

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. 35, No. 37, of The Florida Administrative Weekly on September 18, 2009, on page 4597. Notice was also sent directly to **NCCI** and to other persons requesting to be notified of such events. An Amended Notice of Hearing was issued on September 30, 2009 to change the location of the hearing.

3. Some of the proposed changes in the Filing have 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 seven 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 -10.3% to -13.4%, 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 -6.4% to -10.0%. An analysis of the underlying frequency and severity components of the loss ratio trends shows that frequency has been declining in Florida at the rate of 7.0% per year in the last eight years for policy year data but the decline accelerated to over 10% in the last few years with the exception of the last year. The latest year indicates a

slowing of the declines, with only a 1% decline in frequency for calendar accident year 2008. It is unrealistic to believe that a 7% or 10% decline in frequency can continue for any extended period of time. Therefore, a more reasonable long term frequency should be considered for trend. In the five years prior to the 2003 reforms, the frequency changes in Florida were not as low as the frequency changes for countrywide data, but since 2003 the Florida declines have been much greater than the countrywide declines. The average countrywide frequency decline for the last five years is -4.6% and over the last ten years the average is -4.5%. The trend data in the Filing reflects losses that have been adjusted to the current level using the **NCCI** initial estimate of the effect of the 2003 reform. If the actual impact of the reforms is greater than the initial estimate, then the use of the data in the Filing would produce trends that are too low. Thus, the use of a -7.0% annual trend for indemnity and -4.0% annual trend for medical is justified.

5. The internal rate of return model used by **NCCI** in selecting the profit and contingencies factor of +2.5% includes anticipated policyholder dividends of 5.6%. 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 245 insurance carriers actively writing workers' compensation in Florida in calendar year 2008, only 97 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. **NCCI** has estimated the investment yield moving forward at 3.028%, a yield that is almost an historic low. While global financial markets are clearly in disequilibrium

currently, this estimate is significantly below average representative portfolio yields over the recent past and expected in the near future as economic performance continues to improve.

9. The **OFFICE** has reviewed **NCCI's** estimation of the cost of capital. The **OFFICE** believes that using the "long term" average short term Treasury rate as a proxy for the risk free rate within the CAPM estimation continues to overestimate the opportunity cost of capital at this point in the economic cycle. As well, the use of the long term equity risk premium as provided by Ibbotson et al. does not reflect market developments that have occurred over time. Indeed, **NCCI** itself has recommended a much lower equity risk premium in its previous filings. Taken together, these factors result in a cost of capital that the **OFFICE** believes overestimates the true cost of capital for workers' compensation insurance companies moving forward.

10. Based on Paragraphs 5., 6., 7., 8. and 9. above, the input parameters to the **NCCI** internal rate of return model for policyholder dividends, investment yield and cost of capital are not justified for this Filing. However, **NCCI** has selected a +2.5% profit and contingencies factor despite the indicated profit and contingencies factor being +10.99% for standard coverage and +11.23% for large deductible. Substituting more appropriate numbers for the policyholder dividends, investment yield and cost of capital shows that the proposed +2.5% profit and contingencies factor is justified for this Filing. The use of a +2.5% profit and contingencies factor in the Filing adequately reflects 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 +2.5% profit and contingencies factor. Thus, the proposed overall decrease for

the "F" classification adequately reflects investment income on unearned premium and loss reserves as required by Sections 627.072 and 627.215(8), Florida Statutes.

11. At the October 6, 2009 hearing, the President of the Florida Roofing, Sheet Metal and Air Conditioning Contractors Association (FRSA) testified that the FRSA's 50 member Board of Directors had met and were in unanimous agreement that the proposed roofing rate of \$16.04 is too low. The FRSA Board believes that a rate of \$16 would make it very difficult to get workers' compensation coverage for roofing. Also, the FRSA Board believes that the rate for next year's filing would require a substantial increase if the \$16 rate is approved this year. The FRSA Board of Directors recommends that there be no further decreases in the roofing rate and that the roofing rate for this filing be maintained at the current rate of \$20.01. Brett Stiegel, the Administrator of the FRSA Self Insurers Fund testified at the hearing and provided the experience of the Fund which insures approximately 25% of the roofing exposures in Florida. The FRSA Fund experience shows that the decline in frequency has abated since 2006, which is the latest year included in the **NCCI** Filing for the roofing classification. Since the FRSA Fund experience is later than that used in the Filing and is at odds with the experience in the Filing, an adjustment to the indicated roofing rate is appropriate.

12. No data was provided to support the proposed change in the minimum premium multiplier. The only data provided compared the number of minimum premium policies in the voluntary market versus the residual market (FWCJUA).

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 +2.5 percent (+2.5%) allowance for profit and contingencies for the proposed rates in the Filing, and identified in Exhibit II-A of the Filing, is approved. 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 -6.8 percent (-6.8%), effective January 1, 2010,

C. The statewide overall rate level change in the Filing for "F" classifications for new and renewal policies shall be -2.2% effective January 1, 2010.

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

H. The decrease in the classification rate for roofing (code 5551) should be limited to the average decrease for the contracting industry group which is -10.8%.

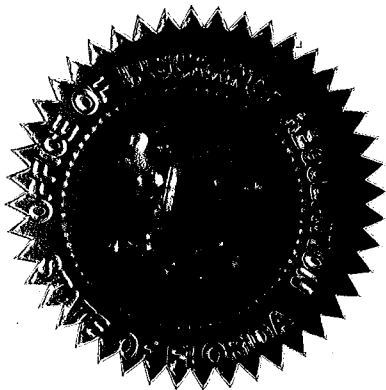
I. **NCCI** shall provide to the **OFFICE** a report for each quarter of calendar year 2010 showing the average intrastate experience modification factor for policies with effective dates in the year 2010 and for the same policies with effective dates for a

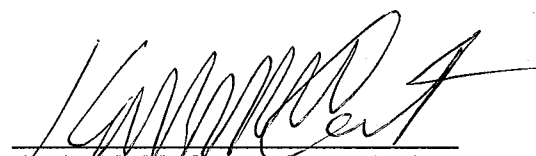
comparable period in calendar year 2009. The report for each quarter shall be filed within 30 days of the end of the quarter. Thus, the first report will be due on May 1, 2010 for the first quarter of calendar year 2010.

To meet statutory timeframes for a January 1, 2010 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 October 28, 2009. 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 15th day of October, 2009.




Kevin M. McCarty, Commissioner
Office of Insurance Regulation

Copies furnished to:

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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 may 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 may 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 may 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.