Washington State Department of
Labor & Industries

Issue Brief

Issue: Retro Insurance Tables Study and Proposed Rules Changes

Date: August 15, 2016

Summary

When the Retrospective Rating rules were updated in 2011, one of the changes made to Washington Administrative Code (WAC) 296-17B-010 was a requirement to study the insurance tables periodically.

The work that is being reviewed does not change the organization of the tables in any way. In fact, the purpose is to make the charges/savings fair and accurate, based on the most recent experience in the State fund and Retro. The most technical aspects of the work have to do with the creation of the insurance charges and insurance savings tables.

The work of the L&I actuaries is being reviewed by the independent actuaries at Oliver Wyman (Eric Hornick and Scott Lefkowitz).

The target effective date for the rules changes is June 2017: meaning, the July 2017 coverage year (July 1, 2017 – June 30, 2018) would be the first impacted. The first adjustment under the new rules will be in May 2019.

Background

The purpose of the Insurance Tables Study is to meet the requirement of WAC 296-17B-010 and to ensure that the results are consistent with the expectation of improved fairness in the distribution of the refunds among participants. Based on the outcome of this study, changes to the insurance tables will be required to ensure these outcomes are met.

We are doing this work with the same principles in mind that guide the Retro program and that were called out in the Proviso study that led to the 2011 rules changes:

- We want the refunds / (assessments) earned by the groups and individually-enrolled employers to be based on safety, return to work, and effective claims management as well as plan choices.

- We are not making any changes in the methods or approach to calculating refunds / (assessments) nor are we fundamentally changing the incentives or rules for participation.

- The changes we are making are simply to sharpen the focus on safety, return to work, effective claims management, and the distribution of total refunds among/between the groups and individually-enrolled employers.

Because these are consequential changes and the math is complex, we engaged a consulting actuarial firm, Oliver Wyman, to provide an independent analysis of the work completed by the L&I Actuarial Services team. [Attachment 1 is a cross-walk of the contract with Oliver Wyman with the current WAC and our staff recommendations.]

Impacts

The net effects of the rules changes are:

1. **Reassignment of risk classes to hazard groups**

   This may result in increased or decreased charges – and consequently refunds / (assessments) -- for certain Retro participants. The forecasted impacts are very limited in scope: few participants see changes at all, most of those move little, some move up and some move down. We calculate hazard group at the time of adjustment, so the impacts will occur starting with the first round of adjustments in May 2019 (*Exhibit 1*).

2. **Recalculation of insurance charges and insurance savings tables**

   This is the foundation behind the math of the Retro program; it's our equivalent of rate making. Our intention is to make the tables more accurate and fair, based on more current data. The proposed changes would have an important redistributive effect.
   - The general trend is relatively lower charges for the participants with greater premium and relatively lower charges for participants in loss-based plans.
   - Conversely, there will be relatively higher charges for the participants with lesser premium and relatively higher charges for participants in premium-based plans.

3. **Different plan choices**

   We do need a change in the rules to require participants risk at least 5% of their standard premium and that their plan choices reflect a difference between maximum loss ratio and minimum loss ratio of at least 20 percentage points. There are a small number of participants that will be required to elect new, different plan choices to come into compliance with this rule (*Exhibit 2)*. Some participants may elect to withdraw from Retro as an alternative.

   The new tables also offer new plan choices in the form of changing single loss limits (*Exhibit 3*). The single loss limits will be modified to reflect:
   a) The rising costs of claims;
   b) The needs of customers; and,
   c) Better alignment of incentives with rewards.

   There will be an introduction of a new intermediate value on the scale of single loss limit choices which will require one more set of tables.

4. **PAF, ELRFs (Performance Adjustment Factor, Expected Loss Ratio Factors)**

The Performance Adjustment Factor is a poorly understood calculated value. The PAF is the figure that is used to derive the correct (best fit) distribution of refunds / (assessments) among and between Retro participants in order to meet the target level of overall refunds (Performance Adjusted Refund). The PAF is calculated for each adjustment of a given coverage period.

