Actuarial Expert Testimony

National Council on Compensation Insurance

Rate Filing #17-19101

Florida Office of Insurance Regulation

Public Rate Hearing

October 18, 2017

Prepared by:

Stephen A. Alexander, FCAS, FSA, MAAA

October 9, 2018

Executive Summary

The NCCI's proposed rates are excessive for two fundamental reasons:

First, the NCCI's targeted underwriting profit of 2.0% for Florida is too high compared to the actual underwriting losses experienced by insurers in other states. Workers compensation insurance in other states is extremely price competitive, and insurers routinely take underwriting losses so they can profit from investing the difference between premiums collected and claims paid out (insurance float).

It is estimated that over a recent 10 year period workers compensation insurers in other states earned approximately 14.0% profit from insurance float and an additional 9% from investing their capital and surplus and took an underwriting loss of 5% for an overall profit before federal income taxes of 18% of premium.

Second, because practically all Florida insurers charge the same NCCI determined rates, there is a lack of normal price competition that prevents rates from reaching their equilibrium levels. The NCCI artificially holds Florida rates higher to reap higher profits for its member and subscriber companies. The NCCI does this by using overly conservative assumptions and by being quick to increase rates and slow to reduce them.

In other states, insurers routinely deviate from NCCI rates based upon their own experience and expectations. Moreover, they tailor rates to fit each employer's unique risk profile (schedule rating) and they use multiple sets (tiers) of rates.

Only 3 out of over 240 Florida insurers deviate from NCCI rates. The Office of Insurance Regulation's rule 69O-189.004 (attached) discourages rate deviations by expecting use of the NCCI's excessive profit and contingency provision.

Furthermore, OIR rule 69O-189.004 impedes new entrants into the market and discriminates and inhibits experimentation and new product development while robbing employers of recourse to competitors. Florida statute sections 627.062, 627.072, 627.091 and 627.211 provide sufficient guidance such that this rule is unnecessary.

Therefore, it is recommended that the Office of Insurance Regulation do the following:

1) Approve a 15.4% rate decrease for industrial classifications based upon a targeted underwriting loss of 4.0% instead of the NCCI's targeted 2.0% underwriting gain, approve a comparably greater rate reduction for F classifications based upon the same 4.0% targeted underwriting loss and approve the reduction in the expense constant from $200 to $160

2) Require the NCCI to file a schedule rating plan providing for premium debits and credits of plus or minus 25% like plans used in other states such as North Carolina (attached).

3) Eliminate OIR Rule 69O-189.004, or at least eliminate the following most egregious provision that discourages rate deviations: *"(5) All companies are generally expected to have the same taxes and profit and contingencies [emphasis added] as included in National Council on Compensation Insurance (hereinafter referred to as NCCI) filings."*

Qualifications

I have been retained by the Florida Workers Advocates to provide actuarial expert testimony regarding the NCCI's proposed 9.6% rate reduction. I am a Fellow of both the Casualty Actuarial Society and Society of Actuaries and a member of the American Academy of Actuaries.

I have several years of experience in consumer advocacy, pricing, reserving, risk management and regulation of all lines of property and casualty insurance. I have been accepted as an actuarial expert witness in administrative rate hearings in the states of Florida, Georgia, California, Texas and New Jersey. On August 18, 2016, I testified on behalf of the Florida Workers Advocates at the rate hearing on the NCCI's proposed 19.6% rate increase.

Recently, I have been accepted in federal and state court as a plaintiffs' actuarial expert witness in cases against Wells Fargo, Mortgage Investors Corp and State Farm. I was employed by the Office of the Insurance Consumer Advocate for 9 years until August of 2015 during which time I performed actuarial reviews of NCCI rate filings.

I have been employed as an actuarial consultant by Allegiant Actuarial Group, Mercer Oliver Wyman and Ernst and Young. I have an MBA from the University of Utah (Phi Kappa Phi and Beta Gamma Sigma), a BS in meteorology from the University of Utah (while serving as an officer in the US Air Force) and a BS in mathematics from the University of Michigan (see attached resume)

Underwriting Profit

At its 2017 Annual Issues Symposium, the NCCI reported that private insurers sustained an average 5% underwriting loss countrywide for the years 1995 through 2016. In only 6 of those 22 years did they average an underwriting profit. For the last 11 years they sustained an average 4% underwriting loss and in only 3 of those years did they make an underwriting profit.

In contrast, workers compensation insurers in the state of Florida sustained an average 3% underwriting profit during the years 2006 through 2015 and made underwriting profits in 6 of those 10 years. These higher Florida underwriting profits are a direct result of the lack of rate competition and the NCCI's building higher underwriting profits into Florida rates.

The NCCI employs an internal rate of return model using overly conservative assumptions that exaggerate Florida's needed underwriting profit and do not match countrywide marketplace realities. In the NCCI's 2006 through 2017 Florida rate filings, its internal rate of return model estimated needed Florida underwriting profits of 2% to 14% while private insurers countrywide were reporting average underwriting losses of 4%.

