STATE OF WASHINGTON
Department of Labor and Industries
Retrospective Rating Program
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April 23, 2014

Dear Retro Stakeholder,

As you may recall, the Department of Labor and Industries (L&I) filed a proposed rule change to remove the performance adjustment factor (PAF) from the calculation of the net insurance charge for participants that elect premium-based plans. The change would become effective prior to the July 1, 2014, enrollment cycle.

A formal Public Hearing on this proposed change is scheduled to begin at **10:00 a.m., Tuesday May 6, 2014**, in Room S118/119 at L&I's headquarters in Tumwater (a map and driving directions can be found on our website.)

Those wishing to present oral testimony via telephone may participate via conference call. Additional details, including a toll-free number, will be published prior to the hearing date.

Written comments will be accepted until 5:00 p.m. on May 6, 2014. Please send comments to:

Department of Labor and Industries
Attn: Jessica Nau
PO Box 44180
Olympia, WA 98504-4180
Email: jessica.nau@Lni.wa.gov
FAX: 360-902-4258

A summary of the proposed rule change can be found on our website. Also attached for your convenience are the FAQ's and consolidated feedback that L&I received via written comments, personal interviews, and public stakeholder meetings.

Thank you.

Jessica Nau

Jessica Nau
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Retrospective Rating
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Attachment(s)

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360-902-4851

Distribution of Refunds Based on Plan Choices and PAF – FAQs

Overview

Based on review of the first adjustment of the 2011 coverage year, the Department of Labor and Industries (L&I) has proposed a rule filing to address a situation that was identified with regards to the calculation of retro adjustments. The department is proposing to remove the performance adjustment factor (PAF) from the calculation of refunds or assessments for participants that elect premium-based plans, with an effective date ahead of the July 1, 2014, Retro enrollment cycle.

Below is a summary of questions provided to the department through written commentary, personal interviews, and public stakeholder meetings.

Q: What is the purpose of the Performance Adjustment Factor (PAF)?

A: The department uses performance adjustment to ensure equity between employers that participate in retrospective rating and employers that do not. The goal of performance adjustment is to make sure that overall, after adjustments, retro participants pay the same share of their losses as employers that do not participate in retro (WAC 296-17B-600).

Q: How do you determine the PAF?

A: Our actuaries compare standard premiums and losses of employers in retro with those of employers not in retro to determine a target refund amount that would result in the groups of retro and non-retro employers funding the same percentage of their claim costs. In doing this, the actuaries pool the experience of the coverage period being adjusted with the experience from the coverage periods beginning the three previous quarters, and take into account possible future changes in losses based on historical data. The actuaries then add interest to the target amount to take into consideration the time value of money.

A performance adjustment factor (rounded to four decimal places) is then selected, so that when we calculate adjustments, the sum of all adjustments will most nearly equal the target refund amount (WAC 296-17B-610).

Q: What other options have been considered regarding ways to address this issue?

A: There were two other options that were considered as potential solutions to this issue.

1) *Eliminating premium-based plans*: Premium-based plans are a lower-risk way for participants to enroll in the program. By removing this option, the department feels this could lead to a decline in participation within the program as it would force participants into taking more risk than they may feel comfortable with.

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2) *Increase the minimum Maximum Loss Ratio Limit*: This would require participants to accept a significant increase in the amount of risk they would have to take in order to enroll in the program. The department feels this could lead to a decline in participation within the program as it would force participants into taking more risk than they may feel comfortable with. Additionally, this approach would not solve the inequity between loss-based and premium-based plans.

Q: Does changing the calculation for premium-based plans affect loss-based plans?

A: This change will not impact the total amount of retro refunds available to all participants; however, it will impact the distribution of these refunds across all participants. Participants in loss-based plans would see either a slight increase in their refunds or a slight decrease in their assessments.

Q: Can we fix this issue in the application contract?

A: No, any fixes that would come from editing the Retro contracts are not supported by the department at this time.

Q: What could be unintended consequences of removing the PAF from the calculation?

A: The department is committed to monitoring all retro calculations to ensure they are promoting fairness and equity. Should an inadvertent issue arise from this rule change, the department would take the steps necessary to address the issue.

