SCOMM

33:8

February 4, 1981

Rep. Brian Rogers and Sen. Terry Stimson, Co-Chairs
Workers' Compensation Study Commission
Pouch V
Juneau, Alaska 99811

Dear Brian and Terry:

I heartily endorse the Workers' Compensation Study Commission's Jan. 30 decision to request funding to conduct a systematic study of claims service and a professional analysis of the profitability of workers' comp in Alaska. I believe both studies are necessary to intelligent policy formulation.

It is my belief, based on previous workers' compensation research of my own and analysis of the Study Commission's other reports, that a ballpark budget of $12,000 for the claims service study would be more appropriate than the $5,000-$10,000 estimate mentioned at the Jan. 30 meeting. In blocking out funds for this project, you might consider that the Study Commission paid almost $5,000 for a review of claims files <u>without</u> interviewing -- and that interviewing claimants is extremely time-consuming (the problems are complex and the difficulty separating claimant feelings from the facts of the matter make the job even more of a challenge).

Before selecting an actuarial firm for the economic study, you might wish to consult with Lena Chang, Ph.D., 6 Beacon St., Boston, MA 02168 (tel 617/227-3808). Dr. Chang, a mathematician with actuarial experience, presents a solid professional viewpoint that sometimes varies from traditional perspectives.

Although the Study Commission declined to review my Jan. 23 report, "Pure-Premium Rate-Filing for Workers' Compensation," at its Jan. 29-30 meeting, I trust that the Study Commission will consider the arguments contained in that report for a rate-making proposal the Commission has not considered: monitoring of reserves with penalties for over-reserving. As I indicated in that report, I believe this proposal holds promise of rate reduction without radical revision of the system.

As soon as they are available, I would like to receive copies of:

a. The Study Commission's report to the Legislature;
b. The final version of the Jan. 15 preliminary draft report to the Study Commission by Robert Williams; and
c. Legislation on workers' compensation proposed by the Study Commission.

Additionally, I have not yet received $420 payment from the Study Commission for the Jan. 16-17 meeting, which I attended at the request of the co-chairmen. Payment due includes $150 per day consulting fee and $60 per diem for two days.

Sincerely,

Richard A. Fineberg
Box 81835 - College Sta.
Fairbanks, Alaska 99708

WHILE IN SESSION:
POUCH V
JUNEAU, ALASKA 99811
(907) 465-4925

REPRESENTATIVE
BRIAN ROGERS
*Alaska State Legislature*

HOME:
BOX K - COLLEGE
FAIRBANKS, ALASKA 99708
(907) 456-2037

10 February 1981

Richard A. Fineberg
Box 81835 - Colle Sta.
Fairbanks, Alaska 99708

Dear Richard,

Thank you for your letter of February 4th regarding recommendations for a systematic study of claims service. Your suggestions, as usual, are astute and most welcome. I will pass them on to the Worker's Compensation Study Commission.

I am enclosing a copy of the Williams report. The other items you requested are not finished yet but will be sent to you as soon as I have them.

I spoke with Licia about your payment for the January 16-17 meeting. She said she had already requested pay but would check into it again today and make sure it is taken care of and on its way to you.

Thanks again for your input.

Sincerely,

Rep. Brian Rogers

BR/vb

PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT

Fineberg's last gasp on Workers' Comp...

BRIAN:

The accompanying set of numbers -- a simplified model based on NAIC data for Alaska and INA's expense exhibit -- show that even during the horrible loss year of 1978, Alaska comp was probably a net money-maker for the carriers. I think most of the complexities I pulled out of my model (tax loss, return on company equity, previous years' surplus, etc.) would probably increase the profit.

This projection --- coupled with the solidly-defined New York State Fund experience --- reinforces my notion of the extreme profitability of workers' comp and the importance of tabulating reserves (especially in a period of high interest rates). This data also raises this question in my mind: IF COMP WAS A BIG MONEY-MAKER IN ALASKA FOR MUCH OF THE 70S -- AND EVEN PROBABLY MADE MONEY IN ITS WORST YEAR -- WHY HAVEN'T WE HAD COMPETITION? (Why are we the only state in which three carriers control 70.4% of the market; cf. Florida, where largest carrier is 7.3%, or Calif., where largest carrier outside state fund is 5.1%)

If the answer lies in our distance from other markets (cost of doing business), risks inherent in our climate and isolation, small size of individual policies and relatively small size of state's premium outside the major carriers, how would deregulating do any good?