In order to reduce the volatility in the PAF, a modest change in the ELR, for the Accident Fund, is needed to assure that the PAF consistently stays as close to 1.0000 as possible. (No change is proposed for the ELR for the Medical Aid fund.)

The impact of this change is to discount the cost of certain claims which, in turn, will result in relatively lower net insurance charges and relatively higher refunds, depending upon the plan choices of the Retro participant, and the performance of all other Retro participants relative to their own plan choices.

5. **PAE, CAE (Premium Administrative Expense, Claims Administrative Expense)**

These values are independent of the performance of the Retro participant and are calculated as a percentage of premiums. The derivation of these factors is based on a review of actual charges over the most recent several years. The current and proposed ratios are defined below.

	PAE	CAE
Proposed	4.3%	9.0%
Current	4.8%	7.0%

The impacts of these changes are modest, variable and not easy to forecast. However, these changes won't influence plan choices or other safety, return to work or claims management programming.

Stakeholder Outreach

The first stages of stakeholder outreach are related to the release of the report from Oliver Wyman. We plan to share the report ahead of the August 19th Retro Advisory Committee (RAC) meeting and to have Eric Hornick, from Oliver Wyman, here in Tumwater to present the key findings and take questions.

Subsequently, we plan to prepare and deliver reports to each Retro participant (and their Third Party Administrator (TPA), if any) with:

- High-level review of the proposed changes
- Calendar of events, including rule-making activities (with hearing dates)

- Implications for similarly-situated customers, e.g.
    - plan changes will be required to come into conformance;
    - no changes required, but increased charges / reduced refunds are likely – it may be advisable to re-consider participation;
    - no changes required, but opportunities for revised plan choices to increase refund potential;
    - contact information for the Retro team and the assigned FIC (Financial Incentive Coordinator).

Before the hearing date(s), we would meet with Retro participants individually and in small groups – sometimes using technology solutions – to answer questions and present additional modeling of anticipated potential results.

We will maintain the current calendar of RAC meetings –with the next being on December 16th -- and will accommodate other Retro Community meetings as well.

