October 6, 2016

Ms. Patricia Hein
Attorney
California Department of Insurance
45 Fremont Street, 21st Floor`
San Francisco, CA 94105

RE: California Workers' Compensation Insurance Pure Premium Rates and Claims Cost Benchmark Effective January 1, 2017

Dear Ms. Hein:

The purpose of this letter is to comment on the California Workers' Compensation Insurance Rating Bureau (WCIRB) pure premium rate and claims cost benchmark filing for policies effective January 1, 2017 through December 31, 2017 (the Filing). Mark Priven is a member of the WCIRB Actuarial Committee representing the Public Members of the Governing Committee. The following table compares the WCIRB and Bickmore projections.

Table 1
Range of Pure Premium Indications

	WCIRB[1] Recommended	**Bickmore Range**[1] Low	Middle	High
Loss to Industry Avg. Filed Pure Premium				
Indemnity	0.264	0.249	0.273	0.289
Medical	0.378	0.321	0.321	0.382
Total	0.642	0.571	0.595	0.671
Loss Adj. Expense/Loss				
ULAE	10.8%	12.1%	11.6%	10.3%
ALAE	20.7%	23.6%	24.0%	22.8%
MCCP	5.7%	6.0%	6.1%	5.7%
Total	37.2%	41.7%	41.7%	38.8%
Impact of SB1160 and AB1244	-0.6%	-0.6%	-0.6%	-0.6%
Change in Off-Balance Factor:	-0.2%	-0.2%	-0.2%	-0.2%
Difference from Industry Average Filed Pure Premium[2]	-12.6%	-19.8%	-16.4%	-7.6%
Average Pure Premium Rate	$2.22	$2.04	$2.12	$2.35

[1] WCIRB Amended 1/1/17 Pure Premium Rate Filing, based on experience as of June 30, 2016
Bickmore based on experience as of June 30, 2016
[2] Difference from Industry Avg. Filed Pure Premium = (Total Loss to Pure Premium) x (1 + Total Loss Adj. Expense/Loss) x (1+ Impact of SB1160 and AB1244) x (1 + Change in Off-Balance Factor) – 1

The average pure premium rate of $2.12 that corresponds to our Middle projection is 4.3% lower than the average rate of $2.22 recommended by the WCIRB. The Bickmore indications for January 1, 2017, reflect several differences in approach and assumptions between the WCIRB and Bickmore. The following table provides an overview of these differences and the impact on our Middle indications versus those of the WCIRB.

Table 2
Impact of Differences in Assumptions & Methods
Bickmore Middle Indications vs. WCIRB Recommendations

Assumptions & Methods	Percent Impact
Ultimate Medical & Indemnity (2015 & Prior)	-4.3%
Loss Trend	-0.5%
Claim Frequency (impacts ALAE and MCCP)	0.5%
Total	-4.3%

The following is a more detailed discussion of the differences in assumptions and methods between those utilized by the WCIRB versus the Bickmore Middle indications.

1. <u>Ultimate Medical and Indemnity Losses Accident Year (AY) 2015 and Prior</u>: The Filing uses these estimates as a basis for projecting policy year (PY) 2017 rates. The WCIRB ultimate loss projections are based on the paid loss development method adjusted for SB 863 and changes in claim settlement rates; the data is valued as of 6/30/16. The Bickmore Middle projections for indemnity costs as of 6/30/16 are based on the same method used by the WCIRB; however, the Bickmore medical cost projections are based on a 50%/50% weighting of the paid (adjusted for settlement rates) and unadjusted incurred loss development methods.

   The WCIRB provides estimates using a variety of loss projection methods. It is our conclusion that the incurred loss development method (latest year, unadjusted) should be given some weight in the selected medical pure premium rate. This conclusion is based on our belief that the ultimate loss projections using the adjustment paid method could be overstated due to an overstatement in the future development of the paid losses. There are several reasons for this.