The accompanying figures also demonstrate that reserves constitute two to three times the expense loading in workers' comp. For this reason -- and in face of reported "strong evidence" of over-reserving in Alaska comp -- I submit we could monitor reserves closely and penalize for over-reserving. Effect of spot-checks would be to bring reserves down. And every $1 in reserves cut would equal $2 to $3 in expense loading cut. In other words, a cut in reserves is twice to three times as significant to rates. (Note enclosed state audit of ALPAC showing over-reserving in past. Suggest legislature might want to find out whether Insurance Division has indications of over-reserving, which I have confirmed from two reliable sources who decline to be identified.)

Will put this in cogent, concise form from Fairbanks. But I thought it wise to give you the solid material I picked up and my assessment of it before you write your report.

Will address memo to you; probably won't circulate it. However, I have made clear to legislators who are familiar with my work that I'm concerned about the lack of attention to Alaska data and the nature of Alaska's market -- and the possible implications for the claimant, i.e., the problems I see in pure-premium rating.

En route to airport. Keep in touch on personal matters.

Cheers,

RF

Sunday, 4:15 p.m.

Richard A. Fineberg
Jan. 18, 1981

WORKERS' COMP IN ALASKA: HOW A PAPER LOSS MASKS A REAL PROFIT.

If all carriers writing workers' comp in Alaska decided to stop at the end of 1978 due to their reported combined loss ratio of 125.4 and their reported 5.3% operating loss, could they pay off all their 1978 claims?

To answer this question I assumed surplus on hand from preceding years (during which reported loss ratios were much lower and profits much higher) was equal to liabilities. Using five-year loss pay-out rates reported by INA (countrywide) for Workers' Comp (see Insurance Expense Exhibit, 3D, attached), I tracked the loss pay-out for five years. IN THE WORST YEAR ON RECENT RECORD, IT APPEARS THAT THE CARRIERS SHOWED BOTH UNDERWRITING AND OPERATING LOSS BUT IN FACT MADE MONEY.

== Assuming conservative 12% earnings on the 1978 surplus for the five-year pay-out period and making eight \$6.6-million semi-annual payments to meet the target of 74.2% incurred loss paid by the end of the fifth year THE CARRIERS HAD \$5.8 MILLION IN EXCESS OF AMOUNT NEEDED TO MAKE THE OUTSTANDING PAYMENTS. (Worksheet attached.)

== Assuming 15% earnings for the same period, the profit on 1978 workers' comp transactions in Alaska jumped to \$15.5 million.

== These figures identify the comp transaction, exclusive of interest earned on the company's equity during the same period. The figures are rough approximations and most probably understate workers' comp profitability during a bad year.

Richard A. Fineberg
Jan. 18, 1981

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS 1978 PROFITABILITY RESULTS (000,000 OMITTED)

ALASKA 5/29/79 (p. 15)

| LINE OF BUSINESS | Premium Earned | Investment Income | Incurred Loss | Loss Adjusting Expense | General Expenses | Sales Expenses | Taxes, Lic. & Fees | Dividends to Policyholders | Fed. Income Tax | Underwriting Profit | Operating Profit |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Workers' Comp | $107.1 | 9.0 % | 95.8 % | 9.3 % | 6.3 % | 7.3 % | 3.5 % | 0.4 % | -8.4 % | -11.8 % | -5.3 % |
| Approx. $ Value | $107.1 | $9.6 | $102.5 | $10.0 | $6.7 | $7.8 | $3.7 | $0.4 | $-9.0 | $-12.6 | $-5.6 |

Paid Loss*

Total Expenses

$23.5

$29.6

$116.7

$53.1

Surplus on hand, year-end $63.6

Outstanding liabilities $79.0 ($102.5 - $23.5)