Indicated Rate Change

The recommended rate change for industrial classification is -15.4% rather than the NCCI's proposed -9.3% before consideration of the reduction in the expense constant from $200 to $160. The additional -5.9% recommended decrease is based upon reducing the underwriting profit provision from the NCCI's recommended +2.0% to -4.0%. The recommended -4.0% underwriting profit provision is consistent with the NCCI's reported countrywide experience of private insurers over the last ten years.

Schedule Rating

Schedule rating plans are in common use in other NCCI states, but are not being used in Florida. Schedule rating plans provide for the modification of rates either up or down to reflect the unique risk profiles of individual employers. The typical range of credits or debits is plus or minus 15% to 25%. For example, XYZ company earned a 15% schedule rating credit after it upgraded its ventilation system and machine guarding.

The state of North Carolina has a typical plan (attached) that provides for rate deviations of plus or minus 25% "to reflect characteristics of the risk that are not reflected in its experience". Schedule rating plans make it more cost effective for employers to invest in safety measures, because they receive immediate rate reductions instead of waiting years for such safety measures to impact their experience modifications.

Rate Deviations

Rate deviations are commonplace in other states, but in Florida the Office of Insurance Regulation has discouraged their use through rule 69O-189.004:

> *"Despite the changes in Section 627.211, Florida Statutes, made by chapter law 2004-82 (Senate Bill 1926) to allow for easier approval of deviations, only three insurers have been approved for a new deviation since the law became effective on July 1, 2004. One of these was for the transfer of an existing deviation. The Office has disapproved seven deviations since July 1, 2004 for lack of justification. Three insurance companies had approved deviations in 2015 (two of the deviations are downward 10% and the other is downward 5%)."* [1]

Included in the attached exhibits is a partial listing of rate deviations approved in the state of Massachusetts. Many of the companies or company groups represented in the complete listing of deviations found on the Office of Consumer Affairs website also operate in the state of Florida.

Premium Discounting

Premium discounting is the combination of schedule rating, rate deviations and policyholder discounts. The NCCI has reported in its annual advisory forums in several states (see attached NCCI exhibit), that employers in other states have received premium discounts averaging 8.6% over the 24 years from 1991 through 2014. If Florida employers had received comparable average discounts from 2006 through 2015, then it is likely Florida insurers' estimated excess profits of $1.8 billion would have been substantially reduced or eliminated.

[1] Florida Office of Insurance Regulation, 2016 Workers Compensation Annual Report

STEPHEN A. ALEXANDER, FCAS, FSA, MAAA

Employment:

2015-Present **Alexander Actuarial Consulting**

- Provided expert actuarial testimony on behalf of plaintiffs' attorneys regarding the following cases:

  Brown, et al. vs. State Farm Fire & Casualty, et al.

  United States of America ex rel., Victor E. Bibby and Brian J. Donnelly vs. Wells Fargo Bank, N.A. and Wells Fargo Home Mortgage, Inc., et al.

  United States of America ex rel., Victor E. Bibby and Brian J. Donnelly vs. William L. Edwards and Mortgage Investors Corporation

- Provided expert actuarial testimony on behalf of Florida Workers Advocates at the Florida Office of Insurance Regulation rate hearing held August 18, 2016 disputing the National Council on Compensation Insurance rate filing requesting a 19.6% rate increase. Prepared a related report titled "The Case for Reform, State of Florida, Workers' Compensation Insurance".

2015-Present **Allegiant Actuarial Group**

Performs pricing and reserve peer reviews for captive insurance companies and risk retention groups.

2005-2015 **State of Florida**
Office of the Insurance Consumer Advocate and
Office of Insurance Regulation
Actuary
Tallahassee, Florida

- Developed a predictive model of sinkhole frequency for the sinkhole prone counties in Florida using R open source statistical software.
- Examined private passenger and commercial auto, homeowners, medical malpractice, workers' compensation, general liability and other property and casualty rate filings.
- Testified at rate hearings and before legislative committees.
- Prepared a comprehensive review of the Florida title insurance industry.
- Developed a proposal to reform the Florida property insurance market.
- Prepared analyses of various legislative proposals to modify the Florida Hurricane Catastrophe Fund and Citizens Property Insurance Corporation.
- Developed an Annual Report Card to grade residential property insurance companies in Florida.

2003-2004 **Mercer Oliver Wyman**
Senior Consultant
Atlanta, Georgia

- Performed reserve and funding studies for self-insurers and captive insurance companies.
- Areas of involvement included hospital and nursing home professional liability, workers' compensation, product and product recall liability, commercial auto liability and commercial property.
- Completed an alternative retention analysis for a large self-insurer with extensive property and liability exposures in the state of Florida.

1999-2003 **Ernst & Young**
Manager
Atlanta, Georgia

- Conducted numerous actuarial audits of insurers and self-insurers.
- Conducted several medical malpractice reserve and funding studies for self-insureds, a large physician and surgeon trust fund and a mutual insurer.
- Completed a feasibility study for the formation of a lawyer's professional liability insurance company including recommended marketing strategy, policy forms and rates.
- Reviewed the adequacy of the reinsurance program of a large property insurer in the state of Florida.
- Conducted a statistical analysis of the workers' compensation closed claim data of a large railroad.
- Completed reserve and funding studies for a state petroleum storage tank pollution liability insurance program.
- Conducted a reserve review of a large insurer with extensive product liability exposures.
- Developed IBNR reserves for a large Japanese reinsurer.

