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OFFICE OF
INSURANCE REGULATION

Docketed by: 10285

OFFICE OF INSURANCE REGULATION

KEVIN M. McCARTY
COMMISSIONER

REVISED WORKERS' COMPENSATION
RATES AND RATING VALUES AS
CONTAINED IN THE FILING SUBMITTED
BY: NATIONAL COUNCIL ON
COMPENSATION INSURANCE

Case No. 91678-07-CO

ORDER ON RATE FILING

On August 24, 2007, the **NATIONAL COUNCIL ON COMPENSATION INSURANCE** ("NCCI") filed, pursuant to Section 627.091, Florida Statutes, Revised Workers' Compensation Rates and Rating Values (hereinafter the "Filing") for consideration and review by the **FLORIDA OFFICE OF INSURANCE REGULATION** ("OFFICE"). The filing proposed a 16.5 percent decrease in the overall rate level, to be effective January 1, 2008, on new and renewal policies.

The **OFFICE**, having concluded that it would be in the public interest to hold a public hearing pursuant to Section 627.101, Florida Statutes, for the purpose of allowing the public an opportunity to speak or present evidence regarding the matters contained in the Filing, and by doing so assist the **OFFICE** in determining whether the Filing meets the applicable requirements of law, held a public hearing ("Hearing") on October 8, 2007, in the Cabinet Meeting Room LL-03 of the Capitol in Tallahassee, Florida.

The Commissioner of the Office of Insurance Regulation, having considered the Filing and additional information submitted by **NCCI**, the supporting data, oral and written statements presented at the Hearing, rebuttal testimony subsequent to the hearing, the

analysis by the staff of the **OFFICE**, and being otherwise fully advised in the premises finds:

1. The Commissioner of the Office of Insurance Regulation has jurisdiction over the parties and the subject matter of these proceedings.

2. Notice of the Hearing was published in Vol. 33, No. 38, The Florida Administrative Weekly on September 21, 2007, on page 4417. An amended Notice of the Hearing was published in Vol. 33, No. 39, The Florida Administrative Weekly on September 28, 2007, on page 4559 to show a change in the location of the hearing. Notice was also sent directly to **NCCI** and to other persons requesting to be notified of such events.

3. The proposed overall decrease in rate level of 16.5 percent for new and renewal business in the Filing has not been justified.

4. Since **NCCI** began including trend in its workers' compensation filings, it has displayed the on-level developed loss ratio trends based on fitting the data to either a linear or exponential curve. Until a few years ago, this loss ratio trend was the primary basis and for many years the only basis for **NCCI's** trend selection. In the last five filings, **NCCI** expanded the trend section of the filings by including not only the loss ratio data, but also data showing frequency and severity. The loss ratio trend data in the Filing clearly shows a downward trend in loss ratios for indemnity, ranging from an annual trend of -7.1% to -11.1%, using both calendar-accident year data and policy year data for the latest 5 years through the latest 8 years for Standard Coverage. The loss ratio trend data in the Filing for medical shows a range of values from -2.3% to -5.8%. An analysis of the underlying frequency and severity components of the loss ratio trend, shows that frequency has been declining at the rate of 4.6% per year in the last eight

years for policy year data and 5.5% for exposure year data but the decline has accelerated to over 10% in the last few years. It is unrealistic to believe that a 10% decline in frequency can continue for any extended period of time. Therefore a more reasonable frequency should be considered for trend. In his prefiled testimony and at hearing, Tony DiDonato stated that he selected a frequency trend based primarily on an eight year period and a severity trend based on a five year period. If the eight year frequency trend of -4.6% is combined with the five year severity trend for each of the four development methods (calendar-accident year paid, calendar-accident year paid plus case, policy year paid and policy year paid plus case), the result is an average annual trend that is close to -6.5% for indemnity and -1.5% for medical. Thus, the use of a -6.0% annual trend for indemnity and -1.0% annual trend for medical is not justified.

5. The internal rate of return model used by **NCCI** in selecting the profit and contingencies factor of 0.0% includes anticipated policyholder dividends of 2.88%. However, the indicated profit and contingencies factor excluding policyholder dividends is -0.21% for standard coverage and -0.55% for large deductible business. Florida workers' compensation rates have not previously included an explicit policyholder dividends provision greater than zero. Further, the failure to explicitly load an amount for policyholder dividends into the rates has not precluded insurers from the paying of policyholder dividends in Florida. Based upon the **NCCI** report entitled "Report on Economic Conditions for the State of Florida 2001 Edition" and other information provided by **NCCI**, the paid policyholder dividends in Florida have been a greater average percent of premium than the countrywide average for the period 1996 to 2004. Thus, policyholders in Florida have received substantial dividends without the explicit inclusion of a provision for policyholder dividends greater than zero.