   a. Type of Claims Being Closed: The closing rate for the permanent disability (PD) indemnity claims has been trending up in the most recent four years, whereas the closing rate for temporary disability claims has been relatively stable (WCIRB Actuarial Committee Meeting Agenda August 3, 2016, Page IV-A-7). This apparent increase does not appear to be a result of an increase in the number of temporary disability claims transitioning to permanent disability claims, which, as a percent of total indemnity claims, has been relatively stable since 2010 (WCIRB Actuarial Committee Meeting Agenda August 3, 2016, Page IV-A-6). This increase in the PD closing rate indicates more losses being paid earlier than they had been historically, potentially overstating the future development of the paid losses.

   b. Type of Settlement: More claims are being settled as compromise and release (C&R) as opposed to stipulated settlements. The percentage of C&R claims as a percentage of total settlements has been trending up since 2010, while the stipulated claims have been trending down (WCIRB Actuarial Committee Meeting Agenda

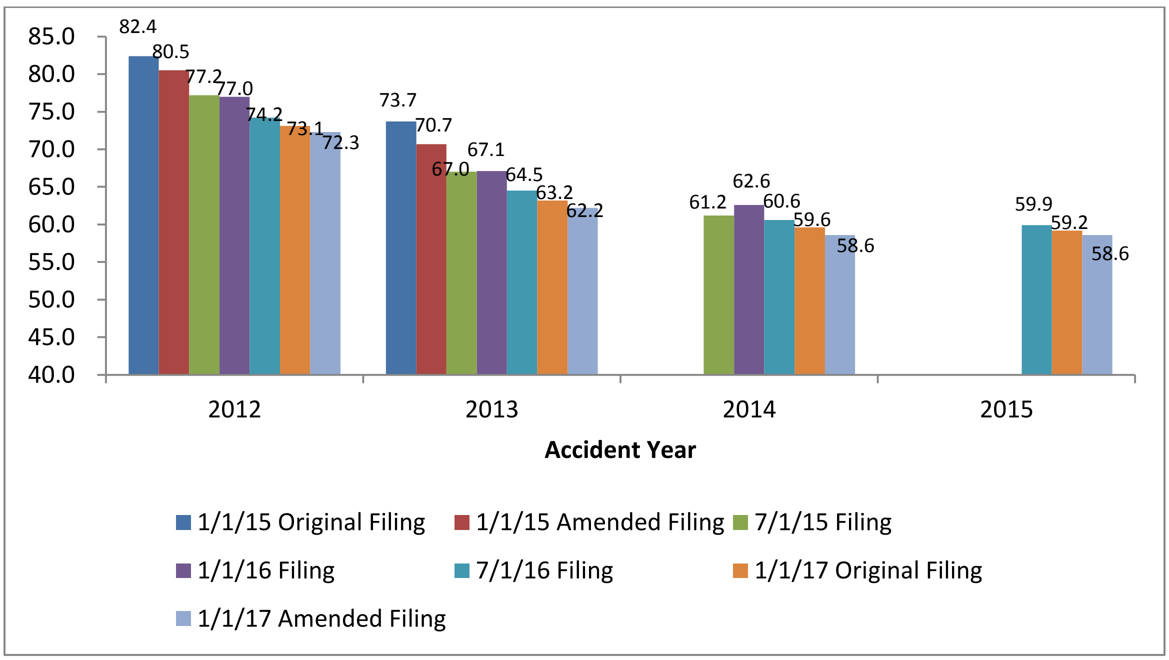
August 3, 2016, Page IV-A-12). This results in more losses being paid earlier than they had been historically, again potentially overstating the future paid development.

c. RBRVS: Switching to RBRVS should result in higher payments associated with medical services that occur earlier in the life of a claim and lower payments in the later stages of a claim. As a result, it is reasonable to expect an proportional increase in medical payments in the early periods of recent accident years when compared to historical payment patterns.

As a result of these considerations, we have weighted together the results of the incurred method with the paid method selected by the WCIRB for medical. For the indemnity Middle projection, we gave the paid method 100% weight. Since SB 863 increased PD benefits, we are concerned that the overall indemnity paid and incurred development factors for more recent years should be higher than they were historically. Since there is no incurred method that adjusts for this, we believe it is most reasonable to use the paid method for projecting indemnity costs. The Bickmore Low indemnity projection gives 50% weight to the incurred and paid methods.

