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PETITIONER	**§**	**BEFORE THE**
STAFF OF THE TEXAS	**§**	**COMMISSIONER OF**
DEPARTMENT OF INSURANCE	**§**	**INSURANCE**

PETITION FOR ADOPTION OF REVISED WORKERS' COMPENSATION CLASSIFICATION RELATIVITIES AND AMENDMENTS TO THE TEXAS BASIC MANUAL OF RULES, CLASSIFICATIONS AND EXPERIENCE RATING PLAN FOR WORKERS' COMPENSATION AND EMPLOYERS' LIABILITY INSURANCE UPDATING THE EXPECTED LOSS RATES AND DISCOUNT RATIOS

The staff of the Texas Department of Insurance files this petition concerning two proposals. The staff proposes the adoption of revised Texas workers' compensation classification relativities to replace those adopted pursuant to Commissioner's Order No. 11-0125, dated February 9, 2011. In addition, the staff proposes the adoption of updated expected loss rates and discount ratios in the Texas Basic Manual of Rules, Classifications and Experience Rating Plan for Workers' Compensation and Employers' Liability Insurance.

Article 5.96 and sections 2053.051 and 2053.052 of the Texas Insurance Code authorize the filing of this petition and the action requested of the commissioner. Article 5.96 authorizes TDI to prescribe, promulgate, adopt, approve, amend, or repeal standard and uniform manual rules, rating plans, classification plans, statistical plans, and policy and endorsement forms for various lines of insurance, including workers' compensation insurance. Section 2053.051 requires TDI to determine hazards by classification and establish classification relativities applicable to the payroll in each classification for workers' compensation insurance. Section 2053.052 requires the commissioner to adopt a uniform experience rating plan for workers' compensation insurance. Sections 2053.051 and 2053.052 provide that the classification system and experience rating plan be revised at least once every five years.

I. Proposal for Consideration and Adoption

A. Staff proposes the consideration and adoption of revised classification relativities to replace those adopted pursuant to Commissioner's Order No. 11-0125, dated February 9, 2011. Exhibit A is a schedule of the revised classification relativities.

B. Staff proposes the consideration and adoption of updated expected loss rates and discount ratios used in experience rating. Exhibit B is a schedule of the expected loss rates and discount ratios and will replace the schedule on pages ER-21 through ER-24 of the manual.

C. Staff proposes that the revised classification relativities be available for use by insurers immediately, but that their use be mandatory for all policies with an effective date on or after June 1, 2013, unless the insurer files an alternative classification rate basis. The staff further requests that the updated expected loss rates and discount ratios in the manual be made effective for workers' compensation experience modifiers with an effective date on or after June 1, 2013.

II. Background and Justification

A. Classification Relativities

Classification relativities compare the anticipated cost levels of each classification to the anticipated cost levels of other classifications. These relativities define likely cost relationships among classifications. For example, if one class has a relativity of ten and another has a relativity of five, one would expect the former class to produce twice the dollars of loss per $100 of payroll as the latter.

The classification relativities currently in effect are based on experience data reflecting workers' compensation experience from policies with effective dates in calendar years 2003 through 2007. The staff proposes to revise the classification relativities to reflect more recent experience. The proposed classification relativities reflect changes in experience based on analysis of experience data from policies with effective dates in calendar years 2005 through 2009.

The staff's analysis uses the Texas Workers' Compensation Statistical Plan data summarized by and obtained from the National Council on Compensation Insurance, Inc., TDI's statistical agent. The report summarizes the five most recent policy years of actual loss experience (2005 at fifth report, 2006 at fourth report, 2007 at third report, 2008 at second report, and 2009 at first report) by type of injury within each class. The staff reviewed this data for reasonability and consistency. Individual losses used in the experience base were limited to $550,000 in order to reduce possible distortions in individual classification indications due to unusually costly claims. The staff then calculated the ratios of unlimited to limited losses by type of injury separately for all state classifications combined and for all federal classifications combined. The staff applied the ratios to the limited losses by type of injury for each classification within the respective state or federal group in order to spread the excess costs over all classes.

Next, the staff developed the serious medical, serious indemnity, non-serious medical, and non-serious indemnity losses separately to an ultimate cost level. The staff adjusted the developed losses to account for changes in the maximum benefits payable to an injured worker and changes in the medical fee schedule. The staff divided the resulting losses by payroll to produce the experience pure premiums, which the staff then balanced to the overall average level of the current relativities using off-balance factors. This last calculation provided a revenue-neutral set of relativities in relation to the current relativities.

The staff then credibility weighted the experience pure premiums with the pure premiums underlying the current relativities. The staff again balanced the resulting relativities to the overall average level of the 2011 relativities so that the indications would be revenue neutral relative to the 2011 relativities.

The staff limited changes in the classification relativities to +25 percent and -25 percent. These limitations minimize rate shock due to large indicated changes in the relativities. The staff balanced the resulting limited relativities to the overall average level of the current relativities using off-balance factors, providing for a set of relativities that was revenue neutral in relation to the current relativities.

B. Expected Loss Rates and Discount Ratios

Modifications to the classification relativities require concurrent changes in the expected loss rates and discount ratios, which are contained in the experience rating plan of the manual.

Expected loss rates are the expected losses per $100 of payroll for the average insured in a classification. Applying the expected loss rate to an insured's payroll during its experience period determines the average losses for that classification. Comparing the insured's actual loss experience with these average losses and applying reasonable credibility standards will determine how much better or worse than average that experience was, and how much better or worse the experience is likely to be in the future.

The expected loss rates currently in effect reflect the average cost and frequency levels of losses that would have been used to experience-rate policies that were effective in 2011. The staff expects the proposed changes in the expected loss rates to reflect the average cost and frequency levels of losses that will be used to calculate experience modifiers with an effective date on or after June 1, 2013. This will produce experience modifications that more accurately reflect the anticipated experience.

The staff limited changes in the updated expected loss rates to +25 percent and -25 percent to minimize rate shock.

As part of the experience rating formula in the manual, larger losses are split into primary and excess amounts to prevent one or more large claims from unduly affecting an insured's experience modification. The primary portion of a loss is the lesser of the amount of the claim or $5,000. The excess portion is the portion of each loss in excess of $5,000. Each portion receives a different credibility weight in the experience rating process.

Discount ratios are ratios of primary expected losses to the total of primary and excess expected losses for each classification. The staff proposes to revise the discount ratios because the sizes of claims change over time due to modifications in medical schedules, permanent and partial disability ratings, the amount of maximum benefits payable to injured workers, and normal inflation. These factors affect the ratio of primary to total expected losses. The staff proposal revises the discount ratios to reflect the ratios that will be used to calculate experience modifiers with an effective date on or after June 1, 2013. The changes in the discount ratios are not subject to capping.

III. Requested Action

Staff respectfully requests that

(1) The commissioner adopt the proposed revised Texas workers' compensation classification relativities and amendments to the manual as specified in the attached exhibits;

(2) The proposed revised classification relativities be available for use by insurers immediately after adoption, but that their use be mandatory for all policies with an effective date on or after June 1, 2013, unless the insurer files an alternative classification rate basis; and

(3) The updated expected loss rates and discount ratios in the manual apply to all workers' compensation experience modifiers with an effective date on or after June 1, 2013.

Respectfully submitted,

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