Prior Work history includes employment in the insurance industry and state government as an insurance agent, risk manager and actuary.

Education:

- MBA - University of Utah, 1978
- BS Meteorology - University of Utah, 1967
- BS Mathematics - University of Michigan, 1965

Professional:

- Fellow - Casualty Actuarial Society, 2001
- Fellow – Society of Actuaries, 2014
- Member - American Academy of Actuaries, 2000

69O-189.004 Deviation Filing Information.

F.S., authorize the filing of premium deviations which automatically expire after a period of one year unless refiled and reapproved. Any such premium deviation filing shall include the following information:

(1) Proposed effective date of deviation.

(2) Proposed deviation percentage.

(3) The basis for the proposed deviation including all relevant factors to explain the justification for the deviation request.

(4) Calendar year earned premium, accident year incurred losses, accident year loss adjustment expense, and loss ratios of the preceding three years. Show the ratio of accident year loss adjustment expense to accident year incurred losses for each year, including Florida experience for the company filing for the deviation. If no Florida experience is available for part of the experience period requested, so state and show the experience in the group as a whole.

(5) Provide an exhibit showing anticipated expenses for the period of the deviation. This exhibit should show production expenses and general expenses. All companies are generally expected to have the same taxes and profit and contingencies as included in National Council on Compensation Insurance (hereinafter referred to as NCCI) filings. Do not include taxes or profit and contingencies unless justification for such factors is provided.

(6) As support for expense exhibits, show actual expenses for the latest three years for production and general expenses.

(7) Pursuant to Section 627.211(3), F.S., the Office shall consider the following areas when evaluating each company requesting a deviation:

(a) Applicable principles for ratemaking as set forth in Sections 627.062 and 627.072, F.S.;

(b) The financial condition of the insurer.

(8) In order to evaluate the financial condition of the company, the following information shall be provided, accompanied by justification, support and explanations where appropriate:

(a) Indicate whether the company's audited financial statements provide unqualified opinions or contain significant qualifications or "subject to" provisions. Yes responses must be explained;

(b) Indicate whether there has been any independent or other actuarial certification of loss reserves shown on the annual statements;

(c) Indicate whether the company's workers' compensation and employer's liability reserves are above the midpoint or best estimate of the actuary's reserve range estimate;

(d) Indicate whether the proposed deviation will have any detrimental affect on the financial status of the company;

(e) Provide historical experience demonstrating the profitability of the company;

(f) Statements, and documentation if necessary, confirming the existence of excess or other reinsurance that contains a sufficiently low attachment point and maximums that provide adequate protection to the company;

(g) Provide any other factors that are considered relevant to the financial condition of the company.

(9) In order for the Office to complete its review of a request for a deviation, the company shall indicate whether the deviation will constitute predatory pricing, including justification for its response.

(10) Pursuant to Section 627.211(3), F.S., the Office shall disapprove the request for a deviation if it finds that any of the following conditions exist:

(a) The resulting premiums would be excessive, inadequate, or unfairly discriminatory;

(b) The deviation would endanger the financial condition of the company;

(c) The deviation would result in predatory pricing.

(11) Section 627.211, F.S., states that the deviation is to be applied to the premiums produced by the rating system. Since minimum premiums, expense constants, and premium discounts have been filed based on industrywide experience, no deviation will be allowed to these unless specific justification is provided. Indicate in the filing where the uniform premium deviation will be applied and provide a copy of your manual page showing how the deviation will be applied.

(12) A copy of the filing shall be submitted to the NCCI. To assure that premium deviation filings are acted upon on a timely basis, such filings should be submitted electronically to http://www.floir.com/iportal, 90 days in advance of the proposed effective date.

Rulemaking Authority 624.308(1) FS. Law Implemented 624.307(1), 624.424(1)(c), 627.211 FS. History–New 6-4-92, Formerly 4-189.004, Amended 3-29-05.

Actuarial Expert Testimony

Office of Insurance Regulation Rate Hearing
NCCI Rate Filing #17-19101
October 18, 2017

Stephen A. Alexander, FCAS, FSA, MAAA

Florida Workers Compensation Rates
Too High for Two Reasons

Underwriting profits are too high compared to other states

Lack of normal price competition that exists in other states

- No schedule rating
- OIR Rule 69O-189.004 discourages rate deviations

Recommendations

Approve a 15.4% rate decrease for industrial classifications based upon a targeted underwriting loss of 4.0% instead of the NCCI's targeted 2.0% underwriting gain, and approve a comparably greater rate reduction for F classifications based upon the same 4.0% targeted underwriting loss.

