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**REPORT OF ACTUARIAL PEER REVIEW AND ANALYSIS OF  
RATEMAKING PROCESSES**

**OF THE**

**NATIONAL COUNCIL ON COMPENSATION INSURANCE, INC.**

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January 12, 2012

Kevin M. McCarty  
Commissioner  
Office of Insurance Regulation  
State of Florida  
Tallahassee, Florida 32399-0326

Dear Commissioner:

Examination Resources, LLC (ER) was contracted to conduct the actuarial peer review and analysis of the ratemaking processes of the

**NATIONAL COUNCIL ON COMPENSATION INSURANCE, INC.  
901 Peninsula Corporate Circle  
Boca Raton, Florida 33444**

hereinafter referred to as "NCCI" or "Company." ER is currently performing a Multi-State Examination of NCCI on behalf of the Advisory Organization Examination Oversight (C) Working Group of the National Association of Insurance Commissioners. The Multi-State Examination encompassed the period from January 1, 2006 through December 31, 2009. However, the scope of the examination was extended to include the review of operations through December 31, 2010.

The Multi-State Examination included a review of NCCI's business practices relating to its rate making process, which was performed by actuaries of Taylor-Walker & Associates, as part of the ER Examiner Team.

ER respectfully submits the following report, which represents excerpts from the Multi-State Examination Report.

## **PURPOSE AND SCOPE OF PEER REVIEW**

The Florida Office of Insurance Regulation initiated a biennial actuarial peer review and analysis of the ratemaking processes of NCCI in accordance with Section 627.285, Florida Statutes. This peer review was to leverage 100% from the report findings for the Operations/Management/Governance Standards 2, 3, 8, and 11 and Ratemaking Standard 1 of the Multi-State Examination that included the review of operations through December 31, 2010.

## **OPERATIONS/MANAGEMENT/GOVERNANCE**

The advisory organization examination is designed to verify that the advisory organization maintains procedures for providing regulated services that are in accordance with applicable statutes, rules and regulations.

### Standard 2 - Operations/Management/Governance

The advisory organization uses sound actuarial principles for the development of prospective loss costs.

### **Results: Pass**

**Observations:** A procedural review and testing were performed to address this standard. A review of a sample of rate filings was performed to address this standard, following guidelines set forth in Actuarial Standards of Practice 12, 13, 23, 25, 29, 30, 38, 39, and 41. A sample of seven separate experience/loss cost rate filings was reviewed by the examiners:

Rate Filing	Effective Date
Illinois	January 1, 2009
Iowa	January 1, 2007
Kansas	January 1, 2007
Maryland	January 1, 2011
Missouri	January 1, 2011
Montana	July 1, 2007

As part of this review, a sample of calculations supporting the derivation of certain loss costs was verified, including:

- On-level factors
- Factors to adjust for loss-based expenses

- Trend factors
- Factors to adjust limited losses to an unlimited basis
- Factors to develop policy year premiums to ultimate
- Loss development factors

The agendas and minutes for all Actuarial Committee meetings held between January 25, 2007 and May 19, 2010 were reviewed to focus on those meetings where methods used in the development of prospective loss costs and/or rates were discussed. The Actuarial Committee was found to act in only an advisory capacity. There are no votes taken, so the Committee does not act to adopt or not adopt recommendations. NCCI staff prepares a work plan at the beginning of each year that summarizes activities to be addressed during the year. The Actuarial Committee meets at least four times per year (normally in January, May, August, and October/November). Occasionally, additional meetings have been held outside of this timeframe (e.g. June 24, 2009 and May 19, 2010). Agendas are distributed prior to the meetings and minutes are distributed subsequently.

Specific methods used in the development of prospective loss costs that were reviewed in meetings held during this time period include:

- A statistical trend model for forecasting frequency, severity, and loss ratio
- Tail factor calculation methodology
- Class ratemaking. This area received the most attention by the Committee since it represented the most significant change undertaken in the period under review.

Two items specifically related only to rates that were reviewed were:

- The cost of capital
- Expense provisions

NCCI staff work together collaboratively with the Actuarial Committee providing input and feedback. A clear example of this is the implementation of the new class ratemaking methodology. The Committee reviewed this methodology from October 2006 through its implementation in 2009, with an analysis presented in May 2010 on the initial year's results. Throughout this process, the Actuarial Committee's questions and suggestions appear to be fully considered.

