W-0914-07-I

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

PETITION FOR ADOPTION OF THE *NATIONAL COUNCIL ON COMPENSATION INSURANCE EXPERIENCE RATING PLAN MANUAL FOR WORKERS COMPENSATION AND EMPLOYERS LIABILITY INSURANCE* WITH TEXAS EXCEPTIONS

The staff of the Texas Department of Insurance files this petition to adopt the *National Council on Compensation Insurance Experience Rating Plan Manual for Workers Compensation and Employers Liability Insurance (NCCI ER Plan)* and the Texas exceptions. Adopting the *NCCI ER Plan* with Texas exceptions is the last major step in Texas' transition to NCCI state status for workers' compensation purposes. The *NCCI ER Plan* with Texas exceptions will replace the current *Texas Experience Rating Plan* (*Texas ER Plan*), which is the last part of the *Texas Basic Manual of Rules, Classifications and Experience Rating Plan for Workers' Compensation and Employers' Liability Insurance* (*Texas Basic Manual*) in effect.

Staff proposes that the commissioner adopt the *NCCI ER Plan* with Texas exceptions for experience rating modifications with effective dates on or after July 1, 2015, and that any future revisions to the *NCCI ER Plan* with Texas exceptions follow either the procedure under Insurance Code Article 5.96 or the procedure in Commissioner's Order No. 3142. Staff also requests that the *Texas ER Plan* remain in effect for calculating experience rating modifications with effective dates prior to July 1, 2015.

Insurance Code Article 5.96 and §§2053.052, 1805.054, 1805.055, and 36.001 authorize staff to file this petition and the commissioner to take the requested action. Article 5.96(a) 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. Article 5.96(b) allows any interested person to initiate proceedings with respect to any matter specified in subsection (a) by filing a written petition with the chief clerk.

Section 2053.052 requires the commissioner to adopt a uniform experience rating plan for workers' compensation insurance and revise the rating plan at least once every five years.

Section 1805.054 allows a Texas workers' compensation insurer to subscribe to an advisory organization. Section 1805.055(a) allows an insurer to submit to or receive from a licensed advisory organization statistical plans, historical data, prospective loss costs, supplementary rating information, policy forms and endorsements, research, rates of individual insurers that are effective at the time the information is submitted or received or that were previously in effect, and performance of inspections.

Section 36.001(a) allows the commissioner to adopt any rules necessary and appropriate to implement the powers and duties of TDI under the Insurance Code and other Texas laws.

I. Proposal for Consideration and Adoption

(1) Staff proposes that the commissioner adopt the *NCCI ER Plan* with Texas exceptions.

(2) Staff proposes that the *NCCI ER Plan* with Texas exceptions be effective for calculating experience rating modifications with effective dates on or after July 1, 2015.

(3) Staff proposes that any future revisions to the *NCCI ER Plan* with Texas exceptions follow either the procedure under Insurance Code Article 5.96 or the procedure in Commissioner's Order No. 3142.

(4) Staff proposes that the *Texas ER Plan* remain in effect for calculating and revising experience rating modifications with effective dates before July 1, 2015.

II. Background

For the last several years, TDI has been working toward making workers' compensation insurance regulation in Texas more efficient. This effort has focused on eliminating functions not required by statute, which reduces TDI involvement in administrative aspects of the process.

On March 21, 2014, the commissioner issued Commissioner's Order No. 3142, which adopted the *NCCI Basic Manual* with Texas exceptions, and the national and Texas-specific endorsements and forms in the *NCCI Forms Manual*. This allowed NCCI to assume certain workers' compensation functions in Texas that TDI is not statutorily required to perform, and advanced Texas in the process of becoming an NCCI state. Additionally, the commissioner ordered that the *Texas ER Plan* would continue in force until TDI adopted the *NCCI ER Plan* with Texas exceptions, independent of the rules, classifications, endorsements, and forms in the *Texas Basic Manual*. Adopting the *NCCI ER Plan* with Texas exceptions, as contemplated in this petition, fulfills that condition.

On July 29, 2014, the commissioner issued Commissioner's Order No. 3455, which adopted the *NCCI Stat Plan* with Texas exceptions. This required carriers to follow the *NCCI Stat Plan* in reporting statistical data with more detailed information, particularly with regard to workers' compensation losses, and further advanced Texas in the process of being an NCCI state.

