

REPORT ON EXAMINATION
OF THE
DELAWARE COMPENSATION RATING BUREAU
AS OF
DECEMBER 31, 2011

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2011 of the

DELAWARE COMPENSATION RATING BUREAU

is a true and correct copy of the document filed with this Department.

Attest By: Grant Biddle

Date: 10 Sep 2012



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 10th day of September, 2012.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart".

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT ON EXAMINATION
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DELAWARE COMPENSATION RATING BUREAU
AS OF
DECEMBER 31, 2011

The above-captioned Report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart", is written over a horizontal line.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 10th day of September, 2012

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SALUTATION

July 17, 2012

Honorable Karen Weldin Stewart, CIR-ML
Insurance Commissioner
State of Delaware
Rodney Building
841 Silver Lake Building
Dover, Delaware, 19904

Dear Commissioner:

In compliance with instructions contained in Certificate of Authority No. 12.007, an examination has been made of the affairs, financial condition and management of the

DELAWARE COMPENSATION RATING BUREAU, INC.

hereinafter referred to as “Bureau” or “DCRB”, a domestic non-stock, non-profit corporation. The examination was conducted at the Bureau’s main office, located in the United Plaza Building at 17 South 30th Street, Philadelphia, Pennsylvania 19103.

The report of such examination is respectfully submitted herewith.

EXAMINATION SCOPE

The last examination was conducted as of December 31, 2007. This examination covers the period from January 1, 2008, through December 31, 2011. Transactions subsequent to the latter date were reviewed where deemed necessary.

The primary focus of this report is the determination of the accuracy of the Bureau's statistical data upon which values for workers' compensation insurance in Delaware are based. The examination, therefore, consisted of a general review and test of the methods employed by the Bureau in compiling statistical data for submission to the State of Delaware as utilized for seeking rate and lost cost adjustments for its members. The financial aspects of the Bureau's operations are secondary in importance since the Bureau's operations are funded by assessment upon its membership.

This report does not contain an analysis of relativity and credibility factors and other items of an actuarial nature.

The format of this report is designed to explain the procedures employed on the examination and any findings. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible officials during the course of the examination.

SUMMARY OF SIGNIFICANT FINDINGS

The examination has no significant items to report.

SUBSEQUENT EVENTS

The examination noted no material Subsequent Events that would impact the Bureau.

COMPANY HISTORY

DCRB is a domestic non-stock, non-profit corporation, operating as a rating bureau to propose classifications, underwriting rules, residual market premium rates, voluntary market loss costs and experience rating and merit rating plans under the Workmen's Compensation Act and the United States Longshoremen's and Harbor Worker's Compensation Act. The DCRB also serves as the Plan Administrator for Delaware Workers Compensation Insurance Plan.

The Delaware Compensation Rating and Inspection Bureau (as it was initially titled) was organized on December 31, 1917, pursuant to the provisions of "The Delaware Workmen's Compensation Law of 1917".

CORPORATE RECORDS

The bylaws of the Bureau were amended in April of 2005, and remained unchanged during the period under examination. Two key points contained in the bylaws:

Purpose of Bureau

The purpose of the Bureau is to be organized for and to devote its assets to the following purposes:

- To qualify and operate as a domestic non-profit corporation under the Delaware General Corporation Law, as amended, or the corresponding provisions of any successor statutes thereto.

- To qualify and operate as an exempt organization under section 501 (c) (6) of the Internal Revenue Code of 1986 or the corresponding provisions of any successor statute thereto.
- To qualify and operate as a licensed rating or advisory organization pursuant to all relevant Delaware Laws and any amendments or successor statues thereto.
- To perform such activities incidental to the business of workers compensation insurance as the Governing Board may authorize as are required by, permitted by or not contrary to law.

Membership

Any insurer authorized to write Workers' Compensation in Delaware shall be entitled to membership and to share equally in the benefits derived from the Bureau upon accepting the obligations of membership. Every member shall conform to the provisions of the bylaws and to any rules or regulation made there under. Each member shall pay a membership fee of \$250 upon becoming a member of the Bureau and a like amount on the first day of January of each succeeding year.

