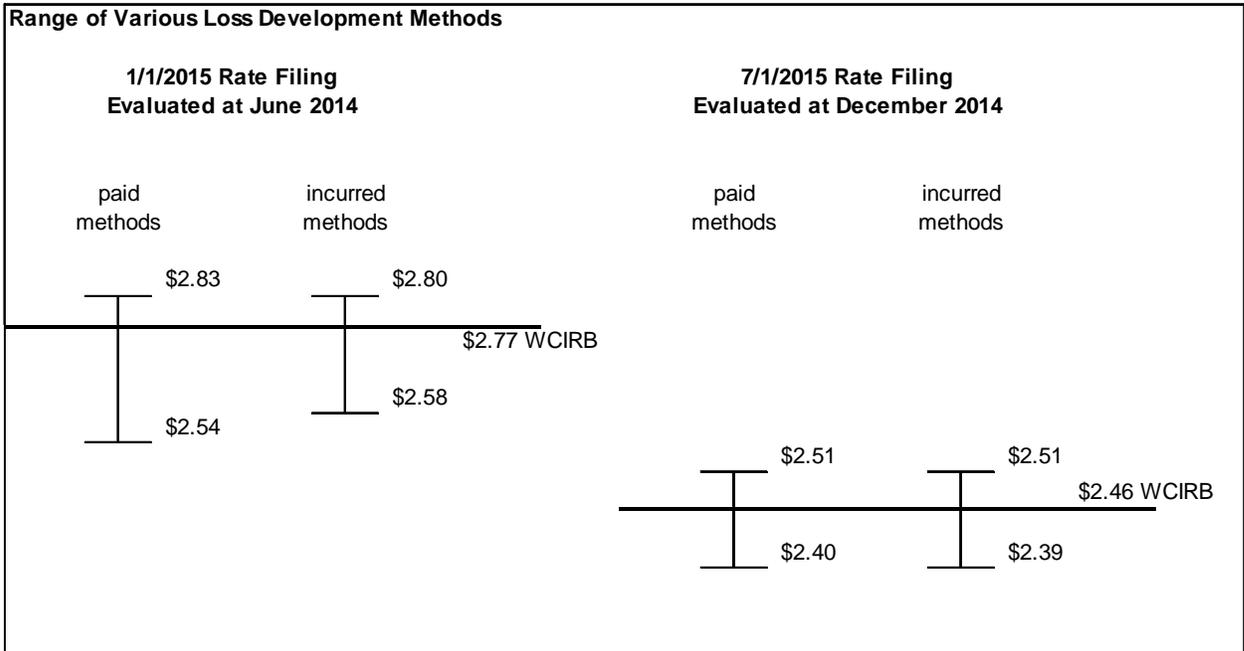


Table 2

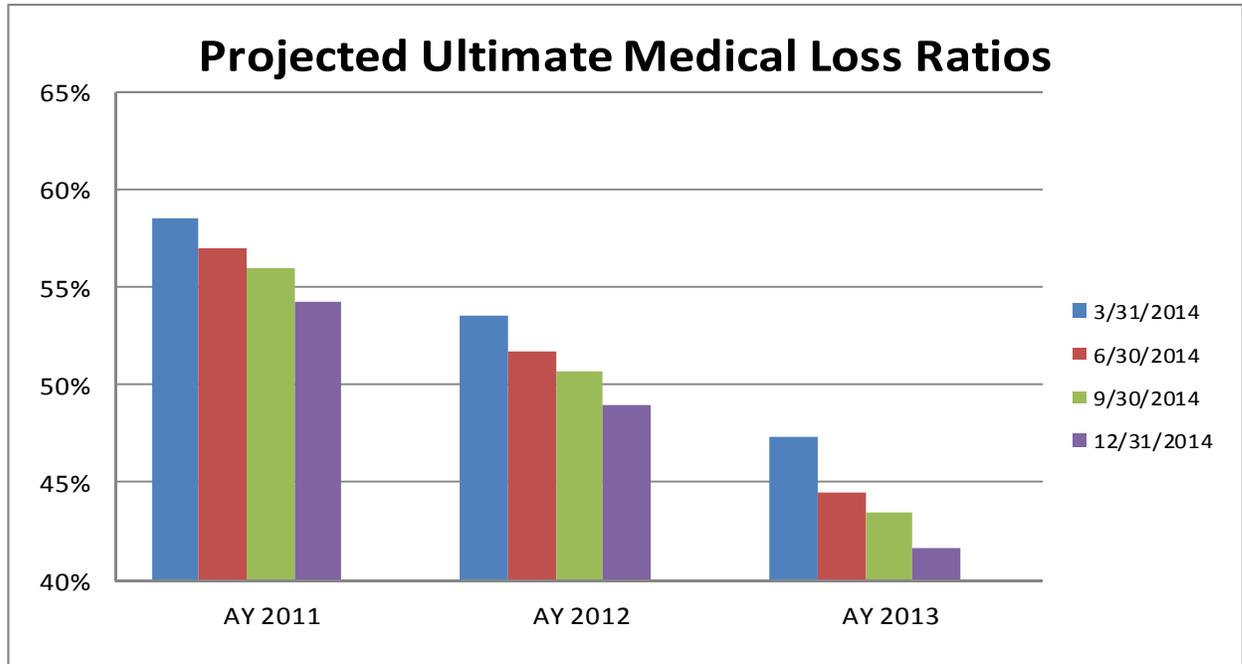


Table 3

WCIRB 7/1/15 PP Rate Filing							
Summary of Impacts on PP Rate Indications							
	(1)		(2)		(3)		(4)
	<u>WCIRB</u>		<u>CDI</u>		<u>Bickmore*</u>		<u>Industry Filed</u>
A. Actuarial Indication @ 1/1/15 Filing	2.77		2.74		2.69		
B. Adjusted for class mix (n/a for mid-yr)	2.77		2.74		2.69		2.59 at Jan 1, 2015
C1. Expected change due to loss inflation updated trend impact	0.03 (0.06)		0.03 (0.06)		0.03 (0.06)		
C2. Change in loss experience loss development	(0.11)		(0.11)		(0.11)		
AY 2014 replacing AY 2012	(0.18)		(0.15)		(0.13)		
LAE	0.01		0.01		0.01		
C3. Change in methodology							
C4. Change in SB 863 assumptions	0.00		0.00		0.00		
D. Actuarial Indication 1/1/15 (= B+C1+C2+C3+C4)	2.46	-5.0% -10.2% -11.2%	2.46	-5.0% -10.2%	2.43	-6.1%	% chg vs Industry Filed % chg vs prior CDI % chg vs prior WCIRB
E. Total SB 863 Impact							
Explicit assumptions	(0.02)		(0.05)		(0.22)		
Implicit with AY 2014	(0.08)		(0.05)				
F. Actuarial Indication 7/1/15 ex/ SB 863 (= D-E)	2.56		2.56		2.65		

2. Loss Trends

The WCIRB utilizes a range of trending assumptions to roll-forward the estimates of ultimate losses developed above to the time period reflected in the filing.

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

As shown in tables 4 and 5, indemnity and medical severity trends over the most recent time frame (2010-2014) have decreased relative to longer-term historical averages (2006-2009), discussed further following the severity and frequency slides.

