

2004 Workers' Compensation Annual Report



Office of Insurance Regulation
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Office of Insurance Regulation

2004 Workers' Compensation Annual Report

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Office of Insurance Regulation 2004 Workers' Compensation Annual Report

Executive Summary

Section 627.211(6), F.S. mandates that the Office of Insurance Regulation (OIR) provide an annual report to the President of the Senate and the Speaker of the House of Representatives which evaluates competition in the workers' compensation market in the state. The report is to contain an analysis of the availability and affordability of workers' compensation coverage and whether the current market structure, conduct and performance are conducive to competition, based upon economic analysis and tests. The report must also document that OIR has complied with the provisions of Sec. 627.096, F.S., which require the office to investigate and study the data, statistics, schedules, or other information as it finds necessary to assist in its review of workers' compensation rate filings.

As mandated, the analysis presented in this report finds the following:

1. Based on a variety of economic measures, the workers' compensation market appears to be reasonably competitive.
 - a. The concentration of insurers suggests that the market for workers' compensation in Florida contains a large number of independent firms.
 - b. None of the firms have enough of the market to exercise any meaningful control over the price of workers' compensation.
 - c. The Herfindahl-Hirschman Index indicates that the market is not concentrated.
 - d. There are no significant barriers for the entry and exit of insurers into the Florida workers' compensation market.
 - e. Based on entries and voluntary withdrawals, it would seem that the Florida workers' compensation market is an attractive market for insurers.
2. The number of actively writing insurers and the competitive analysis indicates that coverage should be generally available in the voluntary market. The residual market is small, suggesting that the voluntary market is absorbing the vast majority of demand.
3. Based on inquiries received by OIR, there appear to be some availability issues in the voluntary market for certain employer groups such as small firms, new firms, and construction firms. The growth of the use of Professional Employer Organizations (PEO) among smaller employers has helped availability by making coverage affordable.

4. Affordability, particularly with the Florida Workers' Compensation Joint Underwriting Association, Inc. (FWCJUA) which is the residual market, has been an on-going issue. Recently enacted legislative changes, Senate Bill 50 A in 2003 and House Bill 1251 in 2004, have addressed affordability in the voluntary and residual market respectively and both are having beneficial results.
5. A number of issues remain to be addressed for the FWCJUA:
 - a. The FWCJUA premiums for tier 3 employers are 170% above the voluntary market. In other words the tier 3 premiums are 2.7 times the voluntary market. This compares to the residual market in 21 other states with an average differential of 35% above the voluntary market.
 - b. Currently, the tier 1 and tier 2 rates for most employers are more affordable than the previous subplans A, B and C. However, on January 1, 2007 the rates for tiers 1 and 2 are to be "actuarially sound rates". Since the "below the line" assessments end on July 1, 2007, there will be no funding mechanism for deficits in tiers 1 and 2. This will undoubtedly require very conservative actuarial assumptions to prevent any deficit. This can only mean higher rates. The Florida Legislature should extend or eliminate the July 1, 2007 expiration date of the "below the line" assessments for tiers 1 and 2 in order to keep these rates at a more reasonable level.
 - c. A thorough study should be made of the FWCJUA statutory requirements and operation in comparison to other states to identify the reasons that Florida's residual market premiums are so much higher than other states.
 - d. While not a part of this report, there are issues to be addressed by the Florida Legislature for the obsolete subplan "D", which is in runoff mode.
6. There are a number of mechanisms used by insurers to compete in the workers' compensation marketplace including both price and non-price components. The biggest difference between the Florida workers' compensation insurance market and other states generally is the amount of price competition in basic rates (i.e. deviations).
7. The Joint Select Committee on Workers' Compensation Rating Reform recommended that the Legislature explore adoption of a loss cost system to promote competition when the workers' compensation market was more stable. Currently, OIR sees no material disruptions in the market that would logically prevent consideration of adopting a loss cost filing system for rates. Although, there is still no clear evidence that such a switch would be a benefit to Florida consumers.
8. The OIR is in compliance with the requirements of Sec. 627.096, F.S.

Office of Insurance Regulation 2004 Workers' Compensation Annual Report

Introduction

Section 627.211(6), F.S. mandates that the Office of Insurance Regulation (OIR) provide an annual report to the President of the Senate and the Speaker of the House of Representatives which evaluates competition in the workers' compensation market in the state. The report is to contain an analysis of the availability and affordability of workers' compensation coverage and whether the current market structure, conduct and performance are conducive to competition, based upon economic analysis and tests.

The report must also document that OIR has complied with the provisions of Sec. 627.096, F.S., which require the office to investigate and study the data, statistics, schedules, or other information as it finds necessary to assist in its review of workers' compensation rate filings.

This inaugural report is the result of this mandate and is divided into the following sections:

1. A review and analysis of the competitive structure of the workers' compensation market in Florida;
2. A review and analysis of the availability and affordability of workers' compensation insurance in Florida;
3. An analysis of the extent to which the market structure, conduct and performance of the workers' compensation market in Florida support a competitive environment, and;
4. A documentation of the OIR's compliance with the provisions of Sec. 627.096, F.S.

As this is the first such report, each section above not only provides the required analysis but also provides historical trends and data to allow some context for the current year analysis. Finally, an executive summary precedes the body of the report.

Competition in the Workers' Compensation Market

A regulated market such as the insurance market, which includes workers' compensation, can not, by design, be expected to conform to the definitional characteristics of a perfectly competitive market. At the same time, the competitive market construct is a useful benchmark for analytical purposes.

In a perfectly competitive marketplace, there are a large number of buyers and sellers whose individual actions have no impact on supply, demand or price. Buyers and sellers have complete information about the product being delivered in the market and the product is homogeneous, meaning that there are no real or perceived differences in the product across sellers.

Both buyers and sellers are price takers; that is, buyers can buy as much of a good or service as they desire at the market price, sellers can sell as much as they wish at the market price. If sellers set their price above the market price, informed buyers will acquire the product elsewhere. If the seller sets their price below the market, informed buyers will purchase from them. This generates sales in the short-run, but the below market price will not be sufficient to cover all of the seller's economic costs, forcing them to adjust price or leave the market.

In the competitive market structure, sellers have freedom of entry to the market and freedom of exit from the market. That is, there are no legal, regulatory, technical or financial impediments to prevent any seller from coming into the market, or conversely, to leave the market at their own choosing.

At the other extreme, another construct that is useful for analytical purposes is the monopoly market structure in which only one firm represents the entire seller side of the market. By construction, the seller's product is unique, with no near substitutes and the seller sets the price. This market is characterized as offering lower output at higher prices than the competitive market result. In practice, of course, it is difficult to find examples of either construct; within the workers' compensation market, however there are 5 states where the workers' compensation market is serviced entirely by a state monopoly. Rather, most markets exhibit elements more like a competitive structure or more like a monopolistic structure.

In the analysis of competitive conditions in these "in-between" markets, the focus is usually on the degree of competition exhibited by the market. Analysis of the number of sellers in the market and their relative size provides some evidence on the ability of one or two large sellers to disrupt competitive pricing and supply in favor of more uncompetitive outcomes. Additionally, analysis of the number of sellers entering and leaving the market can provide some indication of the breadth, dynamism and perceived attractiveness of a market to current and potential sellers.

Number of Companies and Market Share

To provide some measure of the degree of competition in the Florida workers' compensation market, the first analysis provides measures of the number of firms selling in the market and their respective market share. To provide some context for the current characteristics of the market, an historical review is also provided. This review spans the last five years, and considers results from 1994. In order to evaluate the level of competition for workers' compensation in Florida, a review was made of the number of firms selling workers' compensation and their market share. The review covered each of the last five years and the year 1994.