6. Policyholder dividends are, by definition, a non-guaranteed return of profits, which means the payment of policyholder dividends is left strictly to the discretion of the insurers. In order for a policyholder to be eligible for a policyholder dividend, the insurance carrier files a participating endorsement that is attached to and becomes part of the policy. Many insurance carriers do not intend to pay policyholder dividends and have not filed such endorsements. Of the 243 insurance carriers actively writing workers' compensation in Florida in calendar year 2006, only 80 carriers paid policyholder dividends. Thus, if the rates are explicitly loaded for policyholder dividends, some employers will pay higher rates without any possibility of receiving a dividend, so that other employers can receive a policyholder dividend. This loading would likely result in unfairly discriminatory rates.

7. Pursuant to Actuarial Standards of Practice 29, "[w]hen the actuary determines that policyholder dividends are a reasonably expected expense and are associated with the risk transfer, the actuary may include a provision in the rate for the expected amount of policyholder dividends." **NCCI** has not demonstrated that for Florida workers' compensation, policyholder dividends are a reasonably expected expense and are associated with the risk transfer. Nor has **NCCI** demonstrated that in accordance with Actuarial Standards of Practice 29, they have considered the following: the companies' dividend payment history, the current dividend policy or practice, whether dividends are related to loss experience, the capitalization of the companies, and other considerations affecting the payment of dividends. Further, **NCCI** did not address these factors at the Hearing or in the Filing.

8. In determining the cost of capital for this filing, **NCCI** has made a major change in its methodology for the Capital Asset Pricing Model. This change increased the cost

of capital over 3 percentage points compared to the methodology used last year. The Discounted Cash Flow Model used by **NCCI** has produced more stable and consistent results. The **OFFICE** 's analysis reveals that **NCCI**'s estimate of the cost of capital is excessive.

9. Based on Paragraphs 5., 6., 7. and 8. above, the 0.0% filed profit and contingencies factor is excessive and should be negative for this filing. The use of a 0.0 percent (0.0%) profit and contingencies factor in the Filing does not adequately reflect investment income on unearned premium and loss reserves as required by Sections 627.072 and 627.215(8), Florida Statutes. The proposed changes in "F" classification premiums also use a 0.0 percent (0.0%) profit and contingencies factor. The proposed overall increase does not adequately reflect investment income on unearned premium and loss reserves as required by Sections 627.072 and 627.215(8), Florida Statutes.

WHEREFORE, in consideration of the foregoing and being otherwise duly advised in the premises, it is hereby **ORDERED**:

The Filing of **NCCI** is hereby **DISAPPROVED**. The Filing will be approved provided the Filing is amended to comply with all of the following and such amendments to the Filing are filed as soon as practicable.

A. The 0.0 percent (0.0%) allowance for profit and contingencies for the proposed rates in the Filing, and identified in Exhibit II-A of the Filing, is disapproved. Exhibit II-A of the Filing shall be re-filed containing a profit and contingencies factor no greater than minus 0.8 percent (-0.8%). The profit and contingencies factor on Exhibit II-A shall also apply to the "F" classifications.

B. The statewide overall rate level change for the Filing for new and renewal policies for other than the "F" classifications shall be -18.4 percent (-18.4%), effective

January 1, 2008, which includes a -6.5% annual trend for indemnity, a -1.5% annual trend for medical, the proposed change in production and general expense and the change in loss adjustment expense. In addition, the overall rate level change is an average of the adjusted paid and paid plus case method with each of these calculated using the **NCCI** proposed loss development factors.

C. The statewide overall rate level change in the Filing for "F" classifications for new and renewal policies shall be adjusted to reflect a -6.5% annual trend for indemnity, a -1.5% annual trend for medical, the proposed change in production and general expense, the change in loss adjustment expense and the proposed change in loss based assessments.

D. The swing limits shall be no greater than the rate level change by industry group plus or minus twenty percent (20%) rounded to the nearest one percent (1%).

E. **NCCI** shall list and explain each and every change in the proposed manual pages, including the experience rating plan manual and the retrospective rating plan manual. These shall be shown in the summary exhibit and described by an explanatory memorandum.

F. The changes in the premium credits for the coinsurance and deductible programs, the changes in the experience rating plan, and the other miscellaneous changes are acceptable to the **OFFICE**, but **NCCI** shall confirm whether the changes noted above affect any of these factors.