Table 4

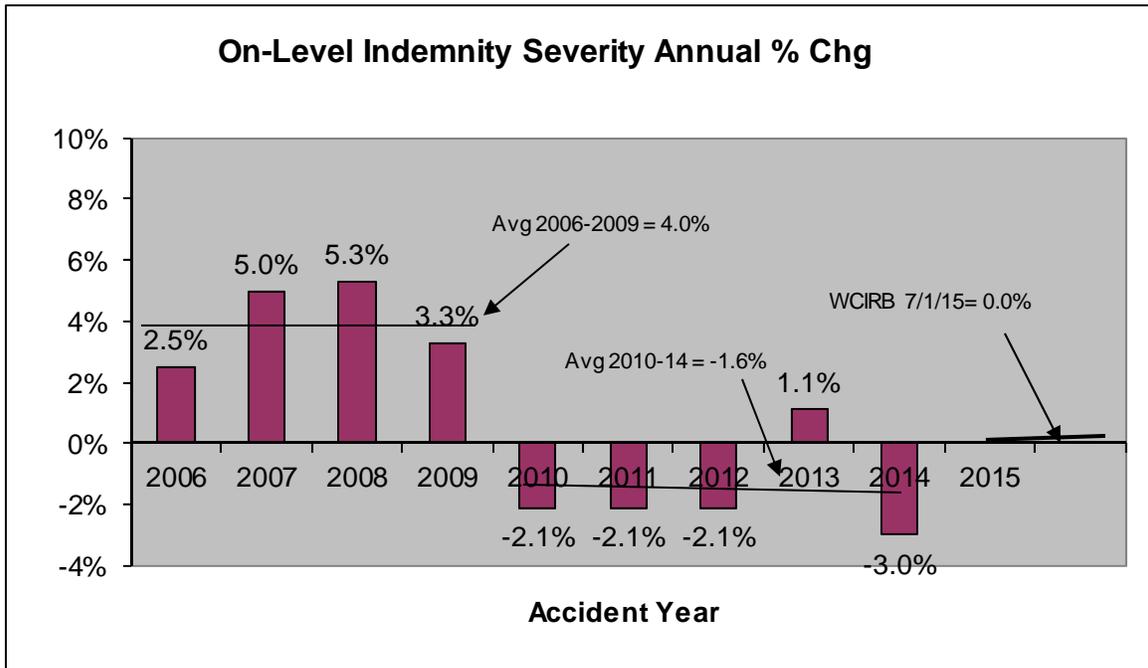


Table 5

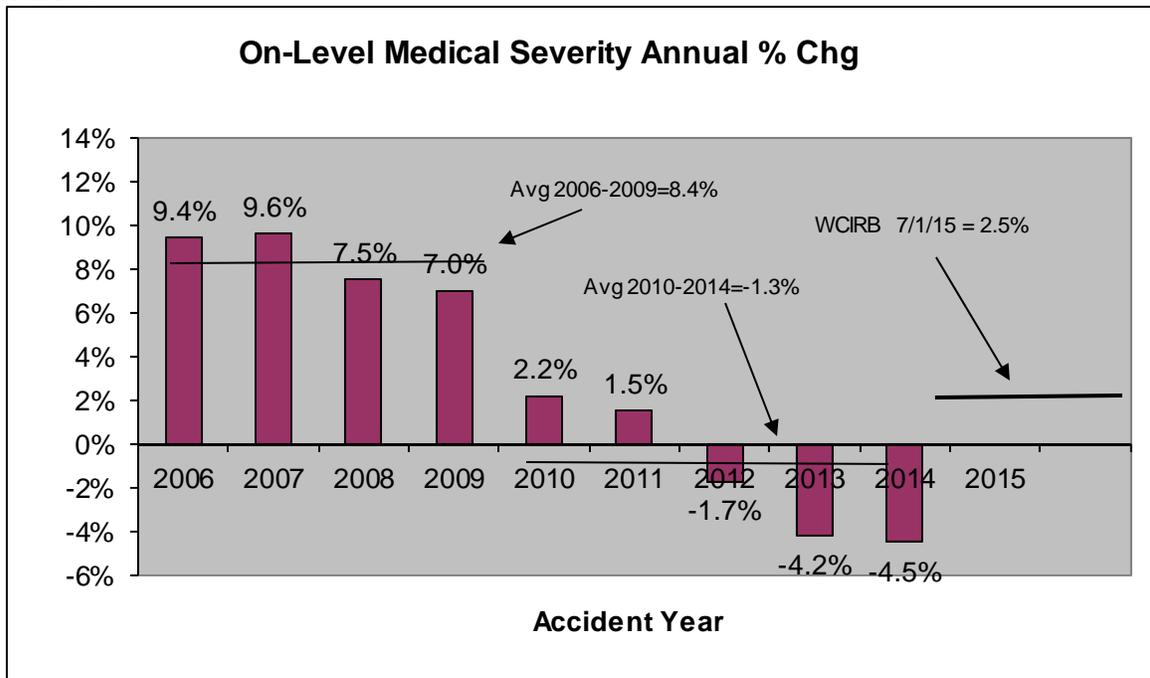
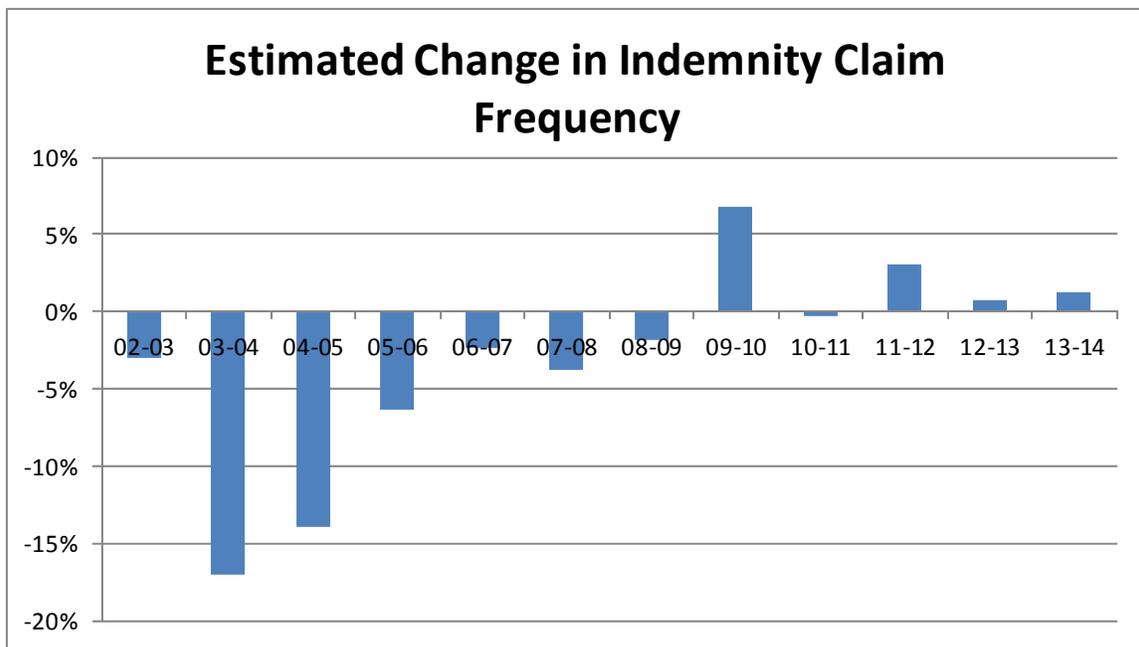


Table 6



We note that the low to negative severity changes indicated for accident years 2010 through 2014 are driven by the unusual increases in frequency shown in Table 6 above in 2010-2014. The WCIRB is performing ongoing analysis to help determine the driver(s)

of this frequency increase. One possible explanation is that this is a result of an increase in small claims that previously were medical-only claims, possibly connected to the state of the economy. The National Council on Compensation Insurance (“NCCI”), which provides data collection and rate development for approximately 35 states and performs a role similar to the WCIRB in California, has noted this increase in frequency nationwide. A second driver may be an observed increase in cumulative injury claims, where claims are made with multiple body parts and can include a psychiatric component.

One public comment received during the hearing for the 1/1/2015 filing stated a concern that the WCIRB was selecting going-forward trends for both indemnity and medical severity that appear high relative to the most recent accident years. The commenter observed that the recent increase in cumulative injury claims, which may be contributing to the increase in frequency, has reached a plateau and thus would have no further impact on the trend going forward. However, the same commenter supports the selection of the 2.5% medical trend in this filing, which while lower than the 4.0% selected in the prior filing, is still somewhat above recent historical observations. CDI agrees with the WCIRB’s rationale that recent negative trends have occurred as a result of SB 863 impacts which have resulted in a downward shift in the cost curve, and going forward we should expect a return to modest positive medical inflation in excess of wage growth.