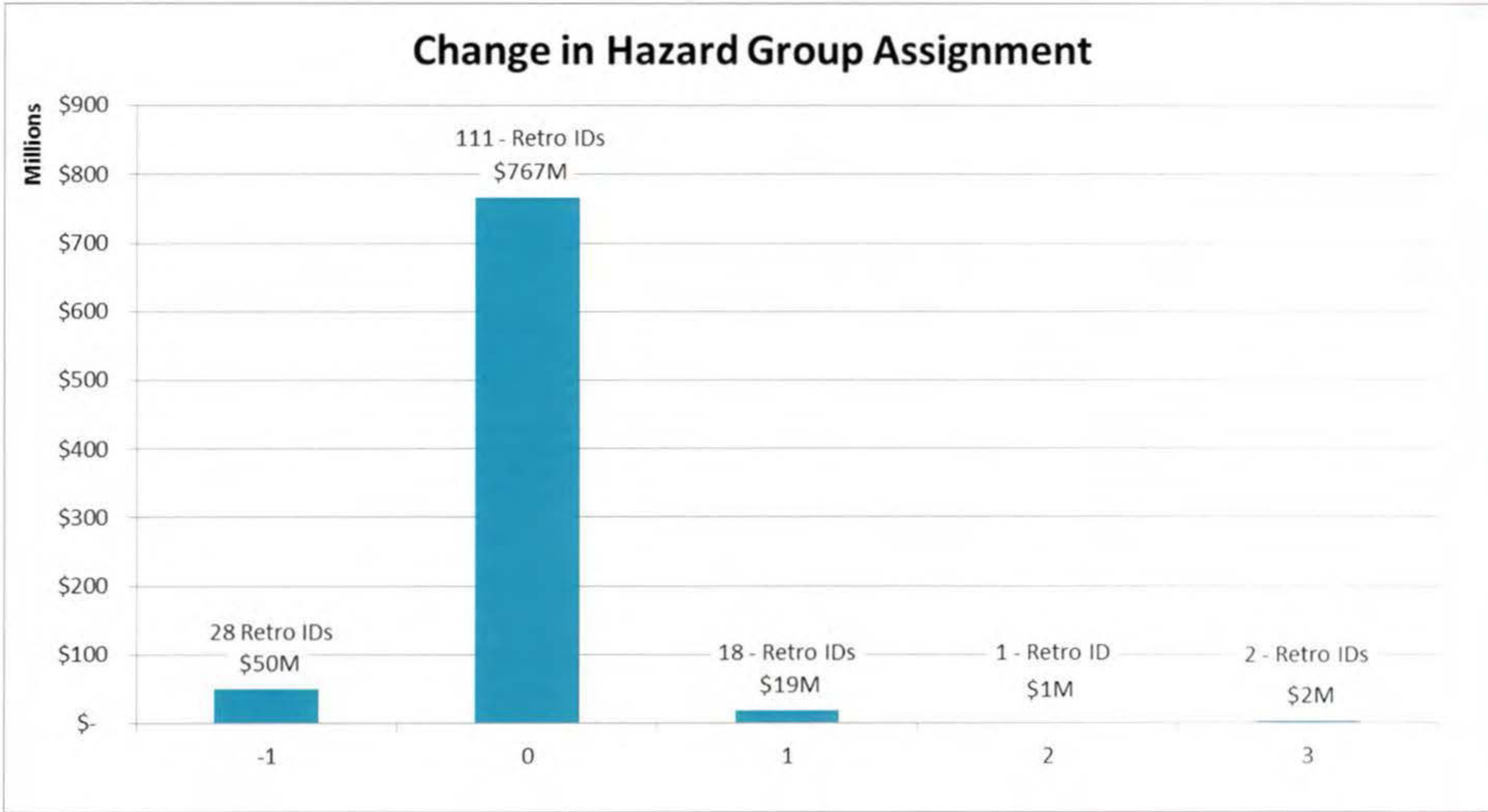
Staff Contacts

Tim Smolen, Program Manager, 360-902-4835

Jessica Nau, Assistant Program Manager, 360-902-9134

Ashley Frank, Financial Incentive Coordinator, 360-902-6573

Exhibit 1



Change in Hazard Group Assignment
Millions
$900
$800
$700
$600
$500
$400
$300
$200
$100
$-
111 - Retro IDs
$767M
28 Retro IDs
$50M
18 - Retro IDs
$19M
1 - Retro ID
$1M
2 - Retro IDs
$2M
-1
0
1
2
3