The following chart shows the ultimate loss ratios for accident years 2012 through 2015 in the most recent five WCIRB filings. The 2012 through 2015 ultimate loss ratios have generally been decreasing, likely due to the changes relating to SB863.

Chart 1
Ultimate Loss Ratios (Medical & Indemnity)
Presented in WCIRB Rate Filings Over Time



WCIRB 1/1/15 Rate Filing is based on data valued as of 3/31/14
WCIRB 1/1/15 Amended Rate Filing is based on data valued as of 6/30/14
WCIRB 7/1/15 Rate Filing is based on data valued as of 12/31/14
WCIRB 1/1/16 Rate Filing is based on data valued as of 3/31/15
WCIRB 7/1/16 Rate Filing is based on data valued as of 12/31/15
WCIRB 1/1/17 Rate Filing is based on data valued as of 3/31/16
WCIRB Amended 1/1/17 Rate Filing is based on data valued as of 6/30/16

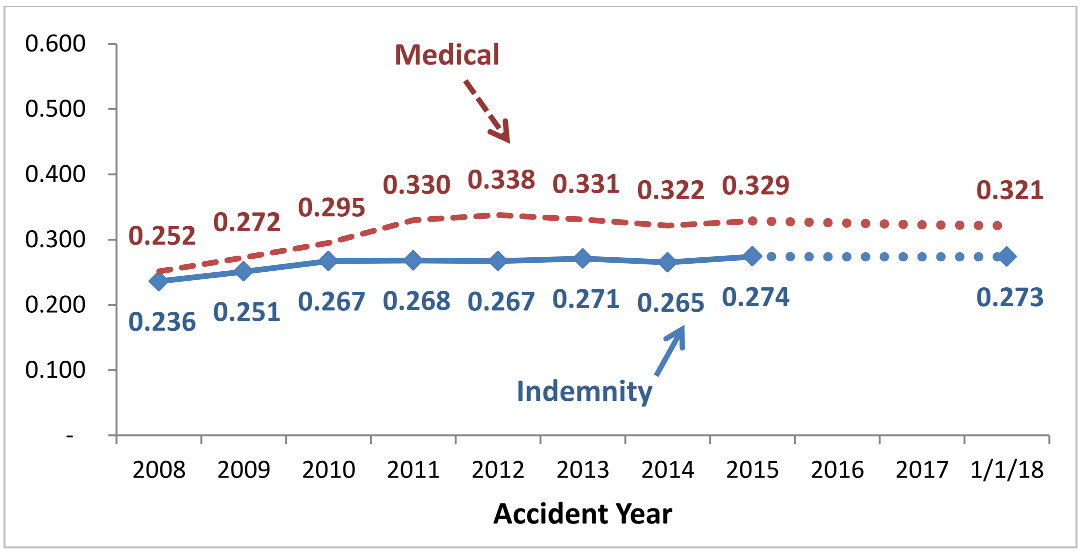
2. <u>Trend Method</u>: The WCIRB January 1, 2017 Filing uses the most recent two full accident years (2014 & 2015) as the base from which to project future claim frequency and average

claim size. We have based the projections on an exponential fit, using accident years 2011 through 2015 as the base period for the low and middle projections, and 2008 through 2015 for the high projection. We continue to believe that the exponential trend is the most appropriate and accurate.

We chose this method for two reasons. First, it utilizes multiple years, not just the two most recent years. Given the variability in loss ratios between valuation dates, we feel it is appropriate to include projections from more mature years in the trending base period since the projections for those years are less likely to move significantly. Second, this method involves trending pure premium directly rather than the WCIRB method of separately trending frequency and claim size. Over the past several years the overall pure premium ratio trend has been very consistent.

The projections using an exponential fit are displayed on the following chart. Please note that the pure premium medical ratios for 2010 and prior have been adjusted to remove MCCP payments.