The main difference of opinion on the trend issue between the Public Members’ actuary and the WCIRB is the use of separate indemnity and frequency trends versus a combined pure premium trend. The WCIRB applies separate trends as previously described, whereas the Public Members’ actuary suggests using a combined trend to limit the impact of the increased frequency of small claims in recent AYs. As shown in tables 7 and 8 below, the result of the separate trends is a very reasonable continuation of the loss ratio trend for both indemnity and medical, and CDI concurs with the WCIRB’s approach.

While we agree with the Public Members’ actuary that stability is desired and that the Public Members’ approach is more stable, we are concerned that we are in a period of change in which responsiveness to changing conditions is of greater than usual importance. The separate severity and frequency trends are telling us that the environment is changing, and while we do not yet have a full understanding of the changes that are happening, the separate analysis of frequency and severity provides information that the combined trend seems to smooth and to mask.

Table 7

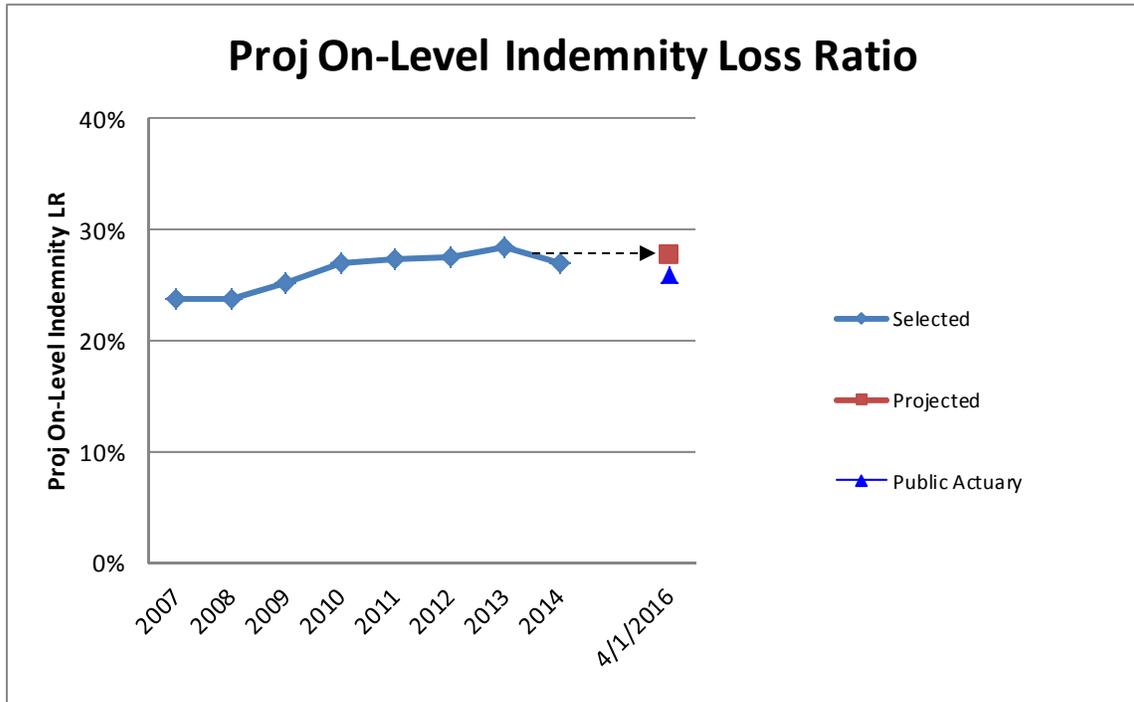
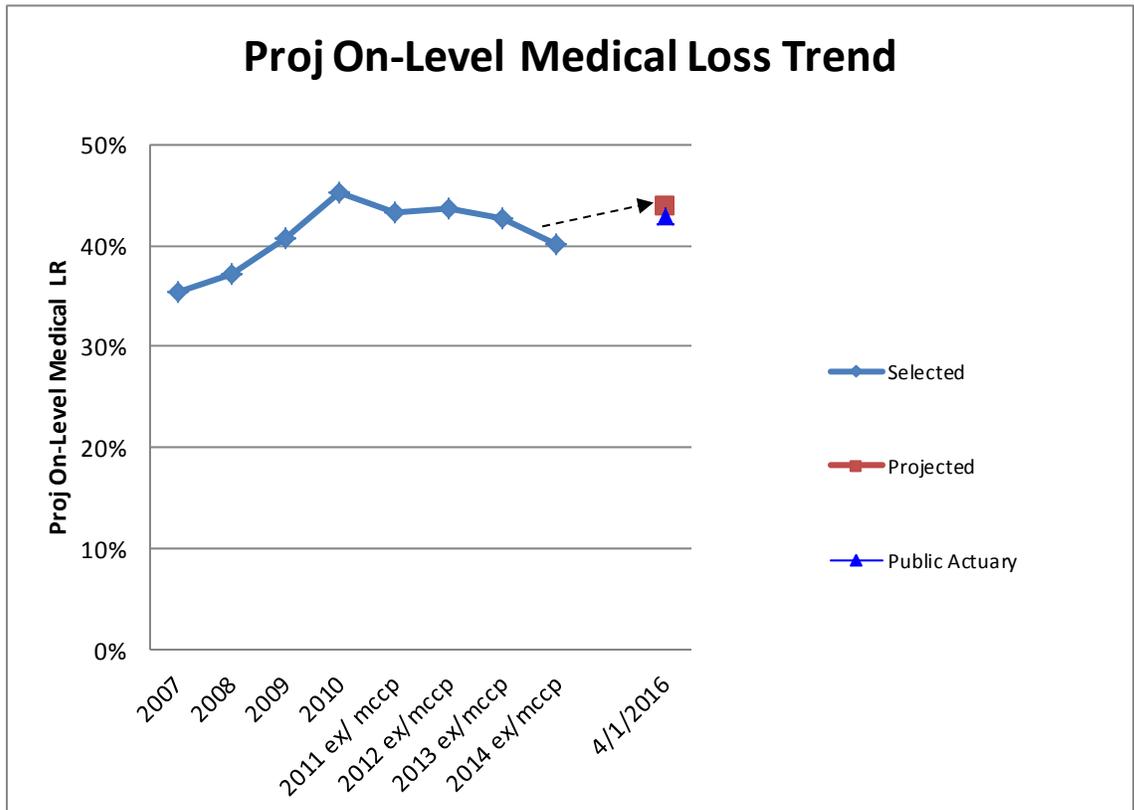