Exhibit 2

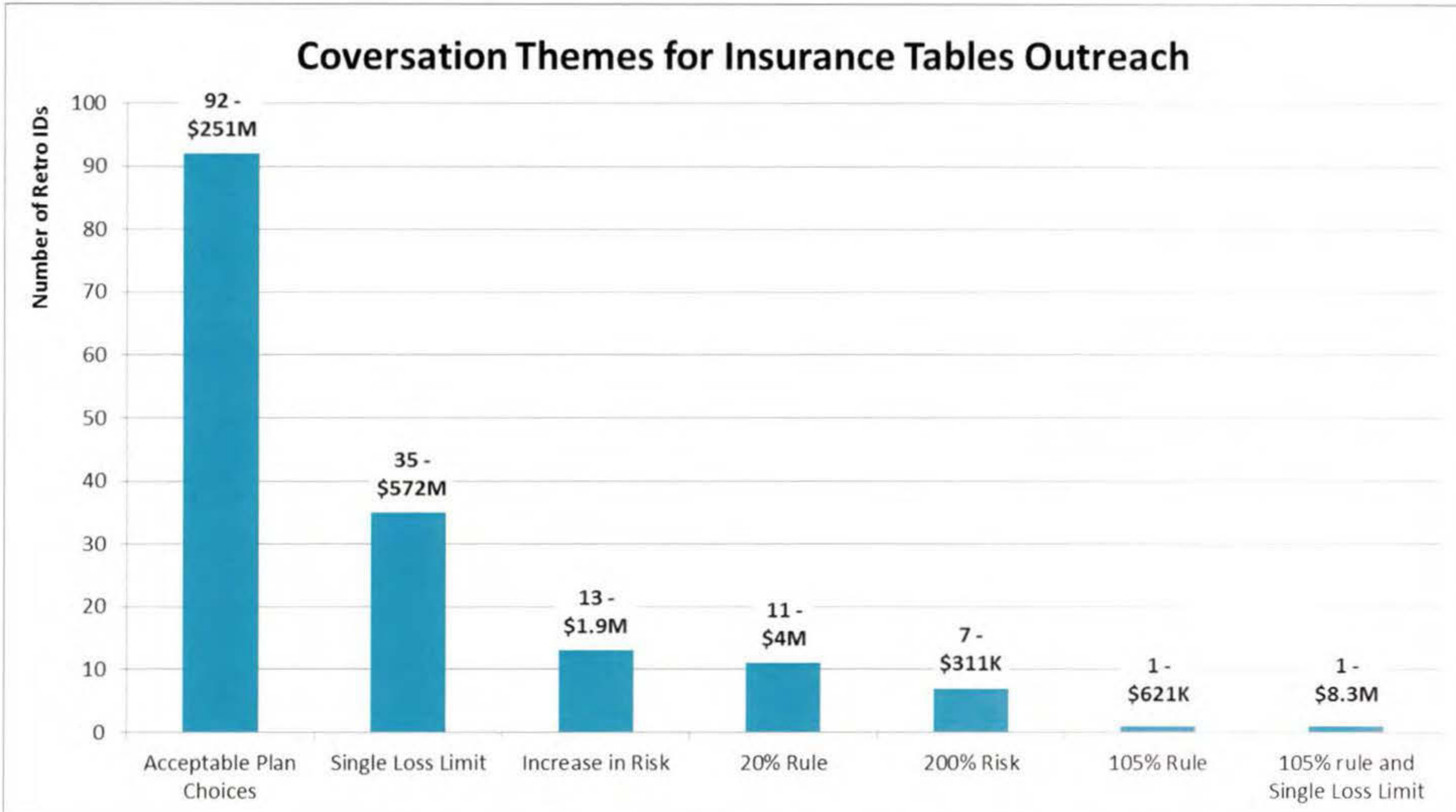
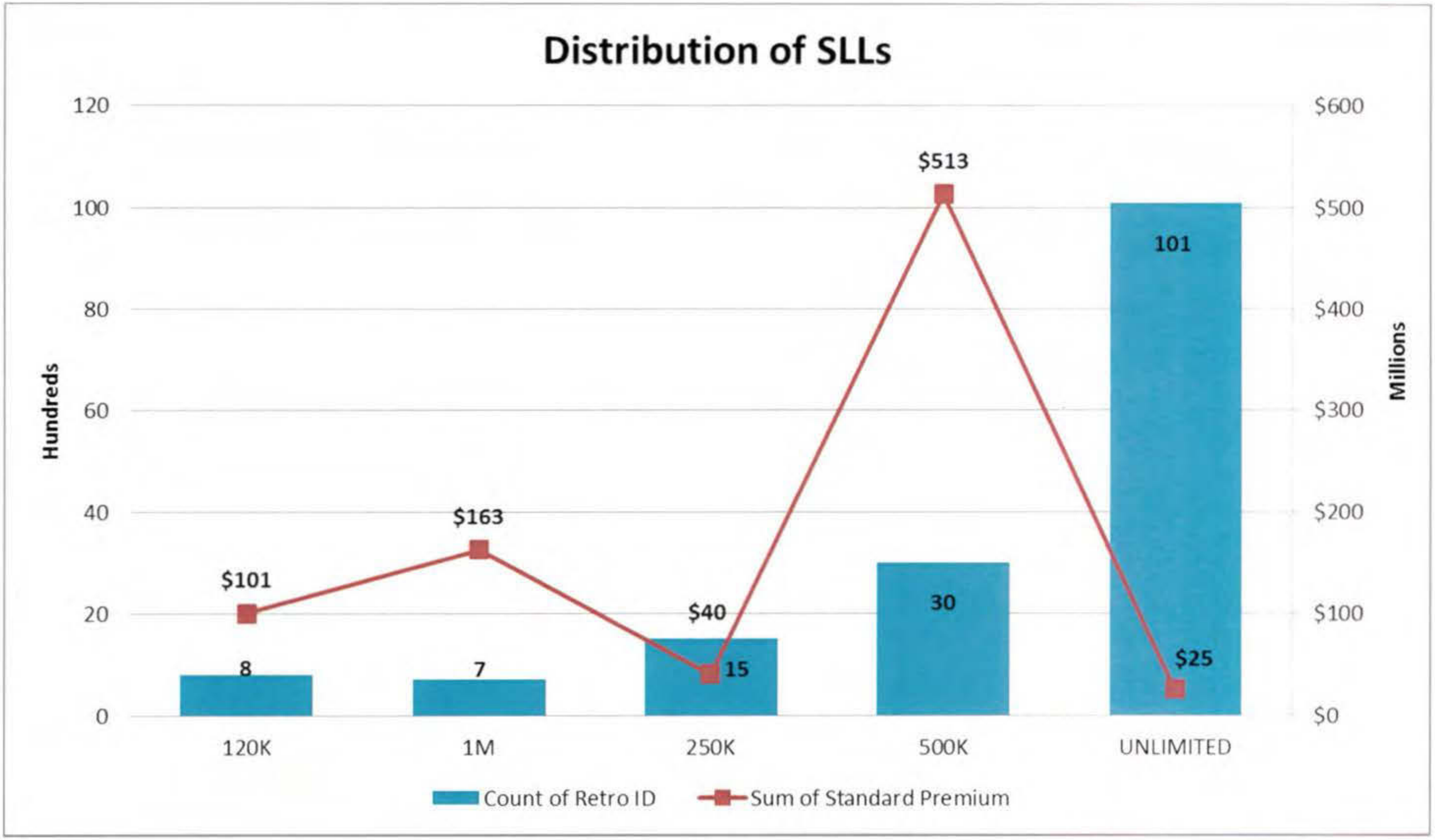