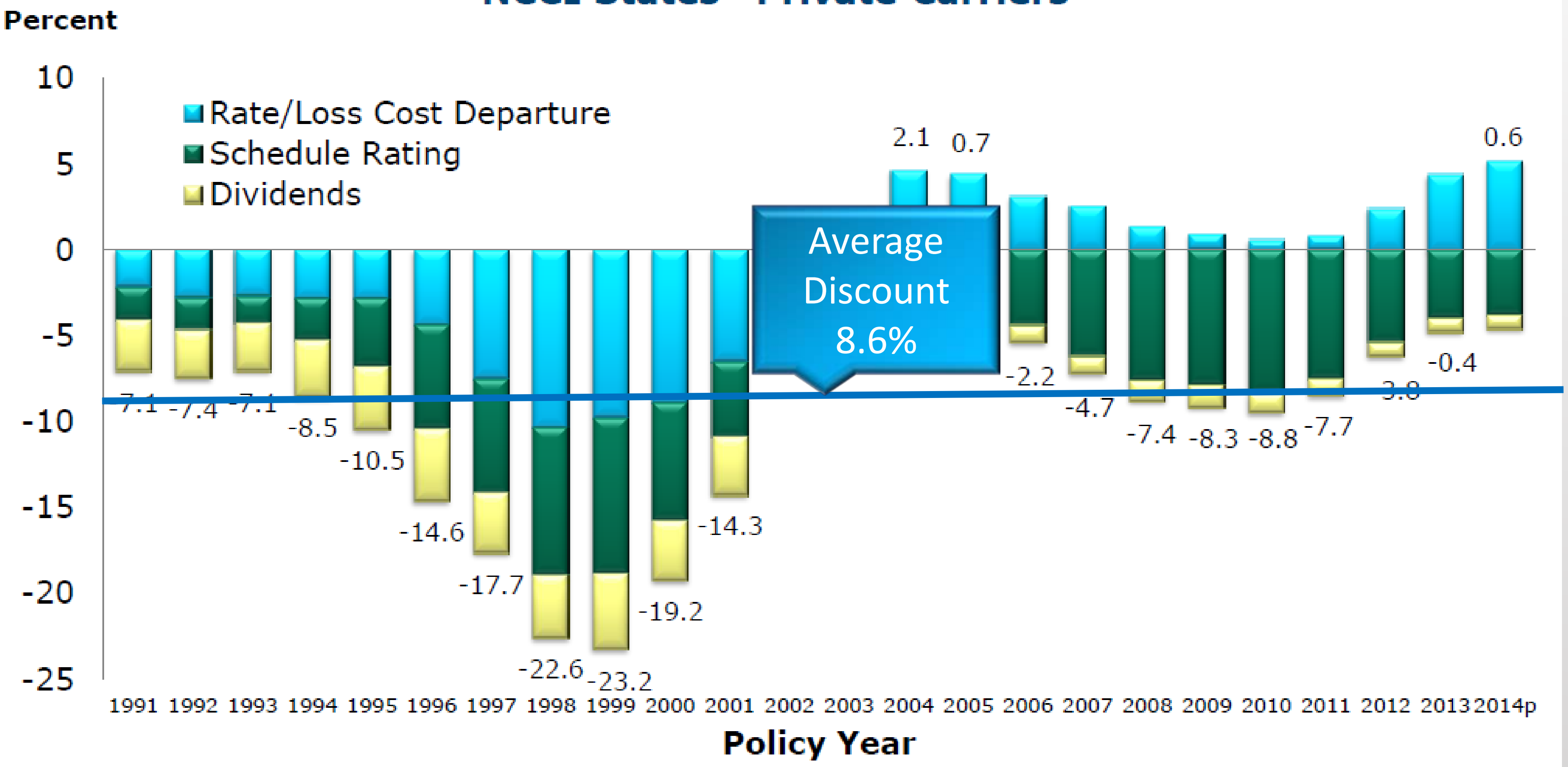
Require the NCCI to file a schedule rating plan providing for premium debits and credits of plus or minus 25% like plans used in other states such as North Carolina.

Eliminate OIR Rule 69O-189.004, or at least eliminate the following most egregious provision that discourages rate deviations:

"(5) All companies are generally expected to have the same taxes and profit and contingencies as included in National Council on Compensation Insurance (hereinafter referred to as NCCI) filings."

Countrywide Workers Compensation Impact of Discounting on Premium

NCCI States—Private Carriers



p Preliminary
Sources: Annual Statement Statutory Page 14 and NCCI's Financial Call data
Dividend ratios are based on calendar year statistics
NCCI benchmark level does not include an underwriting contingency provision
Based on data through 12/31/2014 for all states where NCCI provides ratemaking services, excluding TX

Indicated Rate Change
Industrial Classifications

	Current Rates	NCCI Proposed	Alexander Proposed
Production	17.9%	18.2%	18.2%
General	5.2%	4.9%	4.9%
Taxes	3.2%	3.0%	3.0%
Underwriting	26.3%	26.1%	26.1%
Underwriting Profit	2.8%	2.0%	-4.0%
Total	29.1%	28.1%	22.1%
Target Loss & LAE Ratio	70.9%	71.9%	77.9%
Rate Change		-9.3%	-15.4%

Note: Expense provisions are before application of premium discounts and expense constant.