Status of the Workers' Compensation Market in the Early 1990's

Self-insurance funds became a dominant part of the market in the early 1990's, writing more than half of the voluntary market. Self-insurance funds, which include group self-insurance funds, commercial self-insurance funds and assessable mutuals, are assessable. Assessable means that if the premiums are insufficient to cover expenses and losses, then each member could be liable for any shortfall. A part of the legislative reforms of 1993 transferred the regulation of group self-insurance funds to the Department of Insurance. This change in regulation, along with the creation of the Florida Workers' Compensation Joint Underwriting Association, Inc. (FWCJUA) and elimination of the assigned risk plan funded by insurance companies created an environment that resulted in dramatic changes in the Florida market.

In 1994 there were 35 self-insurance funds and two self-insurance funds that had recently converted to insurance companies. These 37 entities wrote 67.7% of the total workers' compensation market in Florida. Beginning in late 1994, self-insurance funds began converting to insurance companies. This trend rapidly gained momentum with the vast majority converting to insurance companies, merging with other entities or going out of business due to insolvency in the next few years. By the year 2000 only four self-insurance funds remain; the same four are still in existence at the end of 2004.

The effect of self-insurance funds on the market has not been well documented in the past because the annual statement data used by A.M. Best and the National Council on Compensation Insurance (NCCI) in their analyses did not include the self-insurance data. This was mainly due to self-insurance funds' annual statements not being sent to the National Association of Insurance Commissioners or if they were sent, they were excluded when an analysis was done for insurance companies. Comparing the analysis in this report to other insurance industry sources will show a major difference in 1994 and somewhat less significant differences for the years 1999 through 2003 because this report includes the self-insurance funds data.

Concentration of Insurers

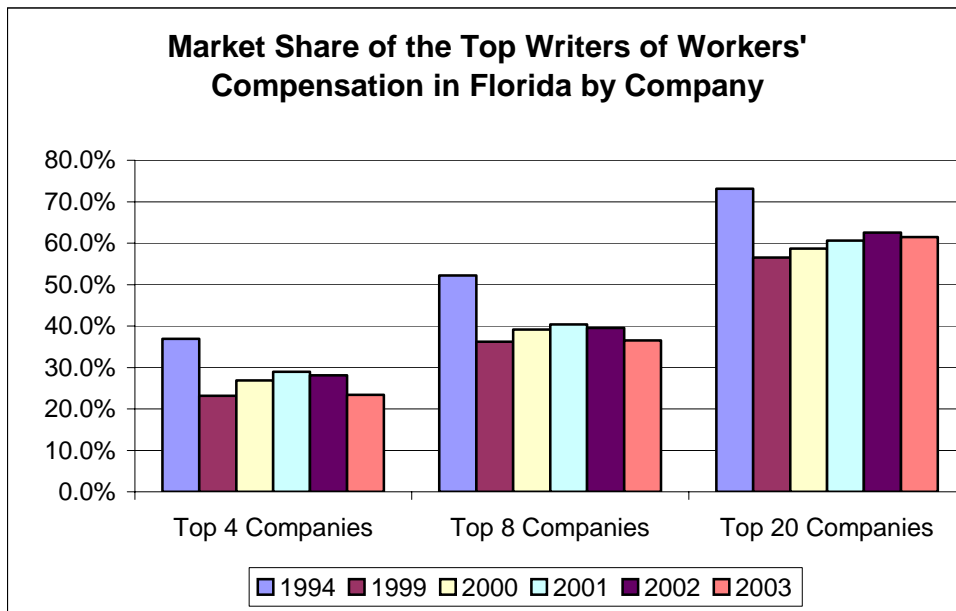
In addition to the total number of firms in a market, economic analysis of competitive conditions typically reviews the market percentage of the top firms in a market to estimate the level of competition between participants and the amount of control an individual firm

might exert over the market. There is no universal agreement among economists on precisely which concentration level measure should be used for analytical purposes. For this first report, the top firm, the top 4 firms, top 8 firms and top 20 firm concentration measures are included.

Unique to insurance markets is whether concentration levels should be based on company level data or on affiliated insurer group data. An insurer group can consist of any number of individual insurers under common ownership. Insurers within the same group would not normally be expected to compete against each other. However, they may act to segment the market so that each insurer targets a slightly different portion of the market. Thus, it seems appropriate to review the market share based on insurer groups. This proves to be quite challenging over time as the members of the group change, group names are changed, company names are changed and groups or individual insurers merge into various combination of entities. The analysis reported here includes both individual insurers and insurer groups.

Exhibit 1 in the Appendix shows all the details of the top writers of workers' compensation in Florida by company and groups of companies. Over the period 1994 to 2003 the concentration by company has decreased for the top writer (13.5% to 6.7%), the top 4 (36.9% to 23.4%), the top 8 (52.2% to 36.5%) and the top 20 (73.1% to 61.5%). The data in Exhibit 1 of the Appendix are graphically summarized in Table 1 for the top 4, top 8 and top 20 company concentration measures.

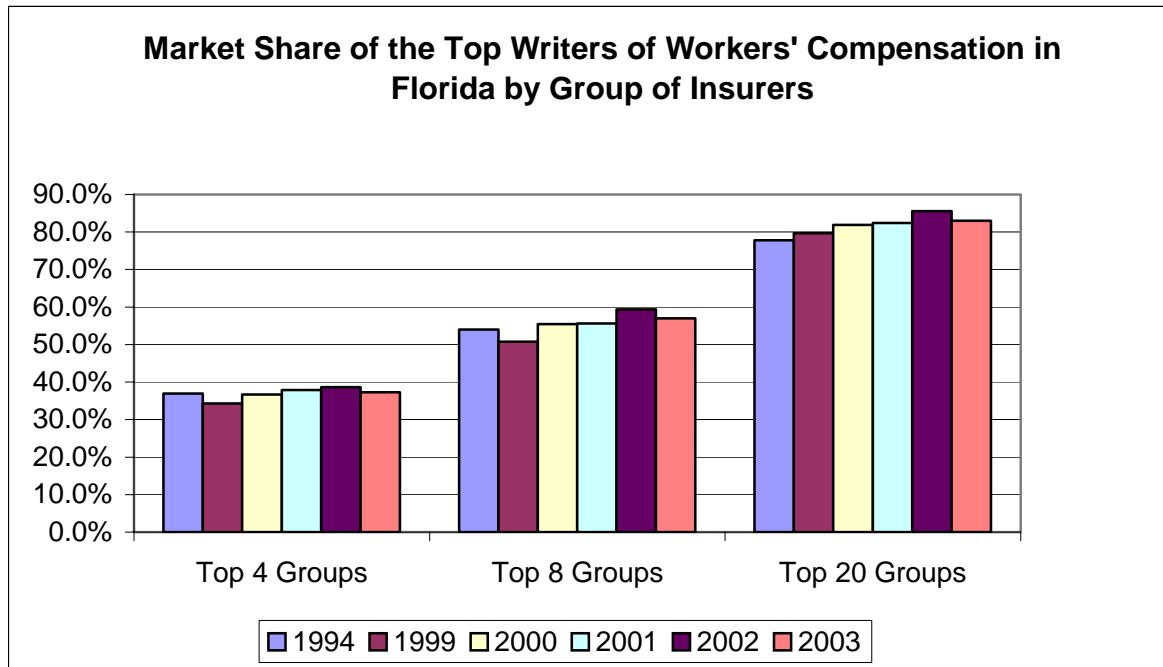
Table 1



In contrast to the company level results, for insurer groups the top 4, top 8 and top 20 have all increased their market share over the period 1994 to 2003. For the last five years, the top

4, top 8 and top 20 all exhibit a similar pattern with an increase each year in market share from 1999 to 2002 and a decrease from 2002 to 2003. Table 2 summarizes these results.