Chart 2
On-Level Medical & Indemnity to Industry Average Filed Pure Premium Ratio
Bickmore Middle Scenario



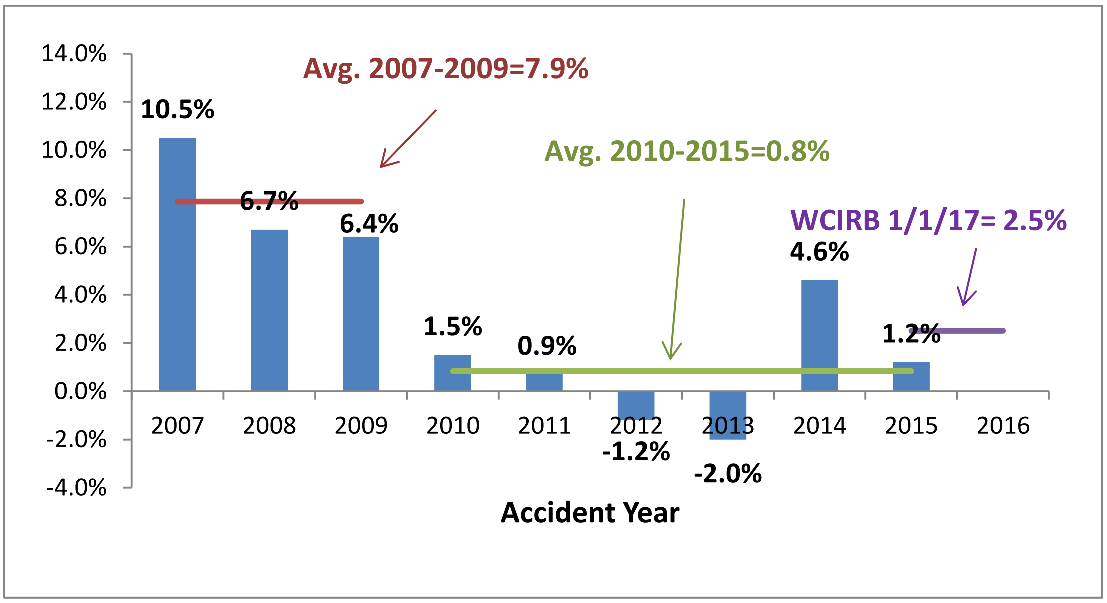
Indemnity - 100% weight to Paid Development method selected by WCIRB
Medical - Based on 50% weight to Incurred Development (Latest Year, Unadjusted, as of 6/30/16) and 50% weight to Paid Development method selected by WCIRB

We should also note that we have differences with the WCIRB regarding the timing of the impact of medical reforms included in SB 863. Key provisions of SB 863, such as the introduction of independent medical review (IMR), retroactively impacted existing claims from older accident periods. At the time SB 863 was implemented, a very large portion of accident year 2011 and 2012 ultimate medical costs were not yet paid. In addition, the projected ultimate medical costs of older accident periods (such as 2011 and 2012) fell after the implementation of the reforms. Based on this, our reform adjustment factors assume that the bulk of the impact of SB 863 on medical costs started in accident periods prior to 2013.

3. Claims Severity: The projected change in the ultimate medical and indemnity severities per indemnity claim show similar patterns; severity increases were quite high in the years immediately following earlier major reforms (2007 – 2009) and have dropped significantly in the past several years (2010 – 2015). We feel it is important to analyze the severity trends. However, we feel that the severity trends have been less predictable than overall pure premium ratios over the past few years. As a result, we do not feel that projecting policy year 2017 costs based on separate frequency and severity changes is the best approach in this Filing.

The following charts show the severity trends by year, as well as the current WCIRB selections for medical and indemnity benefits. The fact that the trends are so different from 2007-2009 versus 2010-2015 makes it very difficult to project trend factors for 2017 and beyond. Note that the medical severities for 2010 and prior have been adjusted to remove MCCP payments.