MANAGEMENT AND CONTROL

The Bureau is controlled by a Governing Board. The Governing Board shall have the general charge of management of the affairs of the Bureau, including the power to adopt and amend the General Rules, and shall be responsible for carrying out the purposes thereof. The Governing Board shall consist of six (6) Bureau members and one (1) Employer Organization Representative. Not more than four (4) Bureau members of the Governing Board at any time shall be domestic company members. The Governing

Board Members of each class shall be elected for a term of three (3) years and until their successors are elected and qualified.

The members of the Governing Committee at December 31, 2011, were:

American Home Assurance Company
Delaware State Chamber of Commerce
Insurance Company of North America
Liberty Mutual Insurance Company
PMC Insurance Company
Selective Insurance Company
Travelers Property & Casualty Insurance Company

Committees

The Governing Board shall have the sole power to create and appoint members to any Committee, and shall also have the exclusive power to create or approve Subcommittees. The Governing Board shall also determine the powers, duties, and number of members, and qualifications of members of such bodies. Any committee may propose for Governing Board approval any Subcommittee to assist the assigning body in fulfilling its designated duties. At any given time, no more than one member of the same Insurance Holding Company System shall be a member of the same Committee.

The following Committees were operational as of December 31, 2011:

Classification and Rating Committee

This committee is responsible for the review and evaluation of the efficiency and equity of the underwriting, classification and rating procedures, as well as the administration of these rules while functioning as a committee when hearing appeals of parties aggrieved by decisions of the Bureau staff. The committee also reviews the recommendations made by the Actuarial Committee relative to loss cost filings. The

committee consists of six (6) Bureau members and two (2) Employer Organization Representatives.

Actuarial Committee

This committee is responsible for advising the Classification and Rating Committee on all matters relating to the prospective loss cost filings pursuant to 19 Del. C. § 2602(j).

Nominating Committee

This committee, comprised of three (3) Bureau members, shall propose a slate of candidates selected from the nominations made by all Bureau members for the vacancies on the Governing Board and all of its Committees.

Officers

On April 27, 2011, the following officers were elected by the Governing Board:

President	Timothy L. Wisecarver
Vice President, Secretary and Treasurer	John E. Panczner
Senior Vice President	Bruce E. Decker
Vice President	John Murphy
Vice President	Bonita Piacentino

The management structure of the Bureau was extremely stable during the period of examination.

SERVICE CONTRACT

Effective January 1, 1982, the Pennsylvania Compensation Rating Bureau (PCRB) and the DCRB entered into a service contract whereby the PCRB furnishes the

DCRB with such services that might be necessary and required by the DCRB in its day to day operations. In consideration for these services the DCRB shall pay the PCRB on the following basis:

- The entire yearly expense of the PCRB shall first be determined.
- Then, the DCRB will assume such proportion of this amount as the net written combined coverage of employers' liability and workers' compensation premiums, written by members of the DCRB in the State of Delaware, bears to total employer's liability and workers' compensation premiums written in the State of Delaware and the State of Pennsylvania by the subscribers to the two (2) Bureaus, during the applicable year. The DCRB paid the PCRB \$625,000 during 2011 for such services.

Expense reimbursements are made on a quarterly basis. Expense items incurred by the DCRB on its own behalf shall be borne directly by the DCRB and are not considered to be part of this service contract,

ACCOUNTS AND RECORDS

The financial affairs of the DCRB are subject to review by an outside auditing firm, Preston, Romano & Shea, LLP. The Bureau's external auditor remained unchanged for each year under review by this examination. Preston, Romano & Shea's independent audit reports were made part of the examination workpapers and certain knowledge from the reports/workpapers was used where deemed appropriate.

In addition to the financial audit performed on the DCRB's operations, a separate review and report was issued by Preston, Romano & Shea on the financial statements of the PCRB's Employee Retirement Plan. The DCRB does not have any of its own

employees but reimburses the PCRБ for a share of all costs including payroll and benefits.

FINANCIAL STATEMENTS

The Bureau's 2011 Audit Report was not available at the time when examination field work concluded. The Financial Statements below reflect the Bureau's audited financial results for 2010. The examination reviewed pro forma financial statements for 2011 prepared by Bureau management. DCRB reported a deficit of \$83,528 for 2011 and it was noteworthy that the Bureau accrued an allowance of \$181,445, effectively writing-down that amount in fines for overdue unit statistical reports from financially troubled companies.