G. The proposed change in the minimum premium multiplier has not been justified and is disapproved.

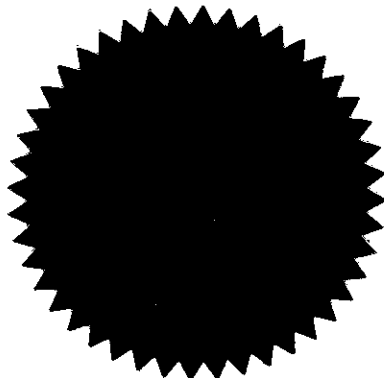
H. The proposed change in the expense constant has not been justified and is disapproved.


I. **NCCI** shall provide to the **OFFICE** a report for each quarter of calendar year 2008 showing the average intrastate experience modification factor for policies with effective dates in the year 2008 and for the same policies with effective dates for a comparable period in calendar year 2007. The report for each quarter shall be filed within 30 days of the end of the quarter. Thus, the first report will be due on May 1, 2008 for the first quarter of calendar year 2008.

To meet statutory timeframes for a January 1, 2008 effective date, **NCCI** shall file the necessary amendments to the Filing as may be required to implement the terms of this Order as soon as practicable but no later than November 1, 2007. No rate change shall be implemented until such amendments are properly filed and final approval is issued by the **OFFICE**. If **NCCI** fails to file the necessary amendments to the Filing to implement the terms of this Order, the **OFFICE** will initiate proceedings under Section 627.141, Florida Statutes to disapprove the current rates.

By making a filing to comply with this order, **NCCI** waives any right to any further proceedings and authorizes the **OFFICE** to enter a final order on the Filing.

DONE and ORDERED this 20th day of October, 2007.




KEVIN M. MCCARTY
COMMISSIONER

Copies furnished to:

NATIONAL COUNCIL ON COMPENSATION INSURANCE
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NOTICE OF RIGHTS

Pursuant to Sections 120.569 and 120.57, Florida Statutes and Rule Chapter 28-106, Florida Administrative Code (F.A.C.), you have a right to request a proceeding to contest this action by the Office of Insurance Regulation (hereinafter the "Office"). You may request a proceeding by filing a Petition. Your Petition for a proceeding must be in writing and must be filed with the General Counsel acting as the Agency Clerk, Office of Insurance Regulation. If served by U.S. Mail the Petition should be addressed to the Florida Office of Insurance Regulation at 612 Larson Building, Tallahassee, Florida 32399-4206. If Express Mail or hand-delivery is utilized, the Petition should be delivered to 612 Larson Building, 200 East Gaines Street, Tallahassee, Florida 32399-0300. The written Petition must be received by, and filed in the Office no later than 5:00 p.m. on the twenty-first (21) day after your receipt of this notice. Unless your Petition challenging this action is received by the Office within twenty-one (21) days from the date of the receipt of this notice, the right to a proceeding shall be deemed waived. Mailing the response on the twenty-first day will not preserve your right to a hearing.

If a proceeding is requested and there is no dispute of material fact the provisions of Section 120.57(2), Florida Statutes would apply. In this regard you may submit oral or written evidence in opposition to the action taken by this agency or a written statement challenging the grounds upon which the agency has relied. While a hearing is normally not required in the absence of a dispute of fact, if you feel that a hearing is necessary one will be conducted in Tallahassee, Florida or by telephonic conference call upon your request.

If you dispute material facts which are the basis for this agency's action you may request a formal adversarial proceeding pursuant to Sections 120.569 and 120.57(1), Florida Statutes. If you request this type of proceeding, the request must comply with all of the requirements of Rule Chapter 28-106.201, F.A.C., must demonstrate that your substantial interests have been affected by this agency's action, and contain:

- a) A statement of all disputed issues of material fact. If there are none, the petition must so indicate;
- b) A concise statement of the ultimate facts alleged, including the specific facts the petitioner contends warrant reversal or modification of the agency's proposed action;
- c) A statement of the specific rules or statutes the petitioner contends require reversal or modification of the agency's proposed action; and
- d) A statement of the relief sought by the petitioner, stating precisely the action petitioner wishes the agency to take with respect to the agency's proposed action.

These proceedings are held before a State Administrative Law Judge of the Division of Administrative Hearings. Unless the majority of witnesses are located elsewhere the Office will request that the hearing be conducted in Tallahassee.

In some instances you may have additional statutory rights than the ones described herein.

Failure to follow the procedure outlined with regard to your response to this notice may result in the request being denied. Any request for administrative proceeding received prior to the date of this notice shall be deemed abandoned unless timely renewed in compliance with the guidelines as set out above.