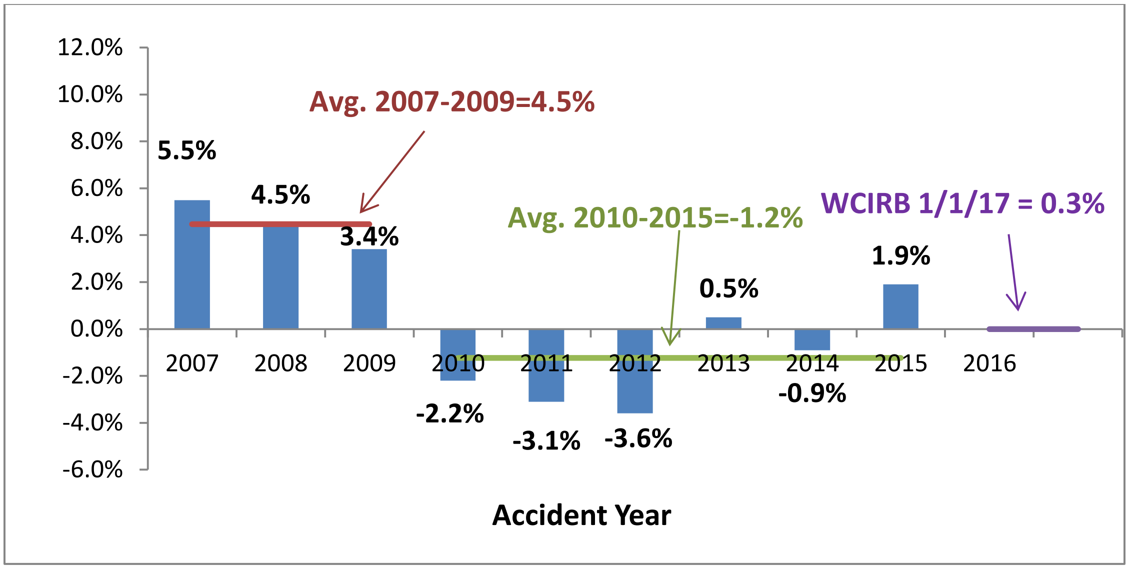
Chart 3
On-Level Medical Severity Annual % Change
Only Includes Indemnity Claims



The Medical Severities for 2007 through 2010 have been adjusted to remove MCCP payments
WCIRB Rate Pure Premium Filing 1/1/17, based on experience as of 6/30/16

As the above chart shows, the WCIRB's selection of a 2.5% medical severity trend is significantly higher than the average severity of the most recent six years (0.8%). After the passage of reforms one might expect a bounce to more "normal" severity increases, however, it has been over three years since SB863 took effect and medical severities continue to be very moderate. Had the WCIRB maintained the same methodology as in their prior filing, averaging the long term and short term average severities, the selected medical severity would have been approximately 1.8%. As a result, we believe that the WCIRB selected medical trend of 2.5% is conservative.

Chart 4
On-Level Indemnity Severity Annual % Change
Only Includes Indemnity Claims



WCIRB Rate Pure Premium Filing 1/1/17, based on experience as of 6/30/16

4. Claim Frequency: The claim frequency trends are also inconsistent by year. As with the severity trends, we feel it is very important to study these trends. However, we do not feel that frequency trend should be used to project policy year 2017 loss results, because over the past few years the claim frequency has been difficult to predict.

5. Loss Adjustment Expense (LAE): There are four main differences between our projected LAE ratios and those of the WCIRB. First, we have reflected differences in projected losses. This increases both the ULAE and ALAE ratios by impacting the denominator of each. Second, we have projected higher ULAE per Earned Premium ratios based on the increasing ratios of paid ULAE to paid losses in the more recent years. Third, we have projected a smaller decrease in claim frequency subsequent to 2015 than the WCIRB. Fourth, the WCIRB has projected annual ALAE per claim increases of 5%, whereas we have projected annual increases of 6.2%. Our estimate is based on the average annual increases over the most recent three years, which have been 3.5%, 6.5%, and 8.7% for 2013, 2014, and 2015, respectively. As a result of our projected higher volume of indemnity claims and higher severities for ALAE, our ALAE projections are higher than those of the WCIRB.

Other Comments

In addition to providing an analysis of the proposed Filing, the following are general comments related to the WCIRB or California workers' compensation which we believe are important to consider.

1. Rate Changes: Given that the WCIRB rates are compared to average industry filed pure premium rates, and the industry rates change between each filing, it can be confusing to figure out the underlying changes to rates. The following table compares the rates in the current and prior Filings.