Table 2



For the ten year period covered by this report, the highest concentration by insurer group for the top writer was 14.7%, the top 4 had 38.7%, the top 8 had 59.3% and the top 20 had 85.6%. Generally, the higher the concentrations based on market share, the less the market would be expected to exhibit competitive behavior. This is a very general conclusion as there is no standard or even agreement on the exact level where the concentration would lead to an uncompetitive market. When considered within an insurance market context, the market share percentages for Florida workers' compensation insurers suggest that the level of market concentration is not so disruptive that a few insurers could exert any meaningful control over the market. This conclusion becomes even more tenable when the composition of firms in the top 4, 8 or 20 is considered.

The relative stability of the percentages over the period reviewed implies a relatively static market environment, but a review of the actual companies and groups reveals a rather dynamic market where the top companies and groups vary significantly over that period. One group was not in the top 20 in 1994, but increased to the fifth largest group in 1999 only to become insolvent and disappear in 2000. To summarize this dynamic aspect of the market consider the following:

Top 4 Analysis

- Only 2 of the top 4 companies in 1994 remain in the top 4 in 1999 and 2003.
- All four companies in the top 4 in 1999 remain in the top 4 in 2003.

- Only 2 of the top 4 groups in 1994 remain in the top 4 in 1999 and 2003.
- Three out of four of the groups in the top 4 in 1999 were in the top 4 in 2003.

Top 8 Analysis

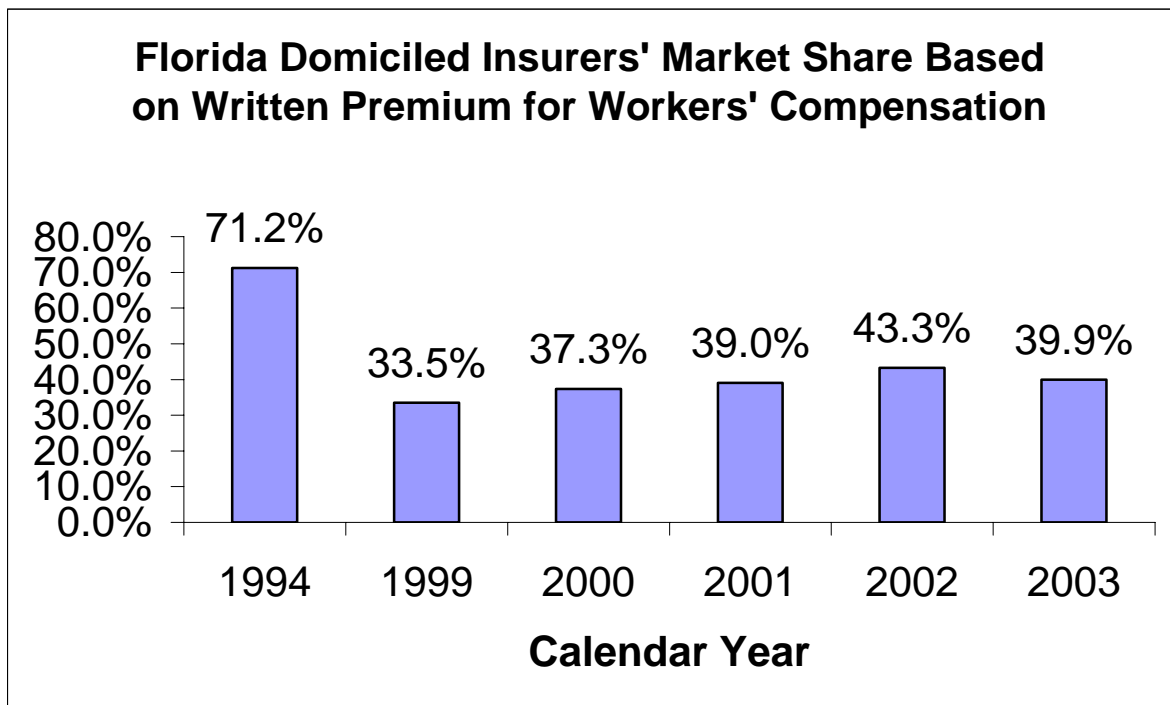
- Only 2 of the top 8 companies in 1994 remain in the top 8 in 1999.
- Only 3 of the top 8 companies in 1994 remain in the top 8 in 2003.
- Only 4 of the top 8 companies in 1999 remain in the top 8 in 2003.
- Only 3 of the top 8 groups in 1994 remain in the top 8 in both 1999 and 2003.
- Seven out of eight of the groups in the top 8 in 1999 remain in the top 8 in 2003.

Top 20 Analysis

- Only 10 of the top 20 companies in 1994 remain in the top 20 in 1999.
- Only 9 of the top 20 companies in 1994 remain in the top 20 in 2003.
- Only 11 of the top 20 companies in 1999 remain in the top 20 in 2003.
- Only 11 of the top 20 groups in 1994 remain in the top 20 in both 1999 and 2003.
- Only 15 of the top 20 groups in 1999 remain in the top 20 in 2003.

In analyzing the market, one question that frequently arises is the percentage written by insurers that are domiciled in Florida. Table 3 shows the percentage of market for domestics in the years 1994 and 1999 to 2003. In 1994 the percent was 71%. For the years 1999 to 2003 the percentage was 34%, 37%, 39%, 43% and 40% respectively. Thus, after the drop from 1994 to 1999, the percentage written by domestics has been fairly stable for the last five years.

Table 3



Another economic measure of the concentration of a market is the Herfindahl-Hirschman Index. The US Department of Justice defines this index as follows:

“The Herfindahl-Hirschman Index (HHI), a commonly accepted measure of market concentration is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. For example, for a market consisting of four firms with shares of thirty, thirty, twenty and twenty percent, the HHI is 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$).

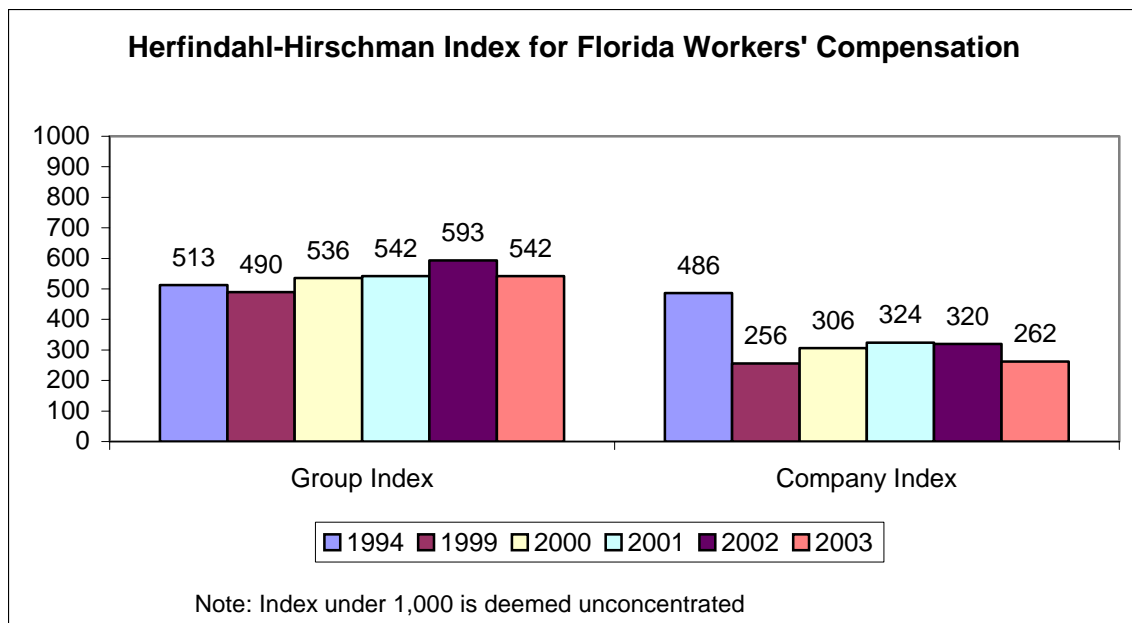
The HHI takes into account the relative size and distribution of the firms in a market and approaches zero when a market consists of a large number of firms of relatively equal size. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases.”