In addition to reviewing the minutes and agendas of the Actuarial Committee meetings, several papers detailing methods used were reviewed. These include:

- Class Ratemaking for Workers' Compensation: NCCI's New Methodology
- Workers' Compensation Ratemaking
- Statistical Trend Estimation with Application to Workers' Compensation Ratemaking
- Catastrophes and Workers' Compensation Ratemaking

Additional methods used by NCCI in trending, on-level calculations, credibility, etc. are widely documented standard actuarial methods.

The unit statistical and aggregate financial data that are used to develop aggregate rates and class rates are subject to a validation processes to ensure completeness and accuracy. Testing indicated that the data used in rate making are complete and accurate. Data for which the completeness and accuracy is in question are not used in ratemaking until it has been corrected.

Based on the above review and the finding that NCCI develops rates and risk classifications in accordance with applicable Standards of Practice, it was concluded that NCCI has implemented policies and procedures to ensure the development of prospective loss costs and/or rates in accordance with sound actuarial principles.

### Standard 3 - Operations/Management/Governance

The advisory organization prepares, submits filings as necessary, adheres to applicable state filing and/or approval requirements and written procedures prior to distribution of prospective loss costs, policy forms, endorsements, factors, classifications or rating rule manuals.

#### **Results: Pass**

**Observations:** A procedural review and detailed testing were performed to address this standard. NCCI makes filings on the System for Electronic Rate and Form Filing (SERFF) in all NCCI states except Florida and Illinois. Florida has an electronic filing system that is referred to as I-File. During the examination, Illinois required that paper filings be made. It is noted that earlier filings with the state of Kansas were also in paper form. However, Illinois and Kansas now require that current filings be made via SERFF.

The effective date of a filing may be based on statutory requirements, regulatory request/input, potential impact to the industry, and/or time required for implementation. Typically, NCCI uses the following business rules to establish the effective dates on rule and form filings:

#### Business Rules for Effective Dates:

- For state item filings, at least 60 days in the future.
- For national rule item filings, at least 6 to 18 months in the future
- For national form item filings, at least 18 months in the future

Typically, the effective date of rate/loss cost filings (except law-only filings) occurs on the same date each year. The actual filing is made in advance of the effective date to accommodate the amount of time it takes to process and approve a rate filing. Generally, the timing of this process remains the same from year to year for each respective state. However, if a rate or loss cost is revised to reflect the impact of a change in the statutory benefit structure, the effective date is established via the underlying legislation. Other types of filings such as rule, form, class and statistical may be prompted by law and rule changes initiated by a regulator for which the effective date for use is set by that jurisdiction. In instances where such filings are initiated by NCCI based on its research, NCCI establishes an effective date based on the business rules noted above.

A sample of 94 item filings was reviewed to determine if filings are made using an approved filing system; if mandated time requirements are followed; if answers to regulator's questions are responsive; if materials distributed relative to a filing are the same as those filed with the applicable state regulator; and if accurate information is provided to subscribers relating to the states' approval status and approved usage date of prospective loss costs, policy forms, endorsements, factors, classifications or rating rules in a timely manner.

The sample size was determined in accordance with the sampling procedures set forth in Chapter 14, of the NAIC Market Regulation Handbook. The population of filings during the examination period was estimated to be 500 filings. Based on the Acceptance Samples Table (AST) in Chapter 14, a sample size of 86 is required. However, since the total population was based on an estimate, the examination team determined that a more conservative sample size of 94 should be selected. Filings for the following states were included in the review: Alabama, Alaska, Arkansas, Arizona, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Maine, Missouri, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, Oregon, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia and West Virginia.

Based on the filings sampled, NCCI makes filings using (SERFF) in all states except Florida and Illinois. Florida has an electronic filing system that is referred to as I-File, which NCCI uses, and paper filings were required by Illinois during the examination period. Of the 94 filings reviewed, 36 involved questions/interrogatories from state regulators for which all answers were responsive to the questions posed. For all filings reviewed, the materials distributed are the same as those filed with the applicable state insurance departments and notifications to subscribers announcing filings, subsequent approvals and effective dates were timely.

With the exception of one filing, all were filed within the appropriate time requirements. The exception was noted when the impact of the 2008 amendments made to Iowa code 515A, which were effective on April 25, 2008, was not reflected by NCCI as a rule change to the Basic Manual until April 24, 2009. However, since the acceptable error rate for the sample equates to five (5) exceptions, and only one exception was noted, it is concluded that based on this sample, NCCI's filing are timely.