Table 3
Pure Premium Rate Comparison: Prior and Current Filings

Industry Group	7/1/16 Filing	1/1/17 Filing	Change
Avg. Insurer Filed Pure Premium[1]	2.57	2.54	-1.2%
WCIRB Recommended Rate			
Actuarial Committee	2.30		
Governing Committee	2.30	2.22	-3.5%
CDI Approved	2.30		
Bickmore Rates			
Low	2.23	2.04	-8.6%
Middle	2.25	2.12	-5.6%
High	2.43	2.35	-3.5%

[1] 7/1/16 based on WCIRB pure premium filing.
1/1/17 Filing rates valued as of 6/30/16.

2. Geographical Differences: One area that continues to be of concern is the significant difference in frequency and severity between the northern and southern parts of the state. We provided specific information regarding differences in claim size by geography in our written testimony regarding the 7/1/16 rate filing. We believe this is an important topic, and commend the WCIRB for their research in this area. We look forward to an update of the WCIRB's analysis of regional differences later this year.

3. Formulary Bill (AB 1124): The California legislature passed Assembly Bill 1124, which requires the adoption of a workers' compensation drug formulary by July 1, 2017. This could be significant, prior studies conducted by the California Workers' Compensation Institute (CWCI) and Workers' Compensation Research Institute (WCRI) have indicated that depending on the design and implementation of the formulary, it could result in reductions of 8% to 42% of drug spending (CWCI "California's Proposed Workers' Compensation Drug Formulary, Part I", August, 2016). We estimate that this represents direct savings of 0.5% to 2.6% of medical costs, and 0.2% to 1.1% of the total pure premium in California. There could also be indirect savings related to a reduction in other activities such as utilization review and independent medical review.

   Even if a formulary is not adopted until 7/1/17, this has the potential to reduce policy year 2017 costs that are associated with payments that occur after 7/1/17. In general, aside from reducing costs associated with future policies, this bill has the potential to reduce the cost of expired and in-force policies, since the formulary could impact all pharmacy costs, regardless of the date of injury. This would represent a windfall to insurance companies. Insurance companies understandably complain when benefits are retroactively increased on policies that insurers have no ability to re-price. It is worth pointing out that insurers at times also benefit from retroactive decreases which were not anticipated in premiums when they were collected.

4. Minimum Wage: Recent and proposed changes to the minimum wage for the State of California and for municipalities within the State could significantly complicate insurance pricing for individual employers. As we discussed in our written testimony relating to the 7/1/16 rates, insurance rates need to be adjusted for minimum wage increases or else those industries that employ a high percentage of minimum wage workers could experience unreasonably high insurance premiums.

   The WCIRB has already done substantial research into the issue of the impact of changes to the minimum wage on workers' compensation rates. We support this research with the goal that the WCIRB will be able to provide sufficient information so that insurers can adjust rates to properly reflect the impact of changes in statewide and local minimum wages.

5. Affordable Care Act (ACA): As we have discussed in prior testimony, there is reason to believe that the ACA could impact workers' compensation costs in California. Key issues include the frequency of hospital billings, the availability of primary care physicians, health comorbidities, generic drugs, and taxes. The Casualty Actuarial Society (CAS) has commissioned the RAND Corporation to study the impact of ACA on both auto liability and workers' compensation. While the studies have not yet been released, the RAND Corporation did present preliminary results at the CAS Loss Reserve Seminar on 9/11/15. The early results indicate that the ACA has probably had an impact on lowering workers' compensation costs. We will be reviewing the final study when it is available and will consider incorporating the results in future projections.

6. Rates by Industry: The average WCIRB January 1, 2017, recommended pure premium of \$2.22 is 12.6% lower than the average insurer filed pure premium of \$2.54. However, the Filing makes it clear that there are substantial differences between the WCIRB and insurance company pure premiums by class (Executive Summary, Exhibit 2).

The following table shows the differences between the WCIRB recommended pure premium and insurance company filed pure premiums by industry group. The information in this table is based on weighted averages of a sampling of 485 class codes representing over 90% of California statewide payroll.