ASSETS, LIABILITIES AND NET ASSETS

Cash	\$	317,905
Accounts Receivable		21,073
Prepaid Expenses		3,500
Assessments due from members		-
Due from PCRB		-
Total Assets	\$	<u>342,478</u>
 <u>Liabilities</u>		
Accounts Payable	\$	80,585
Accrued Expenses		-
Assessments refundable to members		258,770
Due to PCRB		<u>3,074</u>
Total Liabilities	\$	342,429
 <u>Net Assets</u>		
Unrestricted	\$	
Board designated technology fund		-
Undesignated		<u>49</u>
Total Net Assets	\$	<u>49</u>
 Total Liabilities and Net Assets	\$	<u>342,478</u>

STATEMENT OF ACTIVITIES

Revenues-Operations		
Assessments	\$	275,230
Assessments-Fines		232,678
Membership fees		75,500
Printing and Special Services		25,191
Interest		419
Other		-
Total Revenues from Operations	\$	<u>609,018</u>
Expenditures-Operations		
Legal	\$	27,378
Delaware Insurance Department audit		22,000
Delaware Insurance Department filing		15,356
Delaware Insurance Plan expense		4,960
Consultant		3,954
Insurance		1,500
Other		762
Travel		600
Allocation of Expenditures from PCRB		<u>658,074</u>
Total Expenditures from Operations	\$	<u>734,584</u>
Total Decrease in Unrestricted Assets	\$	(125,566)

PLAN OF OPERATION

This examination focused on six (6) major functions of the DCRB's operations. In this Report, these were classified as follows: Inspections & Classifications; Unit Statistical Report Processing, Policy Review, Call System, Payroll Reviews and Insurance Department Filings. Each of these functions is briefly described below under the related caption.

Inspections and Classifications

The objective of the classification system is to group insureds into classifications so that the rate for each classification reflects the exposures common to that distinct

business enterprise. Subject to certain expectations, it is the business of the insured within Delaware that is classified, not the separate employments, occupations or operations within the business. In that regard, a series of employment classification codes with descriptive work activities have been established by the Bureau. These class code assignments are continuously studied by the Bureau's staff and are periodically revised as deemed appropriate. When changes are needed, they are subsequently filed with and approved by the Delaware Insurance Commissioner.

The rates for the classifications are divided into two (2) types. Those classifications that have sufficient Delaware payroll are called "Reviewed" classifications. For those classifications that do not have enough experience to be "credible" in an actuarial sense, the DCRB includes other available data to establish rates. These classifications are referred to as "Non-Reviewed".

Since an insured's workers' compensation premium is usually determined by multiplying payroll times the rate for a particular classification, appeals and inquiries about correct classifications are frequent. The DCRB endeavors to resolve disputes through internal study and by performing field inspections. The inspectors sometimes visit the location of the risk to obtain information concerning the insured though much of this work is now done through correspondence and/or file review. The primary objective of inspections is to provide operational information for review by a DCRB classification analyst to establish that insureds have been properly rated and classified.

The examination tested the inspection process through a random sample review of inspection reports. Inspection procedures appear to achieve the stated objectives. DCRB staff members are assigned to give final decision on all assigned classifications, based

upon the inspection report. The DCRB performed the following number of recent inspections:

2009- 113
2010- 171
2011- 192

Unit Statistical Report Processing

Insurance companies (also referred to as “carriers”) are required to report premiums earned and losses incurred on all policies using a “Unit Statistical Report” form. Twenty months subsequent to the effective date of each policy, a first Unit Statistical Report is required to be submitted. This initial report shall contain policy premium data, including payroll exposure and manual rates by classification codes, premium experience modifications and premium discounts, if applicable. The report shall also indicate the carrier’s total amount of paid and outstanding losses for that policy broken down by claim number. Other loss information to be supplied includes: the date of the claim, the classification code, kind of injury and type of payment. The claim reserves and loss payments shall be as of eighteen (18) months after the effective date of such policy.

Annually thereafter, additional Unit Statistical Reports are filed with the DCRB during the second through tenth years, if necessary, to reflect the updated status of outstanding claims only. Corrections to filed Unit Statistical Reports are to be made utilizing specified procedures. As a supplement to the Unit Statistical Report, individual case reports are required to be filed for the following:

- 1) All permanent total disability claims established on a life pension basis.
- 2) All death claims established on a life pension basis.