III. Justification

Adoption of the *NCCI ER Plan* with Texas exceptions is the last major step in Texas becoming an NCCI state. NCCI is a licensed advisory organization in Texas, the largest provider of workers' compensation and employee injury data and workers' compensation statistics in the nation, and the statistical agent and administrator for certain workers' compensation functions in Texas. This rule would adopt the *NCCI ER Plan* with Texas exceptions, which amend the *NCCI ER Plan* to comply with unique Texas statutory and rule requirements. NCCI will format the final Texas exceptions to match the style of its other manuals. The *NCCI ER Plan* is currently approved in 38 jurisdictions.

To facilitate this petition, NCCI has provided the draft of the July 1, 2015, Table of Expected Loss Rates and Discount Ratios, Table of Weighting Values, Table of Ballast Values, and various claim limitations, which appear in the *NCCI ER Plan*. NCCI is in the process of filing these tables and claim limitations with TDI. The tables and claim limitations provide a baseline for these values. In the future, NCCI will update these values and claim limitations as part of its annual loss cost filing. Staff has based much of its analysis of the impact of adopting the *NCCI ER Plan* on the information in the draft tables and claim limitations in anticipation of NCCI filing these updated values in September 2014. NCCI has assured TDI that the values in the September 2014 filing will be identical to the values provided in the draft.

An experience rating plan helps ensure that rates reflect individual risk characteristics accurately and helps tailor a risk's premium prospectively, which provides employers a financial incentive for maintaining a safe workplace. It determines whether an insured's claims experience is better or worse than the average risk within that classification by comparing the actual loss experience of individual insureds with the average insured within the same classification.

The rules in the *NCCI ER Plan* and the *Texas ER Plan* cover the same areas:

- eligibility for experience rating modification
- calculation of the experience rating modification
- application of the experience rating modification.

However, there are substantive differences between the *Texas ER Plan* and the proposed *NCCI ER Plan*:

- NCCI's experience rating modification formula incorporates an experience rating adjustment that reduces the amount of the medical-only claims used in the experience rating modification calculation; changes the split point, with corresponding updated weights, ballasts, and claim limitations; updates the expected loss rates and discount ratios; and includes a maximum debit modification.
- The *NCCI ER Plan* includes a transition period for eliminating negotiated experience rating modifications.

Experience Rating Modification Formula

The *NCCI ER Plan* proposes the use of the experience rating adjustment to reduce the amount of medical-only claims used in the formula by 70 percent instead of using the entire amount of the loss. NCCI's research shows that including 30 percent of the medical-only losses produces experience rating modifications that appropriately reflect differences between risks.

The *NCCI ER Plan* establishes the split point, which separates losses into primary and excess components. The calculation of the experience rating modification uses the entire primary loss, while only a portion of the excess loss is used. NCCI will update the split point as part of its annual loss cost filing. Adopting the *NCCI ER Plan* with the values in the draft of the July 1, 2015, Table of Expected Loss Rates and Discount Ratios, Table of Weighting Values, Table of Ballast Values, and various claim limitations that NCCI anticipates filing in September 2014 changes the split point from $5,000 to $15,500 in the calculation of experience rating modifications.

While the split point separates the loss into its primary and excess components, the weighting value determines the portion of the excess loss used in the calculation of the experience rating modification. In addition, the ballast value is a stabilizing element to help limit the effect of any single loss on the experience rating modification and to help reduce fluctuations in the experience rating modifications due to a single loss. Both the weighting values and the ballast values vary with the size of the risk. The claim limitations ensure that large claims do not have an undue impact on the experience rating modification. NCCI updates the weights, ballasts, and claim limitations as part of its annual loss cost filing to ensure that they stay consistent with the split point.

The *NCCI ER Plan* will also include updated expected loss rates and the discount ratios used to calculate experience rating modifications. Both of these values vary by classification and are typically updated when the individual class experience is analyzed. Currently, TDI staff updates the expected loss rates and the discount ratios in conjunction with updating the relativities, which typically occurs every two years. Since NCCI will update these values annually in conjunction with its loss cost filing, this ensures that the expected loss rates and discount ratios will reflect the most recent experience observed for each individual classification code.

The *NCCI ER Plan* proposes a maximum debit modification as a cap to ensure that the debit modification for a risk remains within a reasonable range. The formula for calculating an experience rating modification reflects both the size of an individual risk and the average claim cost observed in Texas. The maximum debit modification replaces the provision in the current *Texas ER Plan* that caps modifications for risks with expected losses of $15,000 or less. The maximum debit modification rule in the *NCCI ER Plan* caps debit modifications for risks of all sizes.

