



AMERICAN ACADEMY *of* ACTUARIES

December 3, 2008

To: Sarah McNair-Grove
Workers' Compensation Large Deductible Subgroup
Casualty Actuarial and Statistical Task Force
National Association of Insurance Commissioners

From: American Academy of Actuaries
Workers' Compensation Subcommittee

Subject: First-Dollar Loss Equivalents for Large Deductible Policies

Dear Ms. McNair-Grove:

Thank you for another opportunity to comment on the reporting of data for large deductible workers' compensation insurance policies to the Workers' Compensation Large Deductible Subgroup (WCLDS) of the Casualty Actuarial and Statistical Task Force. The Workers' Compensation Subcommittee (WC Subcommittee) of the American Academy of Actuaries¹ is pleased to offer these comments pursuant to your request. This correspondence follows our August 28, 2008 proposal.

On November 3, 2008, the WCLDS held a teleconference to discuss, among other things, our August 28, 2008 submission. In the course of that teleconference, the prospect of identifying a first-dollar loss equivalent for large deductible policies as a possible basis for allocating loss-based assessments was raised. Subsequent communications have indicated that the WCLDS has not yet definitively embraced that construct as a part of its work, but the WC Subcommittee has agreed to consider that question as the deliberations of the WCLDS continue. Accordingly, the following narrative and attached exhibit are offered in the spirit of providing further assistance to the WCLDS, with the understanding that your group may or may not decide to pursue use of these materials for purposes of your continuing endeavors.

The "BACKGROUND" and "LIMITED NATURE OF THIS RESPONSE" portions of our August 28, 2008 proposal are equally applicable to this communication and are incorporated by reference. In particular, the WC Subcommittee's understanding is that modification of the Annual Statement as a means of addressing questions concerning large deductible coverage has been tabled. The WC Subcommittee's expectation is that

¹ The American Academy of Actuaries' mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

use of its proposed first-dollar equivalent for premium (previously provided) and/or this proposal pertaining to losses will be limited to a few circumstances in which the collection of the suggested data may assist in administration of specific assessments (not premium taxes) and will serve those purposes in lieu of expansion of the Annual Statement.

THE WC SUBCOMMITTEE'S RESPONSE:

The WC Subcommittee has developed a consensus in support of using the following reporting items to develop a first-dollar loss equivalent for large deductible business:

1. Calendar Year Case Incurred Losses for Large Deductible Policies Included in Total Workers' Compensation Losses Incurred on Statutory Page 14 of the Annual Statement
2. Calendar Year Case Incurred Losses Within the Applicable Deductible Retention for Large Deductible Business (Paid Losses During Year Plus Change in Case Outstanding Within the Applicable Deductible Retention)

The first amount cited above is readily available to workers' compensation insurers. Similarly, the WC Subcommittee expects that paid losses within the applicable deductible level and changes in case outstanding losses within the applicable deductible level are generally obtainable from existing carrier systems and records.

For comparative purposes, the WC Subcommittee is recommending that changes in Incurred But Not Reported (IBNR) amounts be excluded from both large deductible losses and from total workers' compensation losses. This approach arises from the WC Subcommittee's belief (as more fully discussed in its August 28, 2008 proposal) that insurers do not currently compute and/or maintain IBNR amounts for losses below deductible amounts by state and line of business.

The sum of calendar year case incurred losses above the applicable deductible retention and calendar year incurred losses within the applicable deductible retention will serve as a first-dollar loss equivalent for large deductible business. Adding the calendar year case incurred losses within the deductible retention to calendar year case incurred losses included in Statutory Page 14 for all policies would produce a comparable aggregate first-dollar loss amount for all workers' compensation business. A proposed reporting format for this data accompanies this memorandum.

Key observations about this approach arising from discussions of the WC Subcommittee are as follow:

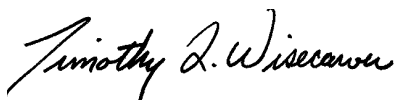
"Large deductible" may mean different things to different audiences. For the sake of consistency both for regulators and carriers, it would be best if prevailing definitions used by the various workers' compensation data collection organizations could be applied and if the definitions thus applied could be specifically articulated as part of the data reporting

requests and instructions, if and when the WC Subcommittee's proposed method is implemented. Additional observations include:

- Large deductible business is already subject to various data reporting requirements pertaining to losses, including unit statistical reports, sometimes supplemented with special calls (particularly where unit statistical data is not required to be reported on a first-dollar basis). The WC Subcommittee's first-dollar loss equivalent proposal anticipates that insurers are, and depends upon insurers being, able to secure complete and accurate information responsive to the components of its proposal, which it sees as being generally consistent with those prevailing reporting requirements.
- The losses envisioned above represent a reasonable basis for deriving the relative proportions of first-dollar losses attributable to large deductible business and all workers' compensation business.
- Defense and cost containment expenses are excluded from the loss figures suggested for use in this proposal because prevailing loss-based assessments generally exclude such expenses.
- While case incurred losses for amounts within the deductible on large deductible business are not, and would not be, prepared or presented in this form within the Annual Statement, carriers would presumably be able to document their tabulations or compilations of such amounts in support of their submissions using our proposal. It would be useful to inform carriers in advance of this potential need, so that they may have the opportunity to preserve and retain the pertinent reports and/or files.

The WC Subcommittee appreciates the opportunity to consider this matter and to share its thoughts with the WCLDS. The WC Subcommittee would be happy to discuss this response with you further at your convenience.

Sincerely,



Timothy Wisecarver
Chair, Workers' Compensation Subcommittee
American Academy of Actuaries