The US Department of Justice divides the spectrum of market concentration as measured by the HHI into three regions that can be broadly characterized as unconcentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800), and highly concentrated (HHI above 1800).

The Herfindahl-Hirschman Index has been calculated for the years 1994 and 1999 to 2003 using both companies and groups. The results are in Table 4. The index based on groups varies from 490 to 593, while the company index varies from 256 to 486. These numerical results further support the contention that the Florida workers’ compensation market can be characterized as not unduly concentrated.

NCCI has at various times, calculated the Herfindahl-Hirschman Index for Florida and all states. NCCI’s analysis has shown Florida to be somewhere in the middle of all states, with a ranking of 28th most competitive in 1999 and 18th most competitive in 1998, which are the most recently available results from NCCI.

Table 4



Entries and Exits

As regulated entities, firms providing workers' compensation insurance are subject to some obstacles to free entry and exit, including legal and financial requirements. However, these obstacles have not been shown to generally affect the entry or exit of insurers in the insurance business in general nor in the workers' compensation insurance business in particular.

Exhibit 2 in the Appendix shows the details of the entrance and exit of firms for each of the years from 1994 to 2004 for Workers' Compensation. The exiting firms are broken down into the following categories:

- Liquidated due to insolvency
- Currently suspended due to solvency concerns
- Merged with other firms
- Voluntarily withdrew from the Florida market, which means that the company requested to withdraw its certificate of authority for workers' compensation

Comparing the number of companies newly admitted versus the number of companies voluntarily withdrawn provides an indication of the desirability of the Florida workers' compensation market from the insurers' viewpoint. A review of Exhibit 2 in the appendix shows that over the last ten years, 118 companies have been admitted and only 69 companies have voluntarily withdrawn. These results are summarized in Table 5. Table 6 shows the breakdown of companies leaving the Florida market. From these data, it would appear that the Florida workers' compensation market is an attractive market for insurers although the number of insurers has decreased due to mergers and solvency problems. The conclusion based on this exhibit is that there are no significant barriers for the entry and exit of insurers into the Florida workers' compensation market.

Table 5

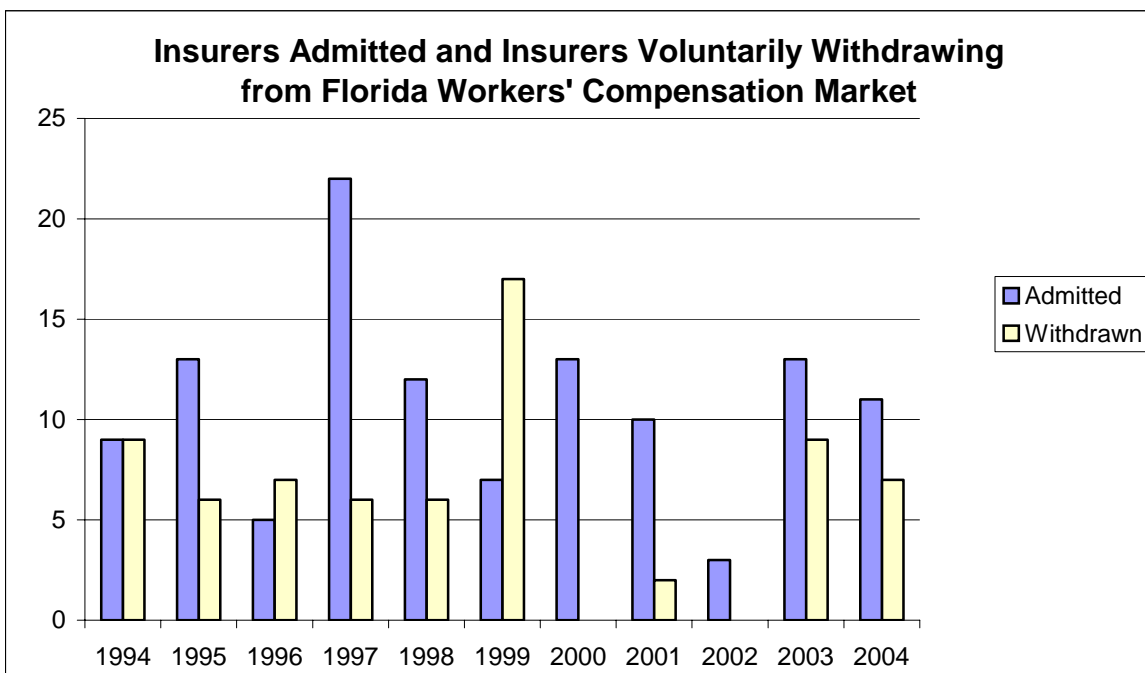
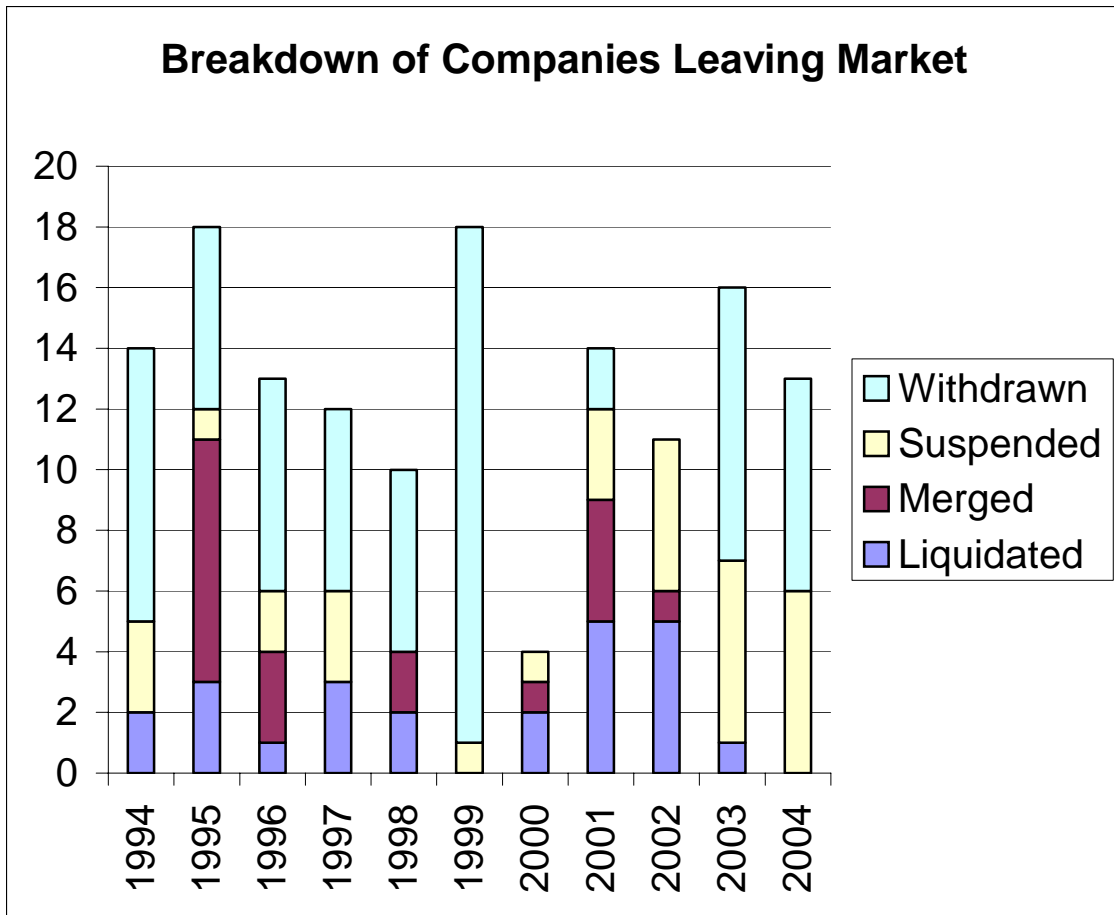