When comparing the current capped modifier rule in the *Texas ER Plan* to the proposed maximum debit modification rule that would initially take effect with the adoption of the *NCCI ER Plan*, the *NCCI ER Plan* produces a somewhat higher maximum debit modification for risks with expected losses of $10,000 or less. The *NCCI ER Plan* produces lower maximum debit modifications for risks with expected losses greater than $10,000, in contrast with the current *Texas ER Plan*, which has no capped modifier for risks with expected losses above $15,000. The values in the current *Texas ER Plan* for capped modifiers have been fixed for a number of years, and the *NCCI ER Plan* uses a formula approach for the maximum debit modification to reflect experience that is more current.

Negotiated Modifications

Rule 4-C-4 – Negotiated Modifications in the Texas exceptions to the *NCCI ER Plan* continue the current negotiated modifier rule in the *Texas ER Plan* for three years. On July 1, 2018, under the proposed exception, Rule 4-C-4 will expire. This three-year transition period allows employers time to improve their safety and loss prevention efforts to improve their experience used in calculating their experience rating modification in the future. Carriers that frequently use negotiated modifications may elect to adjust their rate filings to compensate for the change. There are few carriers that use negotiated modifiers. As Rule 4-C-4 nears expiration on July 1, 2018, NCCI will make a filing under Commissioner's Order 3142 to discontinue Statistical Code 9890 – Negotiated Modifications, effective July 1, 2018.

New Rules for Texas

In addition to the above changes that will affect policyholder premiums, the *NCCI ER Plan* and the Texas exceptions contain other changes that are not currently part of the *Texas ER Plan*, but that are not expected to affect premiums. These changes include:

- The *NCCI ER Plan* states that a unity (1.00) factor may apply to a risk when a risk does not have a calculated experience rating modification or when the experience rating modification calculation results in a 1.00 modification.

- The *NCCI ER Plan* allows an intrastate modifier for a risk to be applied to the premium developed in another state until there is sufficient experience to calculate an intrastate experience modification for a risk.

- The *NCCI ER Plan* defines the rating effective date as the date appearing on the risk's experience rating worksheet and is the earliest date that a specific experience rating modification is applied to a policy. NCCI uses a Rating Effective Date Determination Table to determine the rating effective date for single and multiple intrastate and interstate risks. If there are multiple policies for a risk that is intrastate or interstate rated, the rating effective date is the effective month and day of the most recent full-term policy in effect with the largest amount of estimated annual premium.

- The *NCCI ER Plan* allows an experience rating modification to include experience of certified self-insurers, authorized self-insured groups, and political subdivisions that have been self-insured in pools or funds, only when the operations that developed that experience are subsequently insured under a standard policy. An affiliate self-insurer or affiliate carrier must submit the experience on the approved form and request that the experience be used to calculate the experience rating modification.

- The *NCCI ER Plan* requires an employer to notify its carrier in writing within 90 days of the date of change in ownership or combinability status. The employer must complete the ERM-14 Form or submit information about the change in a narrative form. Notifications submitted in narrative form must be on the employer's letterhead and must be signed by an officer. The proposed rule further requires that the employer submit ownership or combinability status information to NCCI for a determination of the impact, if any, on the experience rating modifications of the entities involved in the change. NCCI may require additional information to make the ruling on the change.

- The *NCCI ER Plan* provides that if entities can be combined in multiple combinations, the combinable entities will be combined into the group that has the largest amount of estimated annual premium.

- The *NCCI ER Plan* provides that for an entity undergoing a change in ownership, in order to exclude experience from the calculation of an experience rating modification, there must also be a material change in operations, including a change in process and hazard to the operations, that NCCI determines is sufficient to support a reclassification of the governing classification. The current rule in the *Texas ER Plan* requires a substantial change in operations to occur within 90 days of the material change in ownership, but the *NCCI ER Plan* does not contain a 90-day requirement.

- The *NCCI ER Plan* provides that if a change in ownership or combinability status changes and the carrier or NCCI is notified within 90 days of the change, then the recalculated experience rating modification applies as of the date of change. However, if the change in ownership is not reported for more than 90 days, the recalculated experience rating modification applies on the next rating effective date following the date that either NCCI or the carrier first receives notice of the change. NCCI may issue, retract, or revise the current modifications and up to two preceding modifications due to ownership or combination status changes.