* First year paid loss assumed equal to countrywide paid loss reported by INA for 1979 (see attached INA annual report)

# AMOUNT NEEDED TO CLOSE OUT ALL WORKERS' COMP CLAIMS IN ALASKA AFTER WORST REPORTED YEAR: WORKSHEET

END FIRST YEAR: $ 63.6 million on hand at end of year

79.0 Unpaid Loss TOTAL:
26.4 Unpaid Loss at end of Years (25.8% of incurred loss – see INA Exhibit 3D attached)

| | Assume 12% int. – (6% semi-annually) | Assume 15% interest 15% (7.5% semi-annually) | To reach target assume 8 semi-annual payments $6.6 mil. each = (8 x 6.6 = 52.8) |
|---|---|---|---|
| START | 63.6 | 63.6 | |
| 18 mo. | − 6.6 | −6.6 | 79 |
| | 57.0 x .06 = 3.4 | 57.0 x .075 = 4.3 | −6.6 |
| | + 3.4 | 4.3 | |
| START | 60.4 | 61.3 | 72.4 |
| 24 mo | − 6.6 | − 6.6 | − 6.6 |
| | 53.8 x .06 = 3.2 | 54.7 x .075 = 4.1 | |
| | + 3.2 | + 4.1 | |
| START | 57.0 | 58.8 | 65.8 |
| 30 mo | − 6.6 | −6.6 | − 6.6 |
| | 50.4 x .06 = 3.0 | 52.2 x .075 = 3.9 | |
| | 3.0 | 3.9 | |
| START | 53.4 | 56.1 | 59.2 |
| 36 mo | − 6.6 | − 6.6 | − 6.6 |
| | 46.8 x .06 = 2.8 | 49.5 x .075 = 3.7 | |
| | + 2.8 | 3.7 | |
| START | 49.6 | 53.2 | 52.6 |
| 42 mo | − 6.6 | −6.6 | −6.6 |
| | 43.0 x .06 = 2.6 | 46.6 x .075 = 3.5 | |
| | + 2.6 | + 3.5 | |
| START | 45.6 | 50.1 | 46.0 |
| 48 mo | − 6.6 | −6.6 | − 6.6 |
| | 39.0 x .06 = 2.3 | 43.5 x .075 = 3.3 | |
| | 2.3 | 3.3 | |
| START | 41.3 x | 46.8 | 39.4 |
| 54 mo. | − 6.6 | −6.6 | −6.6 |
| | 34.7 x .06 = 2.1 | 42.2 x .075 = 3.2 | |
| | + 2.1 | 3.2 | |
| START | 36.8 | 45.4 | 32.8 |
| 60 mo. | − 6.6 | − 6.6 | − 6.6 |
| | 30.2 x .06 = 1.8 | 38.8 x .075 = 2.9 | 26.2 |
| END | + 1.8 | + 2.9 | |
| End → | 32.0 On hand | 41.7 on hand | 26.2 to pay out |
| | − 26.2 | 26.2 | |
| | $ 5.8 Balance after pay-out (at 12% int.) | $ 15.5 Balance after pay-out (at 15% int.) | |

Compiled by Richard A. Fineberg for Workers' Compensation Study Commission

Sources: Starting point is 1978 NAIC profitability report presented to Commission by staff. (Assume no surplus on hand at start of year.)

Loss pay-out rate taken from INA Insurance Expense Exhibit (1979, 3D, attached)

Alaska Division of Insurance
(via R.A. Fineberg)

