



STATE OF ARIZONA
DEPARTMENT OF INSURANCE

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CHARLES R. COHEN
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CIRCULAR LETTER 1999-9

TO: Insurance Rating Organizations; Insurance Industry Representatives;
Insurance Trade Associations; Property & Casualty Insurers; and Other
Interested Parties

FROM: Charles R. Cohen
Director of Insurance

DATE: December 1, 1999

**RE: Administration of Workers' Compensation Laws; Arizona Revised
Statutes, Title 20, Chapter 2, Article 4**

The Arizona Department of Insurance (Department) administers the Arizona Revised Statutes, Title 20, Chapter 2, Article 4, governing the workers' compensation (WC) rates and rate-related activities of insurers.

As discussed in previous Circular Letters 1998-3 and 1999-1, I am authorized to designate a Statistical Agent pursuant to A.R.S. § 20-371 to assist in gathering and compiling loss and expense data used to make WC rates in this state and to make compilations of that data available to licensed WC rating organizations. Until earlier this year, the National Council on Compensation Insurance (NCCI) had been the only licensed, active WC rating organization in this state for the past approximately thirty years. Consequently, all authorized WC insurers were NCCI members, and the NCCI was the sole repository for all loss and expense data arising out of the transaction of WC insurance in this state. The advent of competition for WC rating organization services, through the licensure and activation of a new WC rating organization, Insurance Data Resources, Inc. (IDR), generated concern that multiple operational rating organizations without a designated Statistical Agent would fracture the Arizona loss and expense database, impair the credibility of each portion of that database, and impair the credibility of the resultant rates. Consequently, this office worked with members of the WC insurance industry and the Arizona Industrial Commission to develop a Request for Proposals for Statistical Agent services.

In late 1998, through a competitive bid process administered by the State Procurement Office (SPO), IDR Statistical Services, Inc. (IDRSS), an affiliate of IDR, was awarded the contract to act as the Department's Arizona Statistical Agent (ASA). From February

1, 1999 through August 27, 1999, IDRSS operated as the ASA. Although IDRSS was licensed as a WC rating organization in Arizona, IDRSS did not act as a rating organization in Arizona during the period it was the Department's ASA.

The purpose of this Circular Letter is to advise that we will not renew the Department's ASA contract when it expires on December 31, 1999, and to explain that action.

Implementation of the ASA was a complex project and various difficult issues arose immediately, including issues associated with obtaining the historical database from the NCCI. Eventually, those issues were resolved to a satisfactory degree and the Department began to see the benefits of an independent ASA. In particular, the ASA provided the Department an opportunity to improve the quality and credibility of the WC loss and expense database upon which WC rates are based.

Effectuation of the ASA demonstrated that edits and validation of a rating organization's data are best performed by an independent third party acting as the Department's agent with the authority to require the rating organization to correct data quality errors. Edits are vital underpinnings of a credible database, which is necessary for credible rates. One of the most important edits is relational editing. This edit determines that the data reported in one field is valid in relation to other fields reported for the same data type and/or among other data types, which may have originated from different computer programs. It is a crosscheck for errors. For example, the edit could determine whether the class code rate reported in the unit report data and the class code rate reported in the policy data for the same risk match by comparing unit report data and policy data. In particular, Detailed Claim Information collected by rating organizations should be thoroughly edited by an independent ASA. Depending upon the nature of the error identified by the ASA, the ASA could prevent a rating organization from posting the data to the production database until the rating organization and/or its member insurer correct the errors.

On August 27, 1999, the NCCI acquired IDR and IDRSS. After the acquisition, the NCCI requested that the SPO assign the ASA contract to NCCI. NCCI proposed operating as an active rating organization in Arizona while also acting as the ASA. After consideration of the conceptual, technical and practical issues involved, the Department determined that it was not feasible for an active rating organization, particularly the sole active rating organization, to simultaneously perform the responsibilities of the ASA in the manner and spirit contemplated by the Department. Therefore, the Department requested the SPO to permit the ASA contract to expire rather than make the assignment to the NCCI.

Although the elimination of competition for WC rating organization services also eliminated the critical necessity for the Department to designate an ASA to guard against the perils of a fractured loss and expense database, it remains desirable to designate an ASA for the reasons described above concerning data quality, among others. However, a rating organization is an agent of its member insurers with respect to their ratemaking and filing obligations. The ASA is the agent of the Department with respect to overseeing the ratemaking and filing activities of insurers and rating

organizations to maintain the quality of data and the credibility of rates. Both in principle and practice, it is an unmanageable conflict of differing interests and perspectives for the sole rating organization to also be the Department's ASA. Under the circumstances, the Department would not be able to properly control the effectiveness, convenience and cost to insurers of the ASA service. Thus, the Department decided to permit the contract to expire on December 31, 1999. The expiration should have no practical impact upon insurers as they should continue to report their data to their rating organization in the manner they have historically reported.

The Department continues to believe that a designated ASA is in the best interests of the state, the WC insurance industry, and consumers of WC insurance. We will consider whether it is feasible to reformulate the ASA contract, including terms and restrictions appropriate to a single rating organization environment, and re-bid it in the future.

On a related matter, earlier this year, after effectuation of the ASA, I established a task force comprised of Department and industry representatives to make recommendations for modifications in Arizona law or practice needed to ensure the stability of WC ratemaking procedures and the credibility of WC rates in a multiple rating organization environment. That task force submitted a well reasoned, superb report. The report's recommendations are now manifested in proposed legislation, which I anticipate will be considered in the upcoming 2000 legislative session. Among other things, the legislation would authorize the Department to designate one rating organization to make a statewide rate filing, authorize the Department to designate a statewide statistical plan, classification plan and experience rating plan, and establish a single, statewide assigned risk plan and appeals board.

I believe our brief experience with multiple WC rating organizations has enabled us to understand and address numerous issues in a way that will benefit the Department, the WC industry and the WC marketplace in the future.

Questions regarding this circular letter may be addressed to Deloris Williamson, Assistant Director, at (602) 912-8466.