- The *NCCI ER Plan* outlines employer actions that, depending on the circumstances, may be considered attempts to evade an experience rating modification. These actions include, but are not limited to: 1) failure to report changes in ownership as required by the rules; 2) a change in ownership; 3) a change in combinability status; 4) creation of a new entity; 5) transfer of operations from one entity to another entity that is not combinable according to the combinability rules set forth in the plan; and 6) misrepresentation on audits or failure to cooperate with the completion of an audit.

- The *NCCI ER Plan* also outlines actions that NCCI may take to ensure the proper calculation and application of all current and preceding experience rating modifications that are impacted by one or more of the potentially evasive actions listed above. These actions include, but are not limited to: 1) combination of experience that would otherwise not be combinable according to the rules; 2) separation of experience that would otherwise be combinable according to the rules; 3) exclusion of experience that would otherwise be included according to the rules; 4) continuation of experience that would otherwise be excluded according to the rules; 5) issuance of experience rating modifications that were not originally issued; and 6) revision or retraction of experience rating modifications.

- The *NCCI ER Plan* provides that if a risk is covered by two or more policies with different effective dates, NCCI may authorize the application of an experience modification for a period of other than 12 months.

- The *NCCI ER Plan* provides that if a carrier receives or anticipates receiving recovery from a special fund or if the carrier successfully pursues a subrogation action against a third party, the timeframe for the current modification revision and two preceding modifications revisions is limited to the risk's fifth most recent rating effective date.

- The *NCCI ER Plan* indicates that if an experience rating modification is issued late because the policyholder failed to cooperate with audits and that modification is an increase over the prior modification, then the increased modification applies retroactively to the inception date of the policy or the rating effective date of the policy, based on Rule 4-E in the Texas exceptions.

Changes to Texas Rules

The *NCCI ER Plan* also proposed some changes to rules that currently exist in the *Texas ER Plan*, but which are not expected to affect premiums. These changes include:

- The *NCCI ER Plan* does not include the rule in the current *Texas ER Plan* that indicates that no experience rating modification, once calculated, will be withdrawn unless additional information is furnished showing that a "gross injustice" has been done to either the insured or the carrier, or unless a material error has been made. This rule has not been applied in at least 10 years and there are rules in the *NCCI ER Plan* that address this situation.

- The *NCCI ER Plan* does not include the rule concerning the appeal provision in the *Texas ER Plan* because the rules adopted in the Texas exceptions of the *NCCI Basic Manual* dictate how appeals are to be handled for all NCCI manuals.

- The *NCCI ER Plan* deletes the anniversary rating date rule and adds the rating effective date rule, which is quite similar.

- The *NCCI ER Plan* indicates that, unlike in the *Texas ER Plan*, a joint venture is not limited to construction, erection, or demolition projects. Instead, the *NCCI ER Plan* defines a joint venture as two or more contractors, not combinable for experience rating under the rules of the plan, associated for undertaking one or more projects as a joint venture.

- The *NCCI ER Plan* does not refer to the National Defense Plan, because neither NCCI nor TDI has jurisdiction over this plan. An experience rating modification is not applicable to the workers' compensation premium resulting from operations under the National Defense Projects Rating Plan, so elimination will not impact any of these projects.

- The *NCCI ER Plan* does not contain the *Texas ER Plan* provision that stevedoring operations of a contract stevedoring risk using union labor supplied under contract from union labor pools are not subject to the *Texas ER Plan*. It appears this rule is obsolete since neither NCCI nor TDI staff recalls withdrawing an experience rating modification for a contract stevedoring risk in at least 20 years.

Impact of the Proposed Changes

Under the proposed *NCCI ER Plan*, more risks will continue to receive a credit experience rating modification than a debit experience rating modification. The number of risks receiving credit experience rating modifications is expected to increase by about 7 percent, or about 2,900 risks, with the proposed changes to the experience rating values.

The proposed *NCCI ER Plan* seeks to make experience rating modifications more responsive to individual risk experience by broadening the distribution of experience rating modifications. As a result, risks with credit experience rating modifications will generally see larger credits, while those with debit experience rating modifications will see larger debits. In addition, risks with primarily medical-only claims will likely see a decrease in the experience rating modification since the proposed NCCI formula discounts medical-only claims by 70 percent. Adopting the proposed *NCCI ER Plan* will increase the number of the largest credit experience rating modifications and the number of the largest debit experience rating modifications. However, the distribution shows that the majority of experience rating modifications will remain between 0.80 and 1.00, which is similar to the current distribution.