## SCHEDULE P—PART 3C—MEDICAL M

Calendar Year Premiums Earned, Accident Year Loss and L

| | Dollars (000 omitted) | | | | | | | Percentages | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1 1973(a) | 2 1974(a) | 3 1975 | 4 1976 | 5 1977 | 6 1978 | 7 1979 | 8 1973(a) | 9 1974(a) | 10 1975 | 11 1976 | 12 1977 | 13 1978 | 14 1979 |
| | Summary Data from Schedule P – Part 1C | | | | | | | | | | | | | |
| 1 Premiums Earned | XX | XX | 25,452 | 16,941 | 15,085 | 8,718 | 14,623 | XX | XX | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2 Loss & Loss Exp. Inc'd. | XX | XX | 21,718 | 14,401 | 12,828 | 7,410 | 12,430 | XX | XX | 85.3 | 85.0 | 85.0 | 85.0 | 85.0 |
| | LOSS & LOSS EXPENSE THROUGH 1 YEAR | | | | | | | | | | | | | |
| 3 Paid | XX | XX | 900 | 428 | 323 | 263 | 81 | XX | XX | 3.5 | 2.5 | 2.1 | 3.0 | .6 |
| 4 Reserve (2) – (3) | XX | XX | 20,818 | 13,973 | 12,505 | 7,147 | 12,349 | XX | XX | 81.8 | 82.5 | 82.9 | 82.0 | 84.4 |
| | LOSS & LOSS EXPENSE THROUGH 2 YEARS | | | | | | | | | | | | | |
| 5 Paid | XX | XX | 1,786 | 1,479 | 835 | 454 | XX | XX | XX | 7.0 | 8.7 | 5.5 | 5.2 | XX |
| 6 Reserve (2) – (5) | XX | XX | 19,932 | 12,922 | 11,993 | 6,956 | XX | XX | XX | 78.3 | 76.3 | 79.5 | 79.8 | XX |
| | LOSS & LOSS EXPENSE THROUGH 3 YEARS | | | | | | | | | | | | | |
| 7 Paid | XX | XX | 3,630 | 2,115 | 1,343 | XX | XX | XX | XX | 14.3 | 12.5 | 8.9 | XX | XX |
| 8 Reserve (2) – (7) | XX | XX | 18,088 | 12,286 | 11,485 | XX | XX | XX | XX | 71.1 | 72.5 | 76.1 | XX | XX |
| | LOSS & LOSS EXPENSE THROUGH 4 YEARS | | | | | | | | | | | | | |
| 9 Paid | XX | XX | 6,330 | 3,115 | XX | XX | XX | XX | XX | 24.9 | 18.4 | XX | XX | XX |
| 10 Reserve (2) – (9) | XX | XX | 15,388 | 11,286 | XX | XX | XX | XX | XX | 60.5 | 66.6 | XX | XX | XX |
| | LOSS & LOSS EXPENSE THROUGH 5 YEARS | | | | | | | | | | | | | |
| 11 Paid | XX | XX | 8,491 | XX | XX | XX | XX | XX | XX | 33.4 | XX | XX | XX | XX |
| 12 Reserve (2) – (11) | XX | XX | 13,227 | XX | XX | XX | XX | XX | XX | 52.0 | XX | XX | XX | XX |