Table 6



Standardized Product

Competitive market results are generally more likely to be found in markets where the product is standardized or virtually standardized such that the consumer is indifferent as to the seller. The coverage provided by workers' compensation policies is uniform across all insurers but it is not clear that employers view all insurers as equal. The nature of insurance (a promise to pay based on a future contingent event) may cause some employers to view the larger companies or the companies that have been in business longer as more desirable. However, this may be offset by recent experiences of the employer or acquaintances of the employer. The influence of a local agent may also affect the employer's perception of insurers. No analysis designed to determine what underlying factors can influence an employer's choice of insurer was undertaken, but no obvious anecdotal evidence that any insurer can unduly affect the market by varying its workers' compensation insurance policy appears evident. Absent this, it would appear that there is sufficient standardization of the workers' compensation policies so as not to impede competitive market behavior.

Non-Price Competition

A standardized product in a perfectly competitive market results in an absence of non-price competition such as product quality, advertising or sales promotion as it would only add to expense without changing the competitive result for any one firm. In the workers' compensation market, it is clear that insurers advertise both locally and nationally and insurers may have promotions for their agents and customers to attract business or retain existing business.

In addition, insurers compete in ways unrelated to the determination of premium such as the following:

- Offering premium payment plans that vary the amount of money paid initially and through installments;
- Demonstrating the availability and effectiveness of specialized loss control;
- Demonstrating the effectiveness of their claims handling including fraud detection;
- Paying higher agent commissions or providing other agent incentive programs, and;
- Emphasizing policyholder service in auditing, policy issuance or certificates of insurance.

Conclusion

This analysis of the concentration of insurers suggests that the market for workers' compensation in Florida contains a large number of independent firms. Further, none of the firms have enough of the market to exercise any meaningful control over the price of workers' compensation.

The changing composition of the top writers reinforces this conclusion by showing that over time, individual firms have not been able to consistently maintain their percentage of the total market. The Herfindahl-Hirschman Index indicates that the market is not concentrated.

There are no significant barriers for the entry and exit of insurers into the Florida workers' compensation market. Based on new entries and voluntary withdrawals, it would appear that the Florida workers' compensation market is an attractive market for insurers.

Workers' compensation coverage is a standardized product and non-price competition is important but not the overriding factor that can affect the overall competitiveness of the market.

In sum, the Florida workers' compensation insurance market, while not meeting all the requirements of perfect competition, appears to be reasonably competitive.

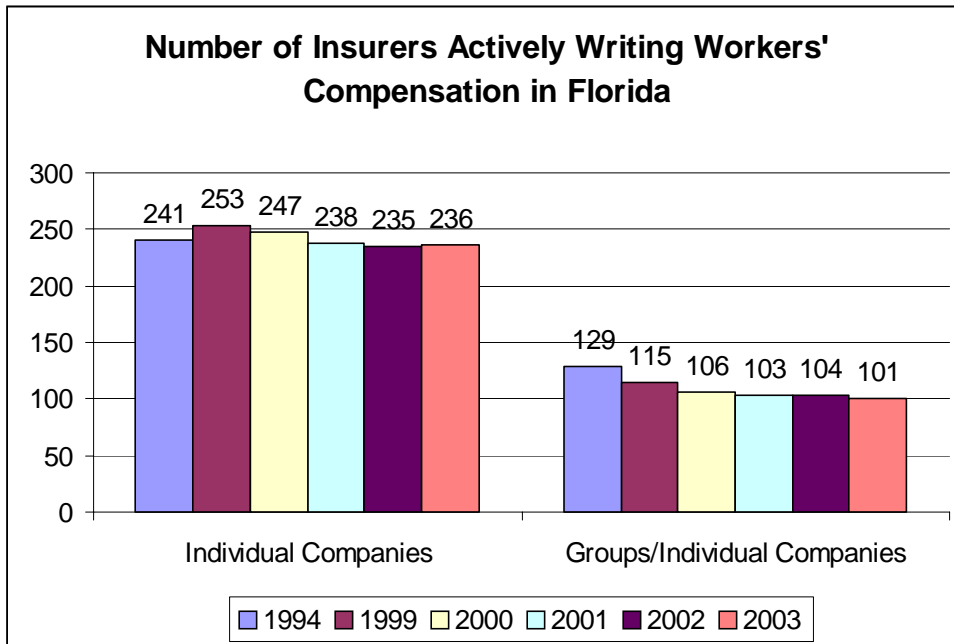
Availability and Affordability

Introduction

The number of individual insurers actively writing Workers' Compensation in Florida has been very consistent from 1994 to 2003. Actively writing means having positive written premium. This does not mean that every insurer with positive premium is seeking new business, but they are renewing some policies.

A review of the actively writing groups along with companies not in a group shows that there has been some consolidation within the industry as the number of groups/companies has steadily decreased; from 129 in 1994 to 101 in 2003. Table 7 summarizes this trend.

Table 7



The analysis of the number of actively writing insurers along with the discussion on competition in the Workers' Compensation market indicates that coverage should be generally available in the voluntary market.

Residual Market

One of the most significant indicators of an availability problem is the size of the residual market. In Florida, the Florida Workers Compensation Joint Underwriting Association, Inc. (FWCJUA) is the market of last resort. Only employers that cannot find coverage in the voluntary market are eligible for coverage in the FWCJUA. Thus, the size of the FWCJUA is a measure of availability of coverage in the voluntary market. Exhibit 3 in the appendix shows the number of FWCJUA policies and the written premium as a percent of the voluntary market.

The Florida Workers' Compensation Insurance Plan (FWCIP) was the residual market for Florida until the FWCJUA was invented on January 1, 1994. All insurance companies writing workers' compensation in Florida funded the FWCIP. If there was a deficit in the FWCIP, then all insurance companies were assessed to cover the deficit. In 1993 the FWCIP issued 48,430 policies with written premiums of \$328 million. The FWCJUA in contrast has varied from 13,933 policies down to 522 policies, with written premium varying from \$73 million to \$5 million.

The FWCJUA's written premium as a percent of total market has not exceeded 2% since 1995 and has been below 1% for most years. Putting this in context by comparing to other states, the NCCI administers the residual market in 25 states. For 2003, the average market share for the residual market in these 25 states was 12%. Only two of the 25 states were below 8%. Thus, in Florida even at 2% the FWCJUA is still very low.

