

**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 **January 1, 2015**.

FILE NUMBER REG-2014-00015

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.

At my direction, the Workers' Compensation Insurance Rating Bureau ("WCIRB") submitted its January 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:

The Approved Advisory Claims Cost Benchmark and Pure Premium Rates

The WCIRB is directed to adopt an Advisory Claims Cost Benchmark at \$2.74 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 \$2.77 per \$100 of employer payroll. The Public Members' actuary recommended a rate of \$2.69 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 \$2.74 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 differs slightly from the recommendations of the WCIRB and Public Members' actuary.

The gap between the recommendations of the WCIRB and the Department is due to differences in actuarial projections regarding Senate Bill ("SB") 863. The Department of Insurance recommends an additional 2.5 % reduction in medical losses due to anticipated savings in SB 863, which the Department projects will result from the new Independent Medical Review process. This additional 2.5 % reduction is not reflected in the WCIRB's recommendation.

Workers' Compensation Pricing

The WCIRB's filing for January 1, 2015 demonstrates that insurers continue to charge premiums that are very close to the estimated cost of providing benefits and adjusting expenses. At the same time, insurers once again filed substantially higher manual rates (rates that could be charged to employers). The rates actually charged to employers, however, are substantially lower on average than the filed rates. This is due to a common insurer practice of discounting from the filed rates. The extent to which insurers will discount from the filed rates in the future, however, remains to be seen.

The fact that insurers are substantially discounting their manual rates has helped to keep workers' compensation insurance prices lower, despite increasing costs. Over the past few years, we have observed many insurers draw down from their surplus and capital to sustain lower pricing. This trend cannot continue indefinitely in the long term but at present, employers are benefitting from competitive pricing. The Department of Insurance will continue to closely monitor this trend to ensure that pricing and discounting are fair and financially responsible.

Impact of SB 863 on Pure Premium Rates

The WCIRB, the Department of Insurance, and the Public Members' actuary all agree that the net impact of SB 863 will result in a reduction to the pure premium rate for 2015. There are differences of opinion, however, regarding the amount of savings attributable to SB 863.

Both the WCIRB and the Department project a relatively modest level of net savings of \$0.02 and \$0.05 per \$100 of payroll, respectively. The Public Members' actuary projects a net savings of \$0.22.

In developing its projection of SB 863-related savings, the WCIRB worked with a number of outside groups, including governmental, academic, and insurer organizations. The Proposed

Decision for the January 1, 2015 Benchmark described in significant detail the WCIRB's assessment of the various components of SB 863.

As was the case in 2014, the Department of Insurance continues to agree with the WCIRB's projection of SB 863-related net savings in most respects. The one significant divergence of opinion, however, stems from the Department's projections in medical cost savings. While the WCIRB chose not to estimate any medical cost savings due to SB 863, the Department of Insurance concluded that we would observe a 2.5 % reduction in medical costs in 2015 due to the implementation of Independent Medical Review ("IMR").

I agree with the SB 863-related savings projections recommended by the WCIRB and Department of Insurance. I also agree with the Department that an additional reduction in medical costs of 2.5 % is a reasonable projection, and I adopt it as part of my pure premium decision and order. Thus, for January 1, 2015, I project that the overall SB 863-related system savings amounts to \$0.05 per \$100 of payroll.

I have instructed the WCIRB to continue to study the effect of the IMR process on system costs in California. As part of the study, the WCIRB will evaluate the impact of IMR on actual claim settlements in 2014. 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 November 10, 2014, and direct the WCIRB to adopt an average Advisory Claims Cost Benchmark of \$2.74 per \$100 of employer payroll and adjust pure premium rates for individual classifications based upon this Benchmark.

IT IS SO ORDERED THIS 13 DAY OF NOVEMBER, 2014.



DAVE JONES
Insurance Commissioner