## SCHEDULE P—PART 3D—WORKMEN'S COMPENSATION

Calendar Year Premiums Earned, Accident Year Loss and Loss Expense Incurred

| | Dollars (000 omitted) | | | | | | | Percentages | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1 1973 | 2 1974 | 3 1975 | 4 1976 | 5 1977 | 6 1978 | 7 1979 | 8 1973 | 9 1974 | 10 1975 | 11 1976 | 12 1977 | 13 1978 | 14 1979 |
| | Summary Data from Schedule P Part 1D | | | | | | | | | | | | | |
| 1 Premiums Earned | 180,260 | 187,579 | 216,376 | 248,223 | 329,523 | 437,299 | 484,589 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2 Loss & Loss Exp Inc'd | 170,698 | 171,132 | 191,792 | 233,162 | 290,541 | 348,738 | 400,314 | 94.7 | 91.2 | 88.6 | 93.9 | 88.2 | 79.7 | 82.6 |
| | LOSS & LOSS EXPENSE THROUGH 1 YEAR | | | | | | | | | | | | | |
| 3 Paid | 44,323 76% | 46,774 77 | 48,070 75 | 60,754 26 | 70,332 24.2 | 79,887 | 88,011 22 | 24.6 | 24.9 | 22.2 | 24.5 | 21.3 | 18.3 (22.9) | 18.2 |
| 4 Reserve (2) – (3) | 126,375 74% | 124,358 73 | 143,722 76 | 172,408 | 220,209 | 268,851 | 312,303 | 70.1 | 66.3 | 66.4 | 69.5 | 66.8 | 61.5 | 64.4 |
| | LOSS & LOSS EXPENSE THROUGH 2 YEARS | | | | | | | | | | | | | |
| 5 Paid | 85,984 | 89,711 | 89,937 | 112,425 48 | 126,050 48 | 146,329 | XX | 47.7 | 47.8 | 41.6 | 45.3 | 38.3 | 33.5 | XX |
| 6 Reserve (2) – (5) | 84,714 | 81,421 | 101,855 53 | 120,737 | 164,491 | 202,409 | XX | 47.0 | 43.4 | 47.1 | 48.6 | 49.9 | 46.3 | XX |
| | LOSS & LOSS EXPENSE THROUGH 3 YEARS | | | | | | | | | | | | | |
| 7 Paid | 107,185 | 112,187 | 116,793 | 136,166 58.4 | 163,784 | XX | XX | 59.5 | 59.8 | 54.0 | 54.9 | 49.7 | XX | XX |
| 8 Reserve (2) – (7) | 63,513 | 58,945 | 74,999 | 96,996 | 126,757 | XX | XX | 35.2 | 31.4 | 34.7 | 39.1 | 38.5 | XX | XX |
| | LOSS & LOSS EXPENSE THROUGH 4 YEARS | | | | | | | | | | | | | |
| 9 Paid | 122,316 | 127,143 | 131,060 | 158,450 | XX | XX | XX | 67.9 | 67.8 | 60.6 | 63.8 | XX | XX | XX |
| 10 Reserve (2) – (9) | 48,382 | 43,989 | 60,732 | 74,712 | XX | XX | XX | 26.8 | 23.5 | 28.1 | 30.1 | XX | XX | XX |
| | LOSS & LOSS EXPENSE THROUGH 5 YEARS | | | | | | | | | | | | | |
| 11 Paid | 132,136 | 135,421 77 | 142,245 | XX | XX | XX | XX | 73.3 | 72.2 | 65.7 | XX | XX | XX | XX |
| 12 Reserve (2) – (11) | 38,562 | 35,711 | 49,547 | XX | XX | XX | XX | 21.4 | 19.0 | 22.9 | XX | XX | XX | XX |

3 yrs pd

1 yr pd

## SCHEDULE P—PART 3E—FARMOWNERS MULTIPLE PERIL, HOMEOWNERS MULTIPLE PERIL, COMMERCIAL MULTIPLE PERIL, OCEAN MARINE, AIRCRAFT (ALL PERILS) AND BOILER AND MACHINERY