Table 8



We note that the medical loss ratios in Table 8 for Accident Years 2011 and subsequent do not reflect costs associated with medical cost containment (“MCC”), which have been separated from medical losses by the WCIRB in their analysis per direction from the CDI and are now included in loss adjustment expense. As the WCIRB started separating MCC expenses from loss in 2011, medical loss ratios for Accident Years prior to 2011 in the table above still include MCC.

3. Loss Adjustment Expenses

In its determination of the provision for loss adjustment expenses (“LAE”) in the proposed rates, the WCIRB developed separate indications for the allocated loss adjustment expense (ALAE) and unallocated loss adjustment expense (“ULAE”). In doing so, the WCIRB considered the historical ALAE and ULAE experience of all companies in the market, including the State Compensation Insurance Fund (“SCIF”).

In filings prior to the 1/1/15 filing, the WCIRB had reflected the experience of SCIF in its calculations of ALAE and ULAE, albeit on a tempered basis (50% of market share). As CDI staff has noted in these prior filing reviews, SCIF’s LAE ratios include a significant component of excess expense, and CDI staff actuaries believe this excess expense should not be included in a prospective estimate of industry average costs required to settle claims in the future. The Public Members’ actuary concurs with CDI on this issue.

Starting with the 1/1/15 filing, the WCIRB adopted a change in its methodology to reflect only private carrier data in its evaluation of ALAE and ULAE. The WCIRB has continued to apply this methodology in this current filing. CDI staff concurs with this methodology.

Table 9

LAE Provision Underlying 7/1/2015 Rate Filing	
	WCIRB Selected
(ALAE ex/MCC)/Loss	19.1%
MCC/Loss	7.5%
Total ALE/Loss	26.6%
ULAE/Loss	6.3%
Total LAE/Loss	32.9%
	WCIRB
Indicated Rate	\$2.46

With regard to the trend assumption underlying the ALAE provision, the WCIRB reviews a number of different methods and considers various trend periods as well as trend bases. The trend underlying the selected method is a 6% change in ALAE dollars per indemnity claim per year, the same as in the 1/1/2015 filing.

One issue that was raised during the WCIRB actuarial and governing committees was whether to increase the ULAE. National writers reflect a much lower ULAE provision in their financial reporting than carriers that focus on the California market. Part of this difference may be how national carriers allocated related costs to states. National carriers, being quite large, can achieve economies of scale and typically have significant volumes of large deductible business in California, which can be expected to complicate the comparison. This has been an ongoing issue, with the WCIRB enhancing its data calls to help gather necessary data to help better understand this issue. We consider resolution of this issue to be important, and look forward to seeing the results of its further study.

4. Impact of Senate Bill 863

In developing its actuarially indicated pure premium rates, the WCIRB included its estimate of the effect of SB 863. The explicit net impact of SB 863 as calculated by the WCIRB is a reduction in pure premium rate of \$0.02, resulting in the net filed pure premium of \$2.46. However, it is reasonable to conclude that a significant driver of the lower than expected loss emergence in AY 2014 is due to SB 863's impact, especially in lower medical costs due to IMR that were not explicitly quantified in prior filings. One perspective is to consider the impact of the lower AY 2014 loss experience as an implicit impact of SB 863. The components of this net impact are shown below in Table 10.

Table 10

WCIRB 7/1/15 PP Rate Filing			
Summary of SB 863 Impacts in PP Rate Indications			
	(1)	(2)	(3)
	<u>WCIRB</u>	<u>CDI</u>	<u>Bickmore</u>
A. PD Increases	0.14	0.14	0.12
B. System Savings 1/1/13 Filing *	(0.21)	(0.24)	(0.34)
C. RBRVS Impact 1/1/14 Filing	0.05	0.05	-
D. Change in SB 863 Assumptions 1/1/15 Filing (more favorable lien volume offset by less favorable IMR volume)	0.00	0.00	0.00
E. Net SB 863 Impact in 1/1/15 Filing E = A + B + C + D	(0.02)	(0.05)	(0.22)
F. Implicit SB 863 Medical Impact AY 2014	(0.08)	(0.05)	-
* Note that (.21) equates to \$1.5 Billion system savings			

In developing its actuarially indicated pure premium rates, the WCIRB included its estimate of the effect of SB 863. This estimated effect was the result of an effort that solicited input and participation from a number of individuals and groups from the industry, government, and the academic community including the Commission on Health, Safety, and Workers' Compensation ("CHSWC"); the California Workers' Compensation Institute ("CWCI"); Bickmore Risk Services ("Bickmore"); and the CDI. This effort began as the bill was in its developmental stages and took place over a period of several months in 2012. The WCIRB's final actuarially indicated estimates of the effect of SB 863 are the result of this collaborative effort.

The actuarial section underlying the proposed decision and order of the 1/1/2014 filing contains a detailed explanation of the WCIRB's individual assessment of the numerous components of SB 863, as well as comparison with estimates developed by other involved parties - especially Bickmore.

One component of SB 863 that is calculated for the first time in the 1/1/2015 filing is the impact of adopting a new physician fee schedule based on Resource Based Relative Value Scale ("RBRVS"). The WCIRB reviewed an analysis developed by the RAND Corporation on behalf of the Department of Workers Compensation for this purpose. The WCIRB made several adjustments to the RAND analysis, including reflecting 1) the mix of physician services which better matches current accidents covered by insurers, and 2) a more complete mapping of all services.