Schedule Rating
versus
Rate Deviations

Schedule Rating:
Modification of rates either up or down to reflect the unique risk profile of an individual employer. Typical range of credits or debits is plus or minus 15% to 25%. For example, XYZ company earned a 15% schedule rating credit after it upgraded its ventilation system and machine guarding.

Rate Deviation:
Modification of rates either up or down for a class or group of rating classes. For example, an insurer deviates upward 15% for all contracting classes.

NORTH CAROLINA RATE BUREAU

SCHEDULE RATING PLAN

1. This Plan is available to any risk whose estimated annual manual premium is equal to or greater than $2,500.

2. Subject to a maximum modification of a 25% credit or a 25% debit, the premium for a risk may be modified in accordance with the following Schedule Rating Table to reflect characteristics of the risk that are not reflected in its experience (Note: The "Risk Characteristics" examples given to evaluate the positive or negative conditions of a risk may be interpreted as "including, but not limited to" those examples):

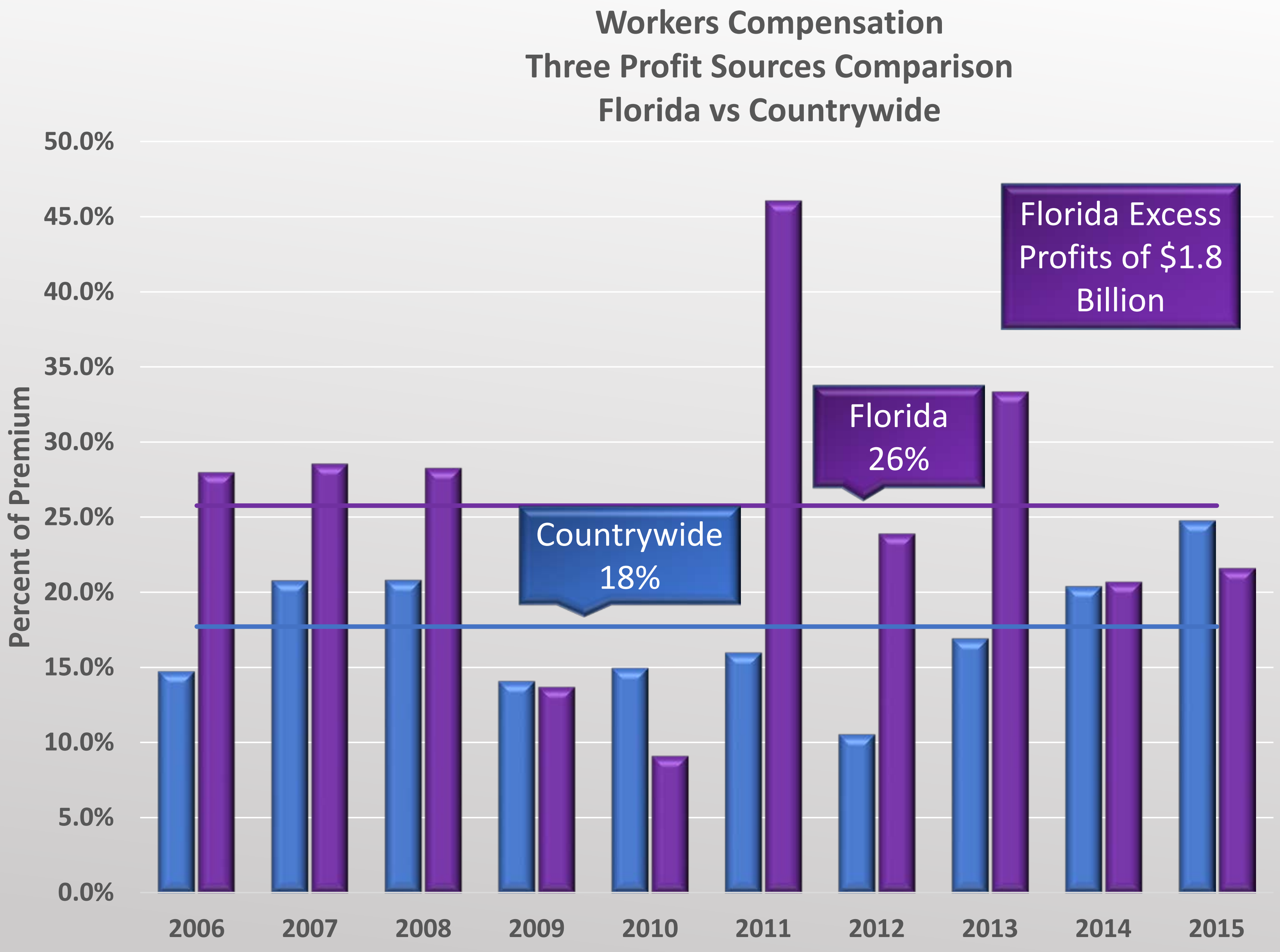
SCHEDULE RATING TABLE

Risk Characteristics	Range of Modifications		
	Credit		Debit
Premises .... Physical condition, preventive maintenance, hazards controlled, housekeeping	5%	to	5%
Classification Peculiarities .... Technology or methodology variations, exposure identification, employee distribution, employee turnover and interchange	5%	to	5%
Health and Medical .... First aid or medical assistance, emergency or disaster plans, return-to-work policy, alcohol or substance abuse programs, industrial hygiene and ergonomics	10%	to	10%
Safety Devices and Equipment .... Type and condition, guarding, personal protective equipment, maintenance	10%	to	10%
Employees .... Selection, training, experience, motivation, supervision	5%	to	5%
Management .... Commitment to workplace safety, involvement in loss control programs, cooperation with insurer	10%	to	10%
Safety Organization .... Accident investigation and analysis, record keeping, safety committee organization and effectiveness	5%	to	5%