The FWCJUA was created to be self-sufficient with no ability to obtain funding from the voluntary market. The only funding mechanism for any shortfall is by assessing FWCJUA policyholders. Assessing policyholders after their policy has expired creates a financial hardship for the policyholders and should be avoided if possible. Thus, the FWCJUA Board has a goal of avoiding assessments and this has contributed to the level of rates and surcharges.

There are surcharges in addition to the rate differential that affects the total premium paid by FWCJUA policyholders. There was a 99% surcharge applied to Sub-plan "C" premiums in excess of \$2,500, an Assigned Risk Adjustment Program (commonly know as, "ARAP") surcharge for experience rated policies and a \$475 flat surcharge added to every policy. The creation of Tiers 1, 2 and 3 by HB 1251 has resulted in a restructuring of the rates and surcharges used by the FWCJUA.

Currently, the premium for tier 1 is 25% above the voluntary rates, tier 2 is 50% above voluntary and tier 3 is 170% above (2.70 times the voluntary rates), plus the ARAP surcharge applies for tier 3. Additionally, all three tiers have a flat surcharge of \$475. Tier 3 policyholders have a burden that tiers 1 and 2 do not have. Tier 3 policies are assessable if premiums are not sufficient to cover losses and expenses. Exhibit 4 in the appendix shows the rate differential and an estimate of the average surcharge for the FWCJUA versus the voluntary market.

It is unrealistic to expect that an actuary's best estimate, which is a prediction of future contingent events, to always exactly coincide with the future results. It is understood and usually explicitly acknowledged that the results for a particular year can be higher or lower than the actuary's estimate. The consequences of the results being higher or lower than the estimate affect the actuary's judgment and ultimate selections.

In a situation where financial backing is substantial, it may be acceptable for the actuary's estimate to be high half of the time and low half of the time, as long as over time the predications coincide with the average result. In other words, if there is a billion dollars in

surplus, the company may not be concerned if the actuary's estimate is \$50 million high or low in a particular year as long as it balances out over a number of years.

If, however, there is only \$10 million in surplus, the company cannot afford for the estimate to be \$10 million lower than the estimate because they will be bankrupt. In this latter situation the consequences of being low are more important than the consequences of being high and this will impact the degree of conservatism that is appropriate in the actuary's selection.

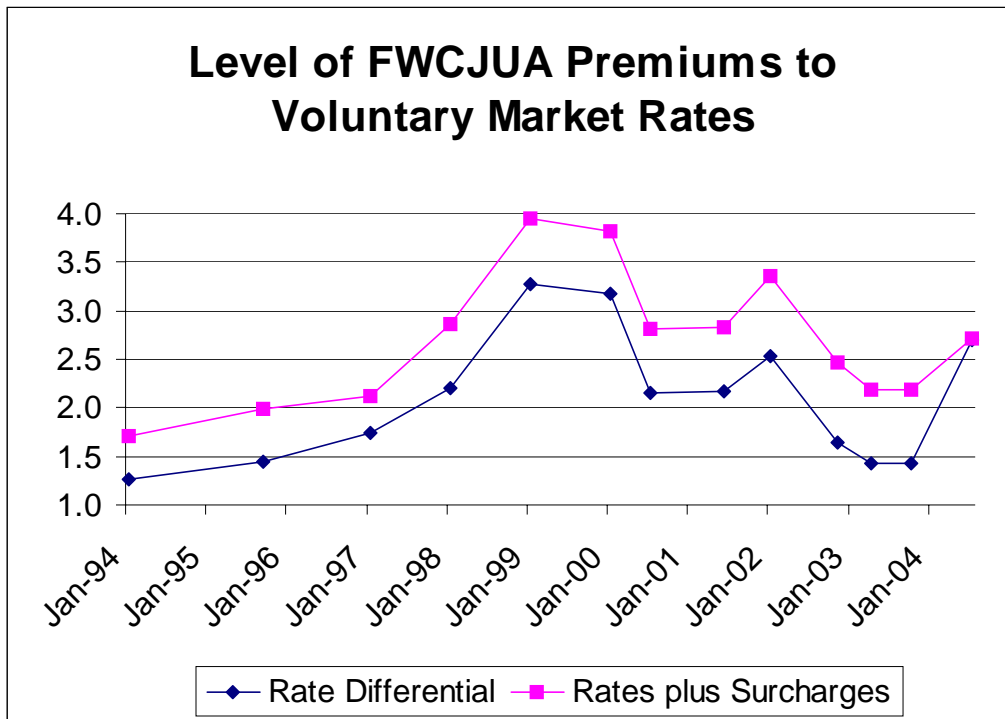
The FWCJUA has been in a situation where the consequences of reserving too low or having rates that are too low (i.e. retroactive assessments to policyholders) have been greater than the consequences of reserves too high or rates too high. If the rates are too high, there may be some complaints from policyholders and others (and there could be federal income taxes that have to be paid) but, if there are assessments due to the rates being too low, every policyholder is affected, even those whose policy expired long ago. At the extreme, some of the policyholders could face severe financial distress or even be put out of business as a result of the assessment.

As a result of these circumstances, the degree of conservatism used in determining FWCJUA rates and surcharges has contributed to the level of rates needed. The main contributor to the FWCJUA rates, however, has been the level of expenses and losses incurred. Both of these were adversely impacted when the volume of FWCJUA business decreased in the late 1990's. As a result of all these factors and others, the FWCJUA rates have been very high in comparison to the residual markets in other states.

NCCI administers the residual market in a number of states. In these states the insurance companies writing workers' compensation provide the financial backing by funding any deficits but keeping any profits. For comparison purposes, information about the premiums charged by these residual markets versus the voluntary market was collected. The result for 21 states is an average differential of 35%, with the highest state being 82% and the lowest 16%. As shown in Table 8, the FWCJUA differential has been much higher than this throughout its history and reached the point that the FWCJUA policyholders were paying 3 to 4 times the voluntary market premium at one time.

Currently, the tier 1 and tier 2 rates for most employers are more affordable than the previous subplans A, B and C. However, on January 1, 2007 the rates for tiers 1 and 2 are to be "actuarially sound rates". Since the "below the line" assessments end on July 1, 2007, there will be no funding mechanism for deficits in tiers 1 and 2. This will undoubtedly require very conservative actuarial assumptions to prevent any deficit. This can only mean higher rates for these two tiers.

Table 8



Having the goal of a small residual market is desirable, but it needs to be balanced with having an affordable residual market. The FWCJUA was very small in comparison to the total voluntary market from 1997 to 2002. This occurred during a period that the FWCJUA rates were not very affordable to many employers and the voluntary market was very competitive. The high premiums in the FWCJUA discouraged many employers from even applying to the FWCJUA. These employers went out of business, did not buy any coverage or sought the services of a Professional Employer Organization (PEO). Coupled with a very competitive market by insurers who aggressively sought new policyholders, created an extremely small residual market.

Ultimately, availability should not be an issue as coverage can be found in either the voluntary market or the FWCJUA. For an employer, however, availability is meaningless if the coverage is not affordable.

Composition of the Buyer

Much of the analysis of the worker’s compensation market, owing to a lack of more detailed data, is done at a high level by insurer or in total. This ignores the reality that the workers’ compensation market is segmented based on a number of characteristics, such as size of employer, type of industry, past experience of the employer or the lack of experience. The

market for large employers versus small employers can be vastly different. The market for construction risks is different from employers with office workers. New businesses typically have trouble obtaining coverage due to the lack of experience that can indicate not only the insurance exposure but also the credit risk, which may affect whether premiums will be paid.