In interviews with DCRB management and staff, the following was noted:

- In 2011, DCRB received 24,942 Unit Statistical Reports (USRs).
- When the initial USR is submitted, it is subject to an extensive series of defined edit checks.
- In 2011, 98.69% of the USRs were submitted on time.
- In 2011, 87.58% of the USRs were processed without generating an edit message

Policy Review

An exact copy of every workers' compensation policy showing the State of Delaware on the information page is required to be filed with the DCRB within 30 days after the effective date of the policy. Similarly, an exact copy of all endorsements or agreements attached to the policy at its inception date or issued subsequent thereto must be filed with the DCRB within 30 days after the date of issue of said endorsement or agreement. The Bureau verifies that policies were issued on approved forms and are in compliance with its underwriting rules. Policy data, including rates, classification codes, and experience modification factors are checked for accuracy through a computer validation program.

Once a file has been established for an employer/insured, this file remains open indefinitely to track workers compensation coverage and experience. The DCRB will contact an insured if no renewal notification is received within 60 to 90 days of the lapse of the prior policy.

The examination judgmentally selected twelve (12) businesses who advertised in the Wilmington, Delaware telephone directory (via yellowpage.com). These businesses were traced to the Bureau's data base to determine if current insurance coverage was on file. It was noted that for the examination sample of twelve (12) businesses, the DCRB could not locate policies for four (4) or 33.3%. The examiner discussed this situation with

DCRB management and staff. It was noted that it is the responsibility of the Delaware Department of Labor to enforce the law that employers must carry and maintain workers compensation. The DCRB notifies the Department of Labor when, upon renewal, the Bureau cannot verify coverage on an employer.

Call System

The DCRB collects detailed policy, statistical and aggregate financial information from each of its member carriers. This data is edited for validity, completeness and reasonableness, and then summarized. The summarized data is used to make filings and reports to the Delaware Insurance Department. During the period under examination, the DCRB began a separate call for the collection of specific medical loss data.

Annually, the DCRB requests its members to submit detailed premium and loss data. These requests for summary financial information are referred to as "Calls". In January 2012, the DCRB requested data as of December 31, 2011, to be received by various due dates. All call submissions are filed electronically. A response is expected from every member even if there is no workers compensation activity during the year in question. The data submitted is reviewed by the DCRB staff for completeness and accuracy and is reconciled to the carrier's Annual Statement Page 14 "Statutory Page", which is required to be filed along with the supporting information. A final review is made to determine that all schedules and supporting schedules agree and reconcile.

The DCRB will note any "Failed Edits" and submit them to the applicable company for explanation/correction. If the DCRB does not obtain an adequate explanation by the time a report is due to the Insurance Department, two (2) types of adjustments can be made. The carrier's statistics can be deleted from the summary (used

in preparing the Insurance Department filing) or the DCRB could reclassify based upon prior periods or other presentations in the Call.

The examination reviewed the Call submissions for seven (7) selected carriers. All underwent thorough reviews with various edit failures. All seven (7) carriers submitted or eventually submitted, (many times there are multiple submissions and the DCRB uses the most recent or corrected submission with no edit failures) information that was acceptable at the time of the next Insurance Department filing. The examiners ran independent edit failure checks noting no edit failures for the final/corrected submissions for the seven (7) companies reviewed.

With regards to the Call Summary Data, the examiners reconciled the Call Summary Data to the Statutory Page 14 data for the seven (7) selected Companies without error.

Payroll Reviews

In an effort to ensure the accuracy of the Unit Reports and the database, the Bureau adopted a Test Audit Program to verify carrier audit premium computations. The Test Audit Program was effective on April 3, 1984, and has the following five (5) purposes:

- 1) To monitor the accuracy and consistency of the Bureau's member carriers' premium audits, verifying that the classification (including governing classifications, standard exceptions and classification of individuals, partners and officers) rating values, experience modifications and related rules applied, are correct.

2) To assure that statistical data reported to the Bureau is consistent with business operations of the insured and complies with the provisions of the Manual of Rules, Classifications and Rating Values.

3) To serve as an educational resource for member carriers in matters related to the discipline of premium audit.

4) To establish quantitative standards of performance for auditing and reporting of data to the Bureau.

5) To maintain incentives for member carriers to meet or exceed established quantitative performance standards.