Calendar Year Premiums Earned, Accident Year Loss and Loss Expense Incurred

| | Dollars (000 omitted) | | | | | | | Percentages | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1 1973 | 2 1974 | 3 1975 | 4 1976 | 5 1977 | 6 1978 | 7 1979 | 8 1973 | 9 1974 | 10 1975 | 11 1976 | 12 1977 | 13 1978 | 14 1979 |
| | Summary Data from Schedule P – Part 1E | | | | | | | | | | | | | |
| 1 Premiums Earned | 401,035 | 438,098 | 467,608 | 560,747 | 671,996 | 729,072 | 763,108 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2 Loss & Loss Exp Inc'd | 249,632 | 295,575 | 338,880 | 340,021 | 390,871 | 419,088 | 497,188 | 62.2 | 67.5 | 72.5 | 60.6 | 58.2 | 57.5 | 65.2 |
| | LOSS & LOSS EXPENSE THROUGH 1 YEAR | | | | | | | | | | | | | |
| 3 Paid | 119,216 | 143,901 | 161,940 | 155,951 | 171,694 | 197,473 | 250,731 | 29.7 | 32.8 | 34.6 | 27.8 | 25.5 | 27.1 | 32.9 |
| 4 Reserve (2) – (3) | 130,416 | 151,674 | 176,940 | 184,070 | 219,177 | 221,615 | 246,457 | 32.5 | 34.6 | 37.8 | 32.8 | 32.6 | 30.4 | 32.3 |
| | LOSS & LOSS EXPENSE THROUGH 2 YEARS | | | | | | | | | | | | | |
| 5 Paid | 186,549 | 231,416 | 261,828 | 254,717 | 311,858 | 320,418 | XX | 46.5 | 52.8 | 56.0 | 45.4 | 46.4 | 43.9 | XX |
| 6 Reserve (2) – (5) | 63,083 | 64,159 | 77,052 | 85,304 | 79,013 | 98,670 | XX | 15.7 | 14.6 | 16.5 | 15.2 | 11.8 | 13.5 | XX |
| | LOSS & LOSS EXPENSE THROUGH 3 YEARS | | | | | | | | | | | | | |
| 7 Paid | 206,214 | 252,965 | 289,837 | 289,152 | 332,301 | XX | XX | 51.4 | 57.7 | 62.0 | 51.6 | 49.4 | XX | XX |
| 8 Reserve (2) – (7) | 43,418 | 42,610 | 49,043 | 50,869 | 58,570 | XX | XX | 10.8 | 9.7 | 10.5 | 9.1 | 8.7 | XX | XX |
| | LOSS & LOSS EXPENSE THROUGH 4 YEARS | | | | | | | | | | | | | |
| 9 Paid | 221,272 | 265,371 | 309,426 | 301,691 | XX | XX | XX | 55.2 | 60.6 | 66.2 | 53.8 | XX | XX | XX |
| 10 Reserve (2) – (9) | 28,360 | 30,204 | 29,454 | 38,330 | XX | XX | XX | 7.1 | 6.9 | 6.3 | 6.8 | XX | XX | XX |
| | LOSS & LOSS EXPENSE THROUGH 5 YEARS | | | | | | | | | | | | | |
| 11 Paid | 229,368 | 275,286 | 319,911 | XX | XX | XX | XX | 57.2 | 62.8 | 68.4 | XX | XX | XX | XX |
| 12 Reserve (2) – (11) | 20,264 | 20,289 | 18,969 | XX | XX | XX | XX | 5.1 | 4.6 | 4.1 | XX | XX | XX | XX |

(a) Completion of this data is optional.

Note: Item 2 is taken from this year's Schedule P – Part 1 and is consequently updated each year. Items 3, 5, 7, 9 and 11 are taken from the Schedule P – Part 1 (or corresponding Part for years prior to 1975) of the year indicated by the heading immediately above each item, and consequently do not change after once being entered.

3-yr (77) paid $\frac{163784}{290541}$ = 56.3%

1 yr (78) paid $\frac{88011}{400314}$ = 22.0%

5 yrs upd $\frac{49547}{\ldots}$ = 25.8%

70 332 ...

Traditional loss developments for 1974 and 1975 showed a deficiency development as reflected in the above exhibit. This surprised the Division of Insurance Examiner in view of the Company's stated and demonstrated conservative reserving procedures. He then had Peat, Marwick, Mitchell & Co. prepare a closed claim study. The study was not intended to be a reserve development, but only a study to see if the experience on the claims that the Company closed between December 31, 1976 and September 30, 1977 correlate with the Company's traditional loss development. The study only reflected those claims which were open at December 31, 1976 and closed by September 30, 1977 and the net amount required to close them. Salvage and subrogation was automatically included in the study due to the fact that the Company handles those items as negative payment. The study was limited to the Company's regular business. The results of the closed claim study are summarized as follows:

| Line | Case basis reserve open at 12/31/76 | Net amount required to Close | Excess of case basis reserve over net amount required to close |
|---|---|---|---|
| Inland Marine | $ 346,560 | $ 254,766 | $ 91,794 |
| Workmen's Compensation | 2,141,714 | 954,423 | 1,187,291 |
| Other Liability | 132,657 | 69,002 | 63,655 |
| Auto Liability | 627,022 | 593,263 | 33,759 |
| Auto Physical Damage | 306,835 | 214,412 | 92,423 |
| Totals | $3,554,788 | $2,085,866 | $1,468,922 |

The excess of December 31, 1976 reserves over the ultimate net settlement on the claims closed during the period January 1 through September 30, 1977 may result from one of the following factors or a combination thereof:

PLEASE NOTE: THE PRECEDING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.