During the review of rate filings, we did not note any concentration of warnings, fines, or other negative actions from state regulators regarding late or incomplete filings. NCCI represents that it has not been fined by any state regulator for not meeting filing/approval documents and has not received any warnings, communications or other negative actions from regulators in rate, rule, form filings, factors, classifications or technical manuals.

#### Standard 8 - Operations/Management/Governance

The advisory organization conducts ongoing research and review of state insurance laws and insurance-related case law in order to be responsive to necessary changes in prospective loss costs, policy forms, endorsements, factors, classifications or manuals, as applicable.

#### **Results: Pass**

**Observations:** A procedural review and detailed testing were performed to address this standard. Compliance with state laws, regulations and new legislation is maintained through direct communications with state regulators by monitoring the relevant legislative activities of each state. NCCI uses state relations executives (SREs) to monitor changes in laws and regulations. SREs are the primary contact with state regulatory authorities and are responsible for establishing relationships with the regulatory community, legislators, insurance trade associations, and employer and agent groups at the state level. This allows the SRE to identify and monitor regulatory changes that impact the statistical plans, forms, rules, rates/loss costs and relevant manuals for each state, and to then initiate changes, as applicable. NCCI has twelve SREs. Each is assigned a group of states for which each is responsible for monitoring the workers' compensation environment.

Through this process, once changes to laws and regulations are identified, the SRE initiates and monitors the appropriate filings with state regulators to make revisions accordingly. NCCI staff, with the appropriate subject matter expertise, assists the SRE in the filing process, and notifying members/subscribers of these changes.

NCCI uses circulars and informational releases to keep subscribers, members, agents and regulators informed of filings and subsequent approval/disapproval, as well as issues affecting the workers' compensation marketplace. These communications are similar to bulletins, press releases, notices, etc. that are used to communicate information to interested persons. These notifications are available both electronically via NCCI's website and in paper form.

A search for changes in laws and/or regulations that pertain to workers' compensation was conducted using NILS Insource. A judgmental sample of 20 new or revised laws that became effective since 2006 were selected for review. The review included statutes/regulations from fourteen (14) states: - Alabama, Arkansas, Colorado, Kansas,

Kentucky, Louisiana, Maine, Montana, New Hampshire, Oklahoma, Oregon, Utah, Vermont and West Virginia. For all items sampled, NCCI identified and adequately addressed the change in law/regulation. The appropriate modifications, additions, deletions or withdrawals to the statistical plan, forms rules, rates/loss costs and/or relevant manuals as necessitated by the underlying law/regulation were changed in a timely manner. In addition, members/subscribers were notified of these changes in a timely manner. NCCI is proactive in informing member/subscriber of changes in forms, rules rates/loss costs, classifications, or manuals that have been made as a result of legislative action.

#### Standard 11 - Operations/Management/Governance

When performing analysis and impact studies of proposed legislation, the advisory organization presents thorough and objective information.

#### **Results: Pass**

**Observations:** A procedural review and detailed testing were performed to address this standard. A sample of five separate impact/benefit change studies were reviewed by the examiners - Iowa (2010), Kansas (2010), Maryland (2008), Missouri (2008) and Montana (2010).

The samples reviewed related to studies triggered by either an action by a government entity such as the State Senate or State House of Representatives or an update of fee schedules. The final presentation of each impact study is the Impact Study Circular distributed to the state government entities and NCCI members. The process begins with a pricing documentation form driving the analysis process, providing guidelines for the analysis, and providing spreadsheets comprising the actual calculations of the analysis. This form requires that the following be disclosed for each impact study: quantified impact, data sources, methodology used, peer review, and identification of the impacted components of the rate filing. NCCI also researched external resources and used them as necessary for each study.

Impact studies are each unique because the approach taken is dependent on the proposed changes. Even when simply updating medical fee schedules, there could be differences in application, exceptions, etc. between states or between current and prior updates. Therefore, studies were primarily reviewed for consistency of approach and procedures. Spreadsheets were reviewed for overall reasonableness and consistency with Impact Study Circulars and some calculations were also spot checked.

The underlying analyses provided by NCCI reconcile with the impact study circulars with the exception of the Missouri study. NCCI explained that this circular was based on the results of an earlier analysis/study, whereas the analysis/study provided to the examiners was based on updated experience. The update was performed to evaluate whether the original overall impact was still reasonable. The updated overall impact indicated in the

spreadsheet was 0.3%, compared to the original estimate in the circular of 0.2%. Therefore, NCCI determined that the original estimate was still reasonable and did not update the circular.