In a test audit, risks above a certain premium value (\$2,500) are selected at random and the Bureau's auditor visits the risk's site. The Bureau's audit team reviews the risk's payroll records, develops actual payroll and notes the corresponding audit premium debit or credit. The Bureau's results are compared to the carrier's audit. Material errors are brought to the carrier's attention. If the carrier overcharged the insured, the carrier is obligated to refund the excess. In the event that the Bureau's test audit developed additional premium within the reviewed policy period, the carrier is advised that the additional premium may not be billed.

If the carrier's reportable differences expressed as a percentage of total tested audits completed is below twenty percent (20%), the carrier has met the program standards. If the carrier's reportable differences expressed as a percentage is equal to or greater than twenty percent (20%), based upon having twenty-five (25) or more test audits completed in any four (4) consecutive calendar quarters, the carrier shall have

exceeded the standards and will be subject to the payment of an incentive charge, which is determined on a graduated scale based on the extent of the percentage difference.

The examiners obtained a universe of payroll reviews performed by the DCRB from 2009 to 2011. During that period, the Bureau performed 656 Payroll Audit Reviews. From the universe noted above the examination selected a sample of Test Audits. Of the twelve (12) items selected, it was noted that the documentation provided appears to be well maintained, is thorough and addresses the Test Audit Program procedures. All items selected contained a Delaware Risk and there was adequate documentation to support the DCRB's conclusions. In discussions with Bureau management, it was noted that in conjunction with the payroll reviews, the DCRB staff also review all claims data related to the selected policy.

The examination reviewed the Bureau's Summary Reports that evaluate the performance of each carrier group. To achieve sufficient credible data, the Summary Reports combine the Payroll Audit Review data for DCRB and PCRB. The examination noted that the combined DCBR-PCRB staff performed over 3,000 Payroll Audit Reviews annually. The examination reviewed the results for the seven (7) carrier groups tested in the Call System Review. No exceptions were noted.

Insurance Department Filing

The examiner reviewed the filings made with the Delaware Insurance Department for 2011 (using 2010 annual statement Call System Data), 2010 and 2009. For the Residual or Assigned Risk market, DCRB calculates and files the final rates charged by the carriers. For the Voluntary Market, the Bureau files Loss Costs. Thereafter, each carrier makes separate filings with the Department, which using the Bureau's approved

Loss Costs, also include expense and profit factors. The filing for 2011 was reviewed in detail and accompanied by interviews with the Bureau President and Chief Actuary. The examiner noted two pertinent points:

The transparency of the Bureau's operations is readily evident in its annual filings. A wealth of information is provided by the Bureau and is readily available on its website. The Bureau discloses the formulae and loss development factors used in the rate and loss cost compilations and also provides pertinent information as per the workers' compensation experience for various industry groups.

A factor affecting the rate/loss cost filings during the examination was one-time and extraordinary. In 2007, the Delaware legislature passed Senate Bill #1, which provided for a rate fee schedule for the medical component of workers compensation claims. The Insurance Commissioner mandated that the passage of this bill should trigger a 23% decrease in workers' compensation insurance rates. The DCRB took the Department to court and incurred material legal expenses (\$317,000 in 2009). Ultimately, as per a ruling by the Delaware Court of Chancery Memorandum dated July 24, 2009, it was mandated that the DCRB was to file and have its rate/loss cost filings approved by the Commissioner and then have these filings reduced by

6% for 2008
6% for 2009
6% for 2010
5% for 2011

STATUS OF PRIOR EXAMINATION REPORT RECOMMENDATIONS

There were no prior examination recommendations

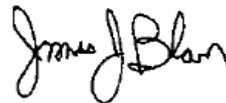
CURRENT EXAMINATION RECOMMENDATIONS

The current examination has made no recommendations.

CONCLUSION

As stated in the Scope of Examination section of this Report, the primary focus of this examination was a determination of the accuracy of the Bureau's statistical data upon which premium rates for Workers' Compensation Insurance in the State of Delaware are based. The examination found no exceptions in this area. The Bureau is properly performing the functions as provided by its bylaws.

Respectfully submitted,

A handwritten signature in black ink that reads "James J. Blair". The signature is written in a cursive style with a large, prominent "J" and "B".

James J. Blair CFE, CPA
Examination Supervisor
State of Delaware