Table 4
WCIRB vs. Insurer Pure Premium Rates by Industry Group

Industry Group	% that WCIRB PP Rates are Higher Than/(Lower Than) Industry Filed PP Rates
Administrative	(2.2%)
Agriculture	(0.1%)
Arts & Entertainment	(15.3%)
Clerical	(6.8%)
Construction	(5.8%)
Education	(12.3%)
Finance & Insurance	(12.9%)
Health	(5.3%)
Hospitality	(1.5%)
Information	(10.6%)
Manufacturing	(0.8%)
Mining	(11.9%)
Other	(2.4%)
Outside Sales	(3.7%)
Professional Services	(11.2%)
Public Administration	(7.1%)
Real Estate	(8.9%)
Retail	(3.9%)
Transportation	(2.3%)
Utilities	(11.0%)
Wholesale	(3.2%)
Total	(4.3%)

Source: Class Rates from WCIRB January 1, 2017, Pure Premium Filing, Pages 15 through 21.
Information by industry is based on weighted averages of a sampling of 485 class codes representing over 90% of California statewide payroll

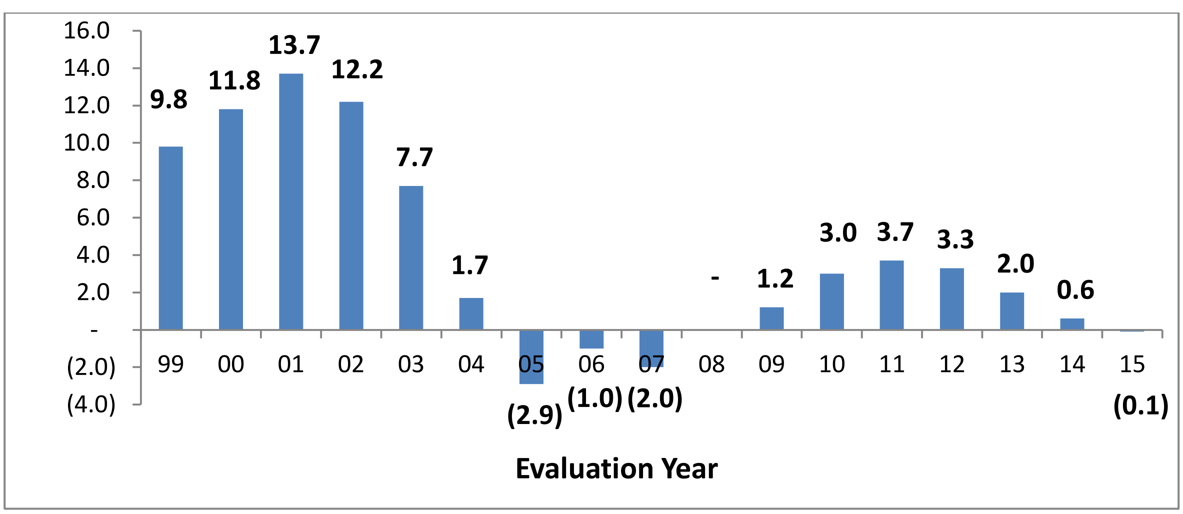
Because of differences between insurance company filed and charged rates, it is difficult to conclude from the preceding table whether or not a specific industry is being under or overcharged in the insurance market. However, the results tend to be very consistent within an industry group.

7. <u>The Insurance Market:</u> The filing indicates both the insurance filed and charged rates of $3.74 and $2.89, respectively, are higher than the WCIRB recommended pure premium rate of $2.22. Pure premium rates only reflect loss and loss adjustment expense, and other insurance company expenses can exceed 20% of premium. While some of this expense is offset by investment income, the return on investments has been low over the past few years. As a result one would expect the charged rates to be much higher than the filed pure premiums.

Although the filing indicates that the industry charged rates are likely now sufficient to cover expenses, prior filings indicated that the charged rates in the most recent years were likely not high enough to cover expenses. Given this, one would expect the market to have been unprofitable in the past but currently profitable. In fact, the WCIRB is showing loss and expense ratios - excluding investment income - of 137%, 115%, 102%, 98% and 99% for accident years 2011 through 2015, respectively (WCIRB Report on June 30, 2016 Insurer Experience, released 10/4/16, Exhibit 5). From the perspective of ensuring insurance company solvency this is welcome news and should be carefully monitored.