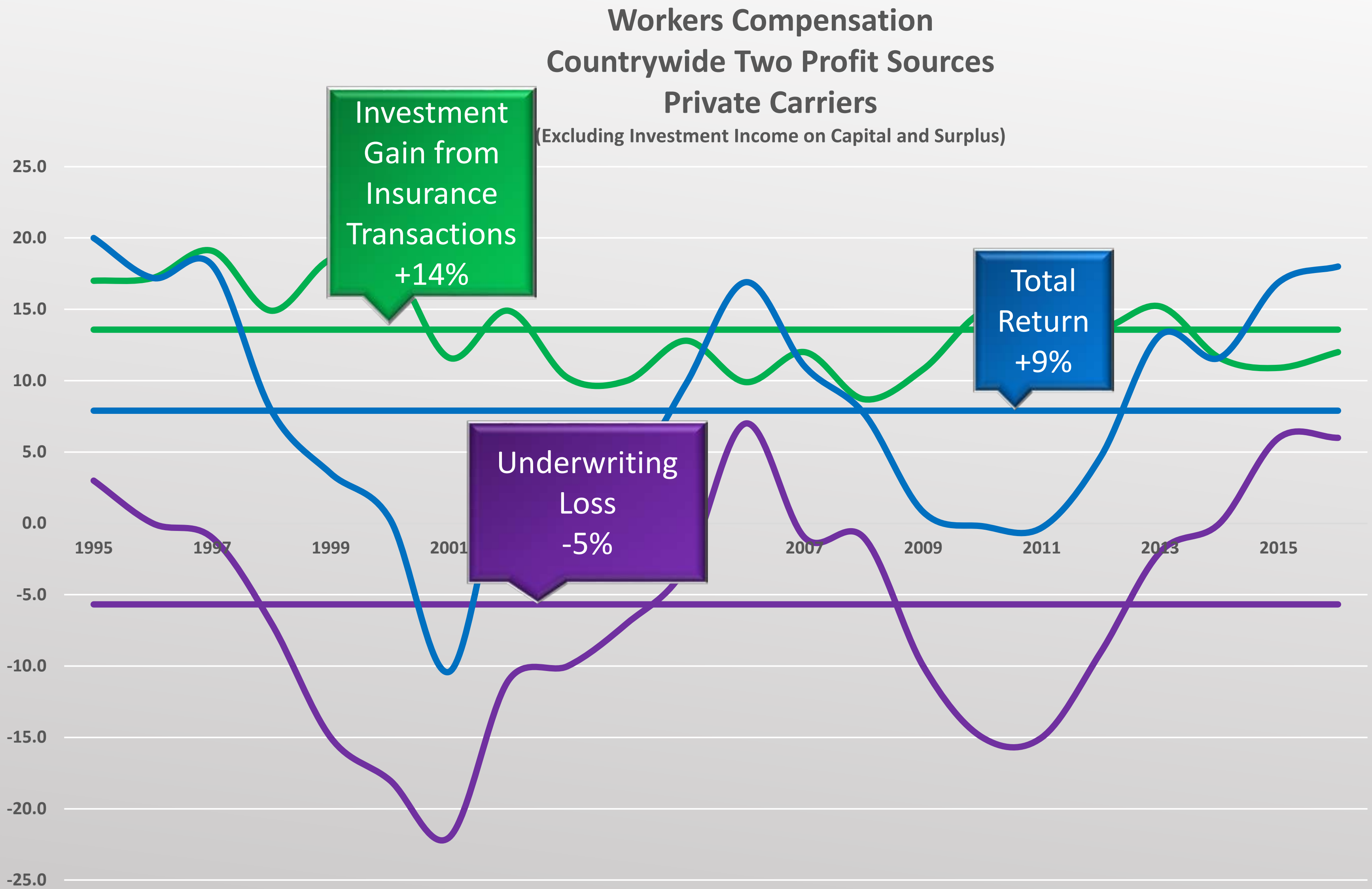
Three Profit Sources
2006 - 2015

	Florida		Countrywide	
Underwriting				
Premium	$1,000,000	100%	$1,000,000	100%
Losses	(510,000)	-51%	(630,000)	-63%
Loss Adjustment	(160,000)	-16%	(150,000)	-15%
Underwriting	(260,000)	-26%	(250,000)	-25%
Policyholder Dividends	(40,000)	-4%	(20,000)	-2%
Underwriting Gain	30,000	3%	(50,000)	-5%
Investment Income from Insurance Transactions	Float			
Reserves	740,000	74%	750,000	75%
Yield	5.5%		5.5%	
Years	3.5		3.5	
Gain	142,450	14%	144,375	14%
Investment Income from Capital and Surplus				
Capital and Surplus	$1,550,000		$1,550,000	
Yield	5.5%		5.5%	
Gain	$85,250	9%	$85,250	9%
Total Profit	$257,700	26%	$179,625	18%