Coversation Themes for Insurance Tables Outreach
Number of Retro IDs
100
90
80
70
60
50
40
30
20
10
0
92 - $251M
35 - $572M
13 - $1.9M
11 - $4M
7 - $311K
1 - $621K
1 - $8.3M
Acceptable Plan Choices
Single Loss Limit
Increase in Risk
20% Rule
200% Risk
105% Rule
105% rule and Single Loss Limit

Exhibit 3



Distribution of SLLs
120
100
80
60
40
20
0
Hundreds
$600
$500
$400
$300
$200
$100
$0
Millions
$101
$163
$40
$513
$25
8
7
15
30
101
120K
1M
250K
500K
UNLIMITED
Count of Retro ID
Sum of Standard Premium

Cross-walk statement of work to rules, with recommendations

	Contract language	Washington Administrative Code (WAC)	Notes	Recommendations
1.1	Review proposed 2016 table of risk classification assignments to the nine hazard groupings.	WAC 296-17-901	Risk classes per hazard group	The review of risk class assignments to hazard groups affected the hazard group assignments.
		WAC 296-17B-560	Determining your hazard group and size group. (1) Each risk classification is assigned to a hazard group, as shown in WAC 296-17-901. To determine your hazard group, we will first multiply your standard premiums in each risk class by the hazard group index for that risk class. This is called the adjusted standard premium.	The assignment of hazard groups to RRID's is indicated by the data (rather than "capping" the movement of risk classes and consequently hazard group assignments to RRIDs).
		WAC 296-17B-910 — WAC 296-17B-990	Insurance Charges Table // Insurance Savings Table -Based Plan, with -Single Loss Limits Hazard Group -	
1.2	Review proposed 2016 actuarial retrospective rating tables: • Insurance charge/savings. • Premium size groups. • Retrospective rating factors. ○ Expected loss ratio factors per fund. ○ Premium administration expense factor. ○ Loss adjustment expense factor.	WAC 296-17-901	We will determine your size group based on your standard premiums using the table in WAC 296-17B-900	This is reviewed annually and there is no effect by these changes.
		WAC 296-17B-300	Choosing loss limits • Single loss occurrence limit • Aggregate loss limits ○ Minimum loss ratio, maximum loss ratio • Restrictions on choice of limits	Single Loss Limits Currently Retro participants have the following single loss limits to choose from (**note: some choices are not available to some participants)*: • $120,000 • $250,000 • $500,000 • $1,000,000 • Unlimited The recommendation is to offer Retro participants the following single loss limits to choose from: • $160,000 • $275,000 • $380,000 • $550,000 • $800,000 • Unlimited