Overall, the number of risks receiving a modification decrease or increase of less than 5 percent is expected to be about 87.8 percent (about 37,000 risks). This is nearly identical to what is experienced in a typical annual update. Of the approximately 12.2 percent (about 5,100 risks) that would change more than 5 percent either way, about 6.5 percent (about 2,700 risks) are expected to move from a credit modification to a debit modification. However, those risks may be able to negotiate their modifications downward, as the negotiated modification rule will still be allowed until July 1, 2018. The transition period will give those risks time to improve their experience modifications through improved accident prevention and safety efforts.

The values that NCCI will update each year in the loss cost filing will reflect an analysis of the overall average Texas modification as well as the most recent experience at an individual class level. Through annual updates of the values in the calculation of the experience rating modification, NCCI will ensure that the *NCCI ER Plan* will continue to perform effectively in Texas.

Many of the changes discussed above in the *NCCI ER Plan* work together to minimize the overall disruption to the industry. For example, the use of the experience rating adjustment decreases the amount of the losses included in the calculation of the experience modification, while the higher split point generally increases the amount of the losses included in the calculation of the experience rating modification. To reduce the impact to individual insureds, NCCI and staff recommend implementing the proposed changes in their entirety, as opposed to transitioning the implementation over time.

Carriers will benefit from having more uniform requirements for experience modifier calculation and application among states. Texas policyholders will benefit from the use of a more efficient and accurate system for calculating experience rating modifications, which results in a credit or debit that is closely aligned to the risk's experience, and from more frequent updates to the weights, ballasts, claim limitations, expected loss rates and discount ratios to assist in regulating the workers' compensation market. Carriers and policyholders will also benefit from NCCI's technical expertise, infrastructure, and support. All NCCI manuals are currently available electronically on the NCCI website to subscribers and affiliates of NCCI. The Texas exceptions to the *NCCI ER Plan* will also be available through the same system. NCCI has the staffing and technical resources to create, maintain, and support links between the information in the NCCI manuals and the Texas exceptions, which makes NCCI's electronic manuals very easy to use.

IV. Post-Transition TDI Functions

With the adoption of the *NCCI ER Plan* as the last major step in Texas' transition toward being an NCCI state, the commissioner of insurance and TDI will continue to fulfill all workers' compensation statutory requirements. These requirements include: 1) prescribing standard policy forms and a uniform policy; 2) approving nonstandard forms and endorsements; 3) determining hazards by classifications; 4) requiring carriers to use the classifications determined for Texas; 5) establishing classification relativities; 6) adopting a uniform experience rating plan; and 7) developing and updating statistical plans, as necessary.

Commissioner's Order No. 3142, adopting the *NCCI Basic Manual* with Texas exceptions, and the national and Texas-specific endorsements and forms in the *NCCI Forms Manual*, ordered that any proposed future revisions to NCCI's manuals be considered under either the procedure established in Insurance Code Article 5.96, or by the following procedure: 1) NCCI makes a filing; 2) TDI publishes notice of the filing on the TDI website and distributes notice of the filing to subscribers to TDI's electronic news, with at least a 30-day period for interested persons to submit comments or request a hearing; and 3) the commissioner issues an order approving the filing, approving the filing with changes, or rejecting the filing. Any proposed future revisions to the *NCCI ER Plan* with Texas exceptions will follow one of these procedures.

V. Requested Action

To maximize the benefits to carriers and policyholders of more uniform rules and requirements across multiple states, staff recommends that TDI adopt the *NCCI ER Plan* with Texas exceptions as the last major step for Texas to become an NCCI state. To complete that process, staff respectfully requests that

(1) the commissioner adopt the *NCCI ER Plan* with Texas exceptions

(2) the *NCCI ER Plan* with Texas exceptions will be in effect for calculating experience rating modifications with effective dates on or after July 1, 2015

(3) any future revisions to the *NCCI ER Plan* with Texas exceptions will follow either the procedure under Insurance Code Article 5.96 or the alternate procedure in Commissioner's Order No. 3142, and

(4) the *Texas ER Plan* will remain in effect for calculating and revising experience rating modifications with effective dates before July 1, 2015.

Respectfully submitted,

Nancy Moore
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Nancy Moore
WC Classification and Premium Calculation

September 16, 2014
Date