The majority of complaints about not being able to get coverage in the voluntary market come from small employers, new businesses and construction employers. Employers with a combination of these characteristics are especially difficult to place in the voluntary market. In some cases, coverage is related to the availability of agents in the local area and the number of insurers the local agents represent.

“A Study of the Availability and Affordability of Workers’ Compensation Coverage for the Construction Industry in Florida” dated January 31, 2003 and provided to the Florida Legislature concluded that construction employers, especially small construction employers, are having difficulty finding affordable workers’ compensation coverage. While the restructuring of the FWCJUA has helped this situation, the problem still exists as documented by the number of employers found by the Department of Financial Services (DFS) to have no coverage. DFS’s workers’ compensation division conducts random sweeps at construction sites to ensure compliance with workers’ compensation laws. In 2004 DFS has issued more than 2,200 stop-work orders to companies that weren’t carrying insurance for all of their workers. The majority of these were construction companies.

According to the National Association of Professional Employer Organizations (NAPEO), “Professional employer organizations (PEOs) enable clients to cost-effectively outsource the management of human resources, employee benefits, payroll and workers’ compensation. A PEO provides integrated services to effectively manage critical human resource responsibilities and employer risks for clients. A PEO delivers these services by establishing and maintaining an employer relationship with the employees at the client’s worksite and by contractually assuming certain employer rights, responsibilities, and risk.” Also according to NAPEO, the average client customer of a PEO is a small business with 16 worksite employees, though larger businesses also find value in a PEO arrangement.

PEO’s have been a significant part of the Florida workers’ compensation market since the early 1990’s. PEO’s have had an erratic history of being able to obtain coverage in the workers’ compensation insurance market. In the early 1990’s coverage was difficult to obtain. By the mid-1990’s coverage was broadly available and relatively easy to obtain. In the early 2000’s coverage became scarce and in 2003 after CNA stopped writing PEO’s, coverage was nearly impossible to find. The successful PEO’s have adapted to this changing market and some have formed their own insurance company. PEO’s have been a source of workers’ compensation coverage for many employers in Florida that could not obtain coverage in the voluntary market, particularly small employers. When the premiums for the FWCJUA have been deemed too high by employers, the PEO market has been the only available option for many employers.

The January 2005 issue of “*Florida Trend*” contains the following updated information on PEO’s:

- PEO's in Florida cover 696,453 employees and 50,907 companies with a payroll of \$17.1 billion.- Source: Florida Association of Professional Employer Organizations, 2003 survey
- 2005 Forecast: "Our clients are growing again so that's good news. The workers' compensation situation in Florida seems relatively stable," says Carlos Rodriguez, division president of ADP TotalSource in Miami.

Conclusion

Based on the analysis of the number of actively writing insurers along with the discussion on competition in the workers' compensation market indicates that coverage should be generally available in the voluntary market. Evidence reviewed does not suggest that availability issues are a systemic problem within Florida's workers' compensation market. It does appear that small firms, new firms, and construction firms may face some market shortfalls in the voluntary market. The residual market is small, suggesting that the voluntary market is absorbing the vast majority of demand. The growth of the use of PEO's among smaller employers has, as well, helped availability by making coverage affordable.

For an employer, availability is meaningless if the coverage is not affordable. On the affordability side, it appears that necessarily conservative actuarial estimates have contributed to uncompetitively high rates in the recent past for the FWCJUA, although statutory changes appear to have helped to moderate rates most recently.

The FWCJUA premiums for tier 3 employers are 170% above the voluntary market. In other words the tier 3 premiums are 2.7 times the voluntary market. This compares to 21 other states with an average differential of 35% above the voluntary market.

Currently, the tier 1 and tier 2 rates for most employers are more affordable than the previous subplans A, B and C. However, on January 1, 2007 the rates for tiers 1 and 2 are to be "actuarially sound rates". Since the "below the line" assessments end on July 1, 2007, there will be no funding mechanism for deficits in tiers 1 and 2. This will undoubtedly require very conservative actuarial assumptions to prevent any deficit. This can only mean higher rates.

The Florida Legislature should extend or eliminate the July 1, 2007 expiration date of the "below the line" assessments for tiers 1 and 2 in order to keep these rates at a more reasonable level. A thorough study should be made of the FWCJUA statutory requirements and operation in comparison to other states to identify the reasons that Florida's residual market premiums are so much higher than other states.

Market Structure, Conduct, And Performance To Promote Competition

The previous sections of this report do not suggest any obvious impediments to a workers' compensation market that has been found to be reasonably competitive. This section concentrates on the ability of the market to promote competition.

Mandatory Rating Plans

Before discussing the ways that workers' compensation insurers compete in the marketplace, it is useful to summarize the rating and premium pricing variations that result from the mandatory rating plans currently in effect. The following rating plans are required of all insurers in the state of Florida:

- Experience Rating Plan – This plan recognizes differences between individual employers by comparing the actual experience of an individual employer with the average expected experience of employers in the same classification. The plan produces an experience modification factor that may increase or decrease premiums. An employer is eligible for this program if the average annual premium is at least \$5,000.
- Premium Discounts by Size of Policy – The premium discount plan adjusts the employer's premium to reflect the fact that the relative expense of servicing large premium policies as a percent of premium is less than that for small premium policies. For example, the policy issuance costs for a \$200,000 policy may be higher than those for a \$20,000 policy, but the cost are not ten times as high.
- Drug-Free Workplace Premium Credit – A 5% premium credit provided to employers that certify the establishment of a drug-free workplace program.
- Employer Safety Premium Credit – A 2% premium credit provided to employers that certify the establishment of a safety program.
- Florida Contracting Classification Premium Adjustment Program - A premium credit is provided for policies with one or more contracting classifications that pay above average hourly wages. The credit amount increases as the average wage paid increases. The credit is calculated based on payroll and hours worked information submitted by the employer to NCCI.
- Small Deductibles - For a reduced premium, the employer agrees to reimburse the insurer for each claim up to the deductible amount and the carrier covers benefits for each claim above the deductible amount. Small deductibles range from \$500 to \$2,500 and are required by section 440.38(5), F.S. An insurer may refuse to issue a policy with a deductible based on financial stability of employer.
- Coinsurance - For a reduced premium, the employer agrees to reimburse the insurer 20% of each claim up to \$21,000. This option is required by section 440.38(5), F.S.

An insurer may refuse to issue a policy with a coinsurance amount based on financial stability of employer.

- Coinsurance and Deductible - For a reduced premium, the employer agrees to reimburse the insurer a deductible amount in the range of \$500-\$2,500 per claim and 20% of each claim up to a maximum of \$21,000. This option is required by section 440.38(5), F.S. An insurer may refuse to issue a policy with a coinsurance and deductible amount based on financial stability of employer.