As a result of the fee schedule change, some services such as medicine and evaluation and management saw significant fee increases, while others such as surgery and radiology saw significant fee decreases. The WCIRB factored in a zero impact due to a change in utilization patterns based on changes in relative fees by service, and indicated that there is little research literature available on the topic. We asked the WCIRB to pursue further study and analysis regarding potential changes in utilization patterns arising from the fee schedule change.

In general, CDI concurred with the WCIRB in its assessment of SB 863, with one exception. The WCIRB did not reflect any explicit medical cost savings due to Independent Medical Review (“IMR”), whereas CDI believes that it is reasonable to expect a 2.5% reduction in medical costs, consistent with our evaluation last year and equivalent to an additional \$0.03 savings attributable to SB 863. As the CDI has already reflected an explicit impact of \$0.03 savings, the implicit impact of SB 863 due to lower AY 2014 loss experience is reduced by a like amount.

We have called upon the WCIRB to do a study of how medical disputes are likely to be settled in California under the new IMR process, how this may be different from the past settlement process, and what cost savings if any are likely to occur as a result. This study is in progress, and we look forward to its results. We will also require that the WCIRB study the impact of IMR on actual claim settlements during 2013 and subsequent years.

Relationship of the Proposed Pure Premium Rates to Current Industry Filed Pure Premium Rates, Manual Rates, Final Charged Rates, and Insurer Profitability

Based on data developed by the WCIRB, it appears that the industry average filed pure premium rate level at January 1, 2015 of \$2.59 is 5% higher than the WCIRB actuarially indicated pure premium rate at July 1, 2015 of \$2.46. Further, the average filed manual rate of \$3.83 indicates an average loading for expenses and underwriting profit (less investment income offset) of 47.9% of pure premiums or 32.4% of manual premium. Comparing it to final charged rate levels of \$2.95 in the first half of 2014 indicates a substantial use of schedule credits or other discounts by the industry, on the order of 20% of manual premium.

We believe that the primary reason why insurers are willing and able to offer such discounts is due to the unusually high level of investment income arising from premiums and reserves associated with policies written in prior years at higher rate and loss levels during the pre-reform era. As indicated in WCIRB’s Executive Summary of the 1/1/2015 filing, the California workers compensation industry generated a return on net worth of approximately 7.4% in 2011 and 3.9% in 2012. Further, the WCIRB projects loss ratios

for Accident Years 2012, 2013, and 2014 to be 10 points, 5 points, and 3 points higher than what the industry has booked, respectively. This relative improvement in AYs 2013 and 2014 versus AY 2012 reflects the favorable impact of lower emerging medical costs. If the trend of lower medical losses holds, industry pricing may be approaching levels that are sustainable in the long term.

**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 Insurance Commissioner should adopt advisory pure premium rates that are on average 5% less than the insurance industry's average filed pure premium rate of \$2.59 per \$100 of payroll (as of January 1, 2015). Stated another way, the Hearing Officer recommends that the Commissioner adopt an average pure premium rate of \$2.46 per \$100 of payroll. This recommended average 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 July 1, 2015. 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 CDI Actuaries Ron Dahlquist and Giovanni Muzzarelli.

PROPOSED 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 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 \$2.46 per \$100 of employer payroll, to be adjusted to the relative classifications consistent with this Proposed Decision;

IT IS FURTHER ORDERED that the experience rating threshold shall be calculated to reflect the adjustment of the Workers' Compensation Claims Cost Benchmark and advisory pure premium rates; and

IT IS FURTHER ORDERED that these regulations shall be effective July 1, 2015 for all new and renewal policies with anniversary rating dates on or after that date.

I CERTIFY that this is my Proposed Decision and Proposed Order as a result of the hearing held on April 30, 2015, 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: May 7, 2015

Patricia Hein
Attorney IV