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Overview

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Below is a summary of feedback that was provided to the department through written commentary, personal interviews, and public stakeholder meetings.

Summary of stakeholder feedback and comments

In support

- I heard the presentations (Bill Vasek, L&I, Sr. Actuary) and it makes sense.
- Yes, remove the PAF from the calculation, for premium-based plans. It may have the effect of complicating the forecast and review of performance.
- Remove the PAF from the calculation.
- We made plan choices assuming the PAF would be 1.0, so it makes sense.
- Fair is fair. This balances out risk for all of us.
- Removing the PAF is in support of previous work on the proviso study group.
- OK as presented.
- We appreciate the approach the department took: bring it to our attention quickly, get outside counsel, consider alternative proposals, and examine means to the goal. Consider language to preclude participants earning refunds when their losses indicate an assessment. Can we fix this in the application contract? What could be unintended consequences of removing the PAF from the calculation?
- In favor of removing the PAF because loss-based plans take more risk and should earn more refunds, if overall refunds to Retro move higher.

- We're in support of the PAF (being) taken out. It does help us to be able to communicate to our members in Retro in that it allows us to estimate what the expected refund and/or additional assessment would be.
- The minutes of the October RAC meeting present a clear example that some employers earned a refund when they should have gotten an assessment. This does need to be changed.
- You need to fix the formula. If three years from now the PAF is over 1.0 and it produces some other error that needs to be fixed, then fix it. You have a responsibility to make sure that the formula works correctly and that people that earn a refund earn a refund and people that aren't entitled to a refund don't get refunds.

Concerns

- We're not opposed to removing the PAF from the calculation. However, we're also not a proponent of removing it either. I do think it's a little early and maybe drastic. We've only had a couple years of the new Retro calculation. Also, when new Retro was introduced, we assumed that the PAF would be at 1.0. Everyone based their plans on it being at 1.0. What is the likelihood of that going over 1.0? Then we have everyone on the other side of Retro saying, "Well, now you guys are all getting another break because it's over 1.0." So, I think I'd just like to see a little bit more studies or some more actuarial calculations done and presented before we move forward with adopting a rule or proposing something like that.
- There was apprehension to eliminating the PAF from premium based plans to "fix" this as a solution given that this would be a permanent change to a calculation that is not a permanent calculation, i.e. there is an "audit" that is to occur every 5 years and LNI is to adjust the calculations accordingly to ensure fairness in refund allocation, etc.
- The formula, to me, is the problem. If it doesn't work under one scenario, taking out a little piece of this formula, what makes that any more accurate? What makes that better? It just solves your immediate problem. And this occurs because the performance adjustment factor approaches 0.85. What happens when the performance adjustment factor approaches 1.15? You're going to have the component problem whereby folks are getting more of an assessment or less of a refund than they should have.

Suggestions

- There should be a provision to study the impact of the PAF being utilized and not utilized in the premium based individual Retro plans refund calculation as part of the overall refund study every 5 years. This will ensure no overcorrections are made premium to loss plans, industry group to industry group (our concern given LNI already made changes to the LDF's to correct for a bias AND that there had not been a Retro adjustment on a year with the new LDF's at the time of the Oliver Wyman study), etc.

- We're not opposed to removing the PAF from the calculation. However, we're also not a proponent of removing it either. I do think it's a little early and maybe drastic. We've only had a couple years of the new Retro calculation. Also, when new Retro was introduced, we assumed that the PAF would be at 1.0. Everyone based their plans on it being at 1.0. What is the likelihood of that going over 1.0? Then we have everyone on the other side of Retro saying, "Well, now you guys are all getting another break because it's over 1.0." So, I think I'd just like to see a little bit more studies or some more actuarial calculations done and presented before we move forward with adopting a rule or proposing something like that.

- We appreciate the approach the department took: bring it to our attention quickly, get outside counsel, consider alternative proposals, and examine means to the goal. Consider language to preclude participants earning refunds when their losses indicate an assessment. Can we fix this in the application contract? What could be unintended consequences of removing the PAF from the calculation?