				These new single loss limits are adjusted to account for: • Inflation in claims costs • Appropriate level(s) of protection • Appropriate pricing of protection • Diversity of options • Incentivize people to take the appropriate level of risk
		WAC 296-17B-420	Premium administration expense charge You will pay a premium administration expense charge for your share of the expenses of the industrial insurance program that are not directly related to claims administration. The premium administration expense charge is the same for all Retro participants.	The premium administration expense factor is currently 4.8%. This will be adjusted using premium and expense data from 2013-2015. The recommended adjusted value is 4.3%.
		WAC 296-17B-430	Incurred loss and expense charge You will pay for the cost of your claims and their administration for those injuries occurring during your retrospective rating enrollment period. The claims administration expense charge is the same for all Retro participants.	The claims administration expense factor is currently 7.0%. This will be adjusted using data from 2006-2015. The recommended adjusted value is 9.0%.
		WAC 296-17B-440	Net insurance charge (Loss-based) your net insurance charge will be calculated using the following formula: (Loss insurance charge factor - Loss insurance savings factor) / [1.0 - (Loss insurance charge factor - Loss insurance savings factor)] x Incurred loss and expense charge *Your loss insurance charge factor and loss insurance savings factor will depend on your maximum and minimum loss ratio choice, size group and hazard group*	This formula is not changing.
		WAC 296-17B-560	Determining your hazard group and size group	No change in the method we use.

		WAC 296-17B-830	Expected loss ratio factors • Accident Fund \ 81.2% • Medical Aid Fund \ 88.0% Separate factors will be calculated by fund and also by enrollment period at the time of each annual retrospective rating adjustment.	The Expected LRFs will be adjusted to get the Performance Adjustment Factor closer to 1.0 consistently. The recommended adjusted numbers are: • Accident Fund = 76.6% • Medical Aid Fund = 88.0% (no change)
		WAC 296-17B-910 – WAC 296-17B-990	* See above	
1.3	Review proposed 2016 largest minimum loss ratios and the smallest maximum loss ratios used in the Retrospective Rating Insurance Charge Tables.	WAC 296-17-901 WAC 296-17B-300 WAC 296-17B-440 WAC 296-17B-560 WAC 296-17B-830 WAC 296-17B-910 – WAC 296-17B-990	* See above	Minimum Loss Ratio, Maximum Loss Ratio Currently Retro participants can choose the following: • a minimum loss ratio between 0.0000 and 0.6000 • a maximum loss ratio between 0.3000 and 1.6000 and requires the relative difference between the minimum and maximum loss ratios to be at least 10%. The recommendation is to * require the relative difference between the minimum and maximum loss ratios to be at least 20% * require participants risk between 105% (new) and 200% (no change) * adjust lower limit of maximum loss ratio to 0.4000 so that participants can choose a maximum loss ratio between 0.4000 and 1.6000
1.4	Review proposed 2016 minimum premium to participate as an Individual member.	WAC 296-17B-100	Individual retrospective rating • Have paid standard premiums at least equivalent to the minimum premium listed in size group 1, Table 1, WAC 296-17B-900, in the four calendar quarters prior to applying for enrollment	The recommendation will be to not change this rule – and to stress that it may be imprudent for some employers, with low premium (less than six-figures), to participate.

		WAC 296-17B-900	Retrospective rating plans standard premium size ranges • Size group number / Standard premium range	
1.5	Review the experience of 2011 and 2012 enrollments to see whether the use of hazard groups and increasing the number of development factors from the previous five (5) factors used prior to 2008 have together improved the accuracy and fairness of Retrospective Rating.	WAC-296-17B		The review will be that, based on current evidence, this is a positive change.