Source: Alexander Pre-Filed Testimony, 8-5-16, OIR Filing #16-12500

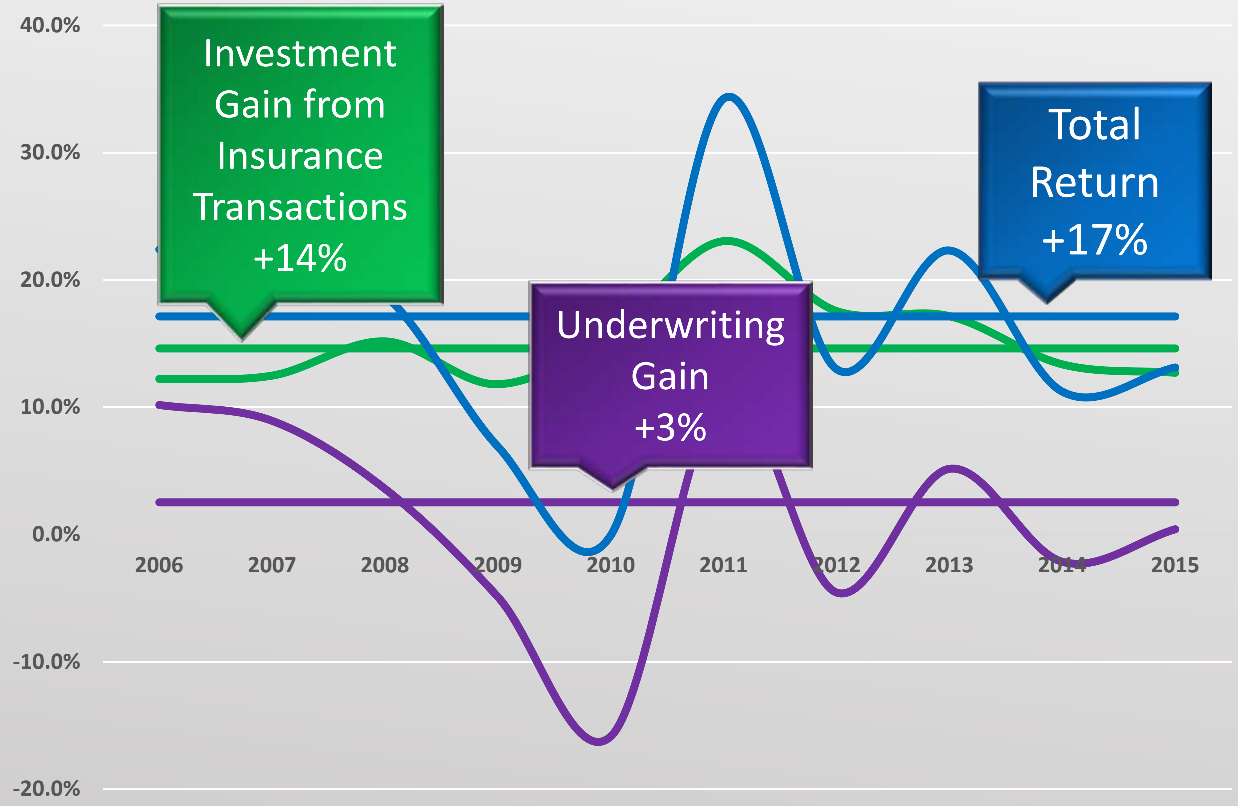


Source: Alexander Pre-Filed Testimony, 8-5-16, OIR Filing #16-12500



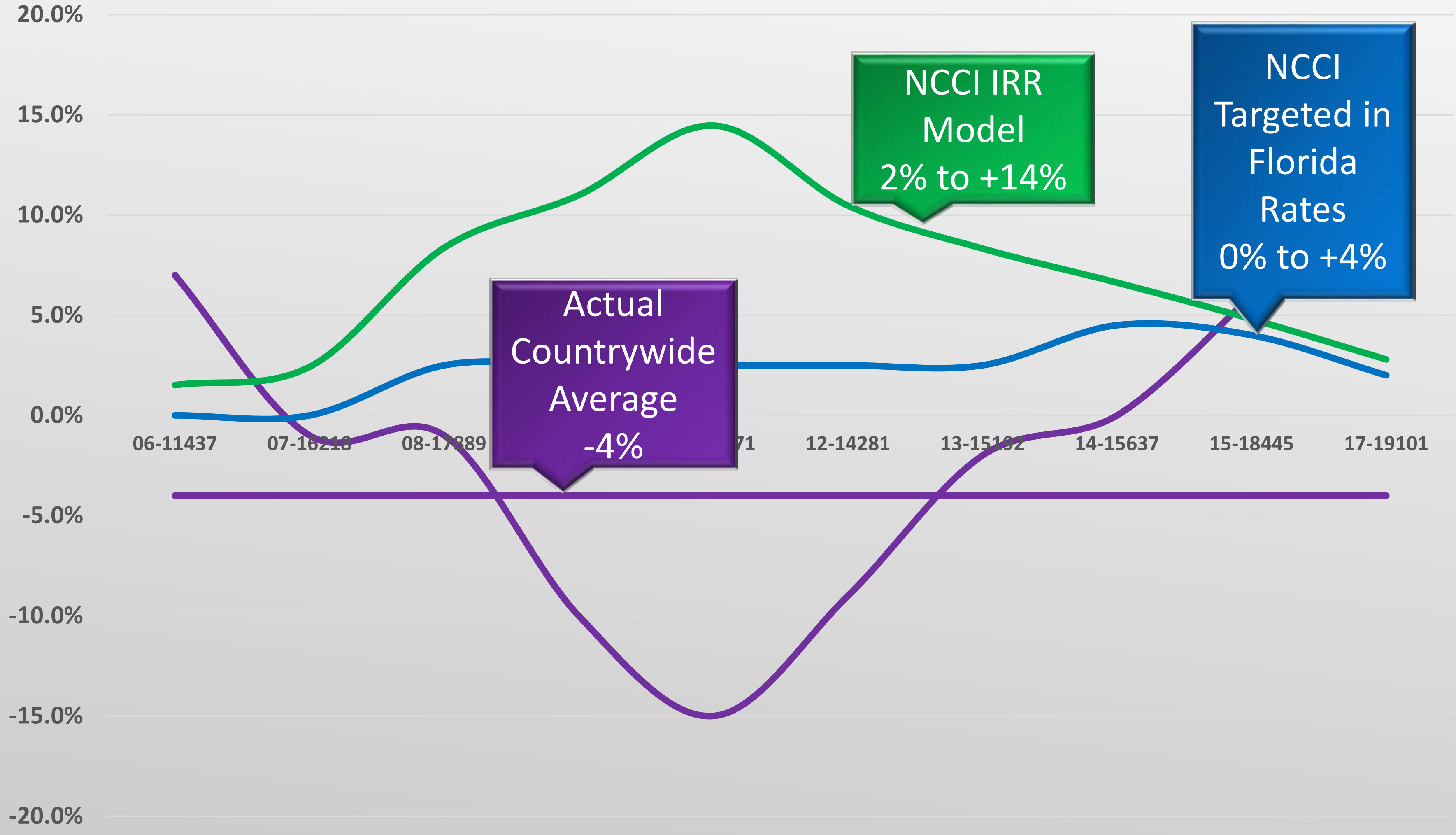
Source: NCCI, Annual Issues Symposium 2017, State of the Line Guide

Workers Compensation
Florida Two Profit Sources
(Excluding Investment Income on Capital and Surplus)



Source: Alexander Pre-Filed Testimony, 8-5-16, OIR Filing #16-12500

Underwriting Gain
Actual Countrywide vs
NCCI Internal Rate of Return Model



Sources: OIR rate filing numbers as indicated and NCCI, Annual Issues Symposium 2017, State of the Line Guide

The Official Website of the Office of Consumer Affairs & Business Regulation (OCABR)

Consumer Affairs and Business Regulation

Deviation and Schedule Credit Plans

Acquired Two Florida Domestics: Comp Options and Affiliated Industries

Also do business in Florida