Based on the examination review of the five sample studies provided, NCCI presents information in an objective manner, using reasonable assumptions, research, and data. More specifically, NCCI has a consistent process to:

1. Research and acquire the necessary available data;
2. Identify and state the significant assumptions; and
3. Present the current and proposed conditions and the analysis driving the cost changes in an objective manner.

There are various teams and positions in place to internally vet analyses and impact studies of proposed legislation. One of these positions is a state team mentor/peer reviewer and another is a management peer reviewer. Peer review of a draft-pricing memo begins after the quality review. At least one person performs this peer review. This review ensures that all material concerns are addressed in the memo and checks that the approach and results are reasonable. If any material changes are later made to the pricing memo, it must undergo another peer review. After the peer review, the memo is sent to several teams for final review, where at least two parties must sign off.

Law Evaluation Analysis Process (LEAP) defines the responsibilities of various personnel in determination of the cost impact of proposed or enacted legislation. The individuals and teams involved in this are: the State Relations Executive (SRE), the LEAP State Team Leader and team members, the State Actuary, Mentors/peer reviewers, the Management Team, Legal Representatives, and the LEAP Pricing Focus Leads.

LEAP does not strictly specify the education and experience of these personnel, though the State Actuary is likely a credentialed actuary. The extensive use of peer review and supervisory approval in each step implies that the impact studies are properly vetted by personnel having the appropriate education and experience.

For changes that are actually enacted, the LEAP State Team determines whether a further technical peer review should be conducted. This decision involves the SRE, State Actuary, Management Team, and LEAP Focus Leads for their final review. Procedures for conducting a technical peer review are also documented.

Based on the examination review, it was concluded that the advisory organization presents thorough and objective information when performing analyses and impact studies of proposed legislation.

## **RATEMAKING**

The purpose of this portion of the examination is to review NCCI's ratemaking, reports and reporting systems, if any, as well as its internal procedures for preparing related reports and responding to data requests, including the timeliness and quality of the response.

### Standard 1- Ratemaking

The advisory organization submits filings and/or submissions to the state within the established time frame.

### ***Results: Pass***

**Observations:** NCCI submits filings to states within established time frames. The activities and processes surrounding ratemaking including the timeliness of filings are also addressed under Standard 3 of the Operations/Management/Governance section of this report. Therefore, the description and results of the testing are summarized under that standard.

## **PEER REVIEW REPORT SUBMISSION**

In addition to the undersigned, the following individuals participated in the peer review. The actuarial phase of the examination was conducted by Randy Ross and Brent Sallay of Taylor-Walker & Associates, Inc.

Douglas Befort, CIE, CFE	Examiner In charge
Randall D. Ross, ACAS, MAAA	Actuary
Brent Sallay, FCAS, MAAA	Actuary

Respectfully submitted,



Examination Resources, LLC  
Todd Fatzinger, CFE, CIE, FLMI  
Examination Manager

**ACTUARIAL LETTER**

January 12, 2012

The Honorable Kevin M. McCarty  
Insurance Commissioner  
Florida Office of Insurance Regulation  
200 East Gaines Street  
Tallahassee, Florida 32399-0305

***Independent Actuarial Peer Review and Analysis of Ratemaking Processes  
of the National Council on Compensation Insurance, Inc.***

Dear Commissioner McCarty:

We were requested to provide our opinion regarding ratemaking processes of the NCCI for the State of Florida. We recently completed a multi-state examination of the NCCI with Examination Resources, Inc. Excerpts of the examination findings are attached.

The examination included a review of rate and loss cost filings for a selected sample of states. Although Florida filings were not necessarily included in the overall sample, we verified that the NCCI's rate evaluation processes and procedures were consistent among all states represented in the sample. We extrapolated this finding to encompass all states for which the NCCI is the designated rate service organization.

Our review was conducted in accordance with all applicable actuarial standard of practice, promulgated by the American Academy of Actuaries. In summary, we found that the NCCI filings complied with the market conduct examination Standards, as further discussed in the attached report.

If you or other Office staff have any questions regarding our report, or if you require any additional information, please contact us. We appreciate the opportunity of working with the Florida Office of Insurance Regulation.

Sincerely,

TAYLOR-WALKER & ASSOCIATES, INC.



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Randall D. Ross, ACAS, MAAA  
Consulting Actuary



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Brent M. Sallay, FCAS, MAAA  
Consulting Actuary