Aside from profitability, another potential financial concern regarding the insurance industry is understatement of liabilities. Every quarter insurance companies provide the WCIRB with updated loss, payroll, and premium information. Included in this information are projected ultimate losses and liabilities on a direct basis. As of June 30, 2016, the total direct insurance company workers' compensation liabilities in California were over $51 billion. One way to measure insurance company reserve adequacy is to compare the ultimate loss projections aggregated for all insurers to those estimated by the WCIRB. The following chart shows that the adequacy of insurance company liability projections has varied significantly over the past 17 years. In the following chart, the positive numbers means that the insurance company estimates are less than those of the WCIRB, whereas a negative number would mean that they are higher than those of the WCIRB. Over the past sixteen years, the insurance company estimates have been lower than those of the WCIRB.

Chart 6
CA WC Insurance Company Reserve Inadequacy
($Billions)

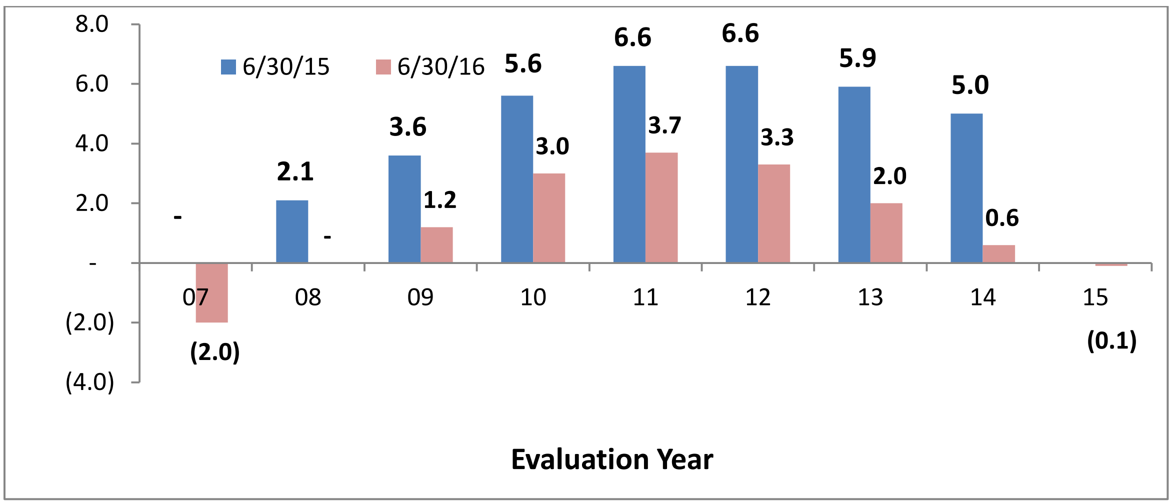


Source: WCIRB Summary of June 30, 2016 Insurer Experience, Exhibit 9.

It should be noted that the comparison of insurer and WCIRB ultimate costs are on a direct basis. Net insurance company ultimate losses are affected by deductibles, reinsurance, and other issues. Nevertheless, the preceding figures should be a good indication of overall reserve adequacy.

While potential insurer under-reserving is concerning, it is encouraging that the insurance company and WCIRB figures have been trending closer together over the past four years. This is a significant development that should ease some concerns about the overall health of the industry's reserving. The following chart compares the reserve differential as of 6/30/15 and 6/30/16. This shows that WCIRB estimates of ultimate costs for prior accident periods decreased between these two valuation dates.

Chart 6
Comparison of CA WC Insurance Company Reserve Inadequacy 6/30/15 vs. 6/30/16 ($Billions)

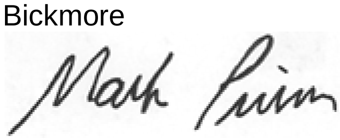


Source: WCIRB Summary of June 30, 2015 and 2016 Insurer Experience, Exhibit 9.

Thank you for your consideration of the issues outlined in this document. Mark Priven will be testifying at the upcoming rate hearing and will be available to discuss these issues in further detail at that time.

Respectfully Submitted,

Bickmore



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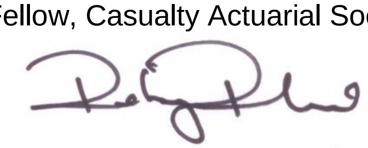

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