COMPANY NAME	EFFECTIVE DATE	PROGRAM DESCRIPTION
ACADIA†	7/1/2016	INS. CO.: -12% DEV.; CONTINENTAL WESTERN INS. CO.: -7% DEV.
ACE		RE UNDERWRITERS INS. CO.: -10% DEV.
AIM*		EMPLOYERS INS. CO.:-20% DEV.; A.I.M. MUTUAL INS. CO.: -10% DEV.
ALLI		. INS. CO.: -10% DEV.; NATIONAL SURETY CORP: -15% DEV.; AN'S FUND INS. CO.: -20% DEV.
AME		SURE MUTUAL INS. CO. & AMERISURE INSURANCE CO.: EXP. CONST. REGARDLESS OF RISK SIZE
AmTrust NGH Grp†	7/1/2016	Amtrust Ins. Co. of Kan: -15% DEV; Security Nat. Ins. Co.: -20% DEV; Technology Ins. Co.: -5% DEV
ARBELLA†	9/1/2016	ARBELLA PROTECTION INS. CO.: 0%, -5%, OR -7.5% DEV., DEPENDING ON CLASS; ARBELLA INDEMNITY INS. CO.: -10%, -14.5% OR -17% DEV., DEPENDING ON CLASS.
ARGONAUT†	7/1/2016	ARGONAUT INSURANCE CO. AND ARGONAUT MIDWEST INS. CO.: 25% MAX. SCHED. CRED.
ARROW MUTUAL†	7/1/2016	DOWNWARD DEV. ON APPROVED MAX. RETRO. FACTORS
BERKSHIRE HATHAWAY†	9/1/2016	BERKSHIRE HATHAWAY DIRECT INS. CO: -15% DEV