Optional Plans Used by Insurers to Compete on Price

Insurers use the following plans to compete on price:

- Policyholder Dividends - Insurers reward their policyholders by returning some of their profit at the expiration of the policy by issuing policyholder dividends, which may be based on the policyholder's experience, the carrier's experience, and other factors.
- Deviations –Section 627.211, F.S. allows insurers to file a uniform percentage increase or decrease that is to be applied to all rates an insurer charges or to rates for a particular class or group of classes of insurance.
- Intermediate Deductibles - For a reduced premium, the employer agrees to reimburse the insurer for each claim up to the deductible amount and the carrier covers the amount of the claim above the deductible amount. Intermediate deductibles range from \$5,000 to \$75,000.
- Large Deductibles – Large deductible policies operate similarly to the small and intermediate deductible, but have a deductible amount of \$100,000 and above. In order to qualify for the large deductible program, an employer must have standard premium of at least \$500,000.
- Consent to rate – The insurer and employer agree to a rate in excess of the approved rate. The insurer must limit this option to no more than 10% of policies written or renewed in each calendar year.
- Retrospective Rating Plans – The final premium paid by the employer is based on the actual loss experience of the employer during the policy, plus insurer expenses and an insurance charge. If the employer controls the amount of claims, they pay lower premiums. Before there were large deductible programs, retrospective rating plans were the dominant rating plan for large employers.
- Waiver of subrogation - For an additional premium, the insurer may waive its right of recovery against specifically named parties liable for injury covered by the policy.

Non-Price Competition

In addition, insurers compete in ways unrelated to the determination of premium such as:

- Offering premium payment plans that vary the amount of money paid initially and through installments;
- Demonstrating the availability and effectiveness of specialized loss control;
- Demonstrating the effectiveness of their claims handling including fraud detection;
- Paying higher agent commissions or providing other incentive programs, and/or;
- Emphasizing policyholder service in auditing, policy issuance or certificates of insurance.

Deviations

In the mid 1980's, the use of deviations as a means of competing was commonplace. From 1983 to 1985 over 40% of the market was written at deviated rates. However, by 1989 only 9% of the market was written at deviated rates. After the two year legislatively required moratorium (1990 and 1991) on deviations, the use of deviations has ceased to be a meaningful factor in the workers' compensation marketplace in Florida. See Table 9 below for details.

Despite the changes in section 627.211, F.S. made by chapter law 2004-82(SB 1926) to allow for easier approval of deviations, no insurer has filed for a new deviation since the law became effective on July 1, 2004. Two insurers have renewed their prior deviations, which means there are currently only two insurance companies with a deviation in Florida.

Table 9

Workers' Compensation Rate Deviations (all downward) from 1981 to 2004							
Year	Number of Insurers	Market Share	Average Deviation	Year	Number of Insurers	Market Share	Average Deviation
1981	1	1.2%	10.0%	1993	0	0%	0%
1982	41	23.6%	12.8%	1994	0	0%	0%
1983	89	46.6%	14.2%	1995	3	unavailable	11.6%
1984	122	54.0%	16.5%	1996	4	unavailable	11.2%
1985	121	40.8%	15.9%	1997	3	unavailable	11.6%
1986	79	18.3%	12.7%	1998	3	unavailable	11.6%
1987	57	11.5%	10.4%	1999	3	unavailable	11.6%
1988	55	11.3%	10.0%	2000	5	unavailable	12.0%
1989	43	8.8%	10.3%	2001	4	unavailable	10.8%
1990	0 (moratorium)	0%	0%	2002	3	unavailable	10.8%
1991	0 (moratorium)	0%	0%	2003	3	unavailable	8.3%
1992	0	0%	0%	2004	2	unavailable	10.0%

Note: For the period 1995 to 2004, the market share is not available because the deviations only apply to a portion of the company's total written premium.

Large Deductibles

In the early 1990's, insurers approached the Department of Insurance about filing a rating plan for large employers (defined as having \$500,000 in standard premium) that would be more flexible in how the premium would be determined. The justification for the flexibility would be based on the following general concepts:

- The rating plan would be used only for very large employers. These employers would generally be eligible to be individually self-insured.
- Rating is similar to rating for excess insurance that is purchased by individual self-insureds.
- The minimum deductible is \$100,000 and could be in the millions. Thus, the employer will be responsible for the vast majority of claims.

The Department ultimately agreed to these type plans with restrictions that were incorporated in Administrative Rule 69O-189.006 (formerly 4-189.006).

As large deductible programs have been implemented, there has been a dramatic shift in premiums. The typical large deductible policy will have a deductible credit that can range from 30% to 90%. Thus, the premiums paid by employers and reported by insurers will be a fraction of premiums paid for other rating plans. This means that premiums in the annual statement and premiums reported for assessments and taxes are much lower than they were previously.

As the volume of large deductible policies written in Florida has increased, the effect has been to lower the base for assessment and taxes such that Florida Statutes have been revised to require premiums to be reported without the deductible credit.

An ancillary effect of large deductibles has been the movement for very large employers to cease being individually self-insured and to buy an insurance policy from an insurance company with a large deductible program.

Competitive Rating

In workers' compensation there are basically two types of filing environments for rates, either "full rates" or "loss cost". In full rate states, the rating organization files a rate for each classification along with other factors used to determine the policyholder premium. In a loss cost state, the rating organization files a so-called "loss cost" for each classification. The loss cost represents the amount by classification that is need on average, to cover the losses and loss adjustment expense for accidents that are expected to occur by employees in that classification. Each insurer in a loss cost state, adds their company expenses and profit to the lost cost filed by the rating organization to produce a manual rate for each classification, which they file with the regulatory authority for approval.

Prior to 1990, only a couple of states used a loss cost methodology for establishing workers' compensation rates. By the mid-1990s the majority of the states had adopted a loss cost system. At the end of 2004, there were 37 states using loss cost, 8 states using full rates and 5 states are monopolistic state funds. In a state with a monopolistic state fund, as the name implies, the state fund provides workers' compensation coverage for all employers in the state. There are no insurance carriers allowed to provide coverage for workers' compensation in a state with a monopolistic state fund.

The Joint Select Committee on Workers' Compensation Rating Reform

The President of the Senate and the Speaker of the House of Representatives appointed members to the Joint Select Committee on Workers' Compensation Rating Reform, as required by Senate Bill 50 A, "to study the merits of requiring each insurer to individually file its expense and profit portion of a rate filing, while permitting each insurer to use a loss cost filing made by a licensed rating organization. The committee was also charged with studying other rating options that would promote greater competition and would encourage insurers to write workers' compensation while protecting employers from rates that are excessive, inadequate, or unfairly discriminatory."

The Joint Select Committee issued their report and recommendations in the form of a letter to the President of the Senate and the Speaker of the House of Representatives dated November 18, 2003.

The committee concluded that a loss cost system should not be adopted at this time, stating in their report:

"The evidence presented to the committee did not demonstrate any obvious benefit or detriment as a result of changing from an administered pricing (full rate) system to a loss cost system. The director of the Office of Insurance Regulation stated that he knew of no evidence that clearly indicated that Florida would be better served under a loss cost system as compared to the current system, and that any such change should not be made until the reforms of Senate Bill 50-A have been in effect for at least 18 months and the insurance market has stabilized. This testimony and the fact that 37 states have adopted a loss cost system, which is also recommended by the NAIC as a way to promote price competition among insurers, leads us to encourage the Legislature to explore such a modification at a time when the impact of SB 50-A and the market stability that it should bring allow for a more conducive environment to revisit such a topic."

Conclusion

There are a number of mechanisms used by insurers to compete in the workers' compensation marketplace including both price and non-price components. The biggest difference between the Florida workers' compensation insurance market and other states

generally is the amount of price competition in basic rates. The use of deviations in Florida, as a competitive mechanism, is practically non-existent.

The Joint Select Committee on Workers' Compensation Rating Reform recommended that the Legislature explore adoption of a loss cost system to promote competition when the workers' compensation market was more stable. Currently, OIR sees no material disruptions in the market that would logically prevent consideration of adopting a loss cost filing system for rates. Although, there is still no clear evidence that such a switch would be a benefit to Florida consumers.

OIR Compliance with Section 627.096, F.S.

Section 627.096, Florida statutes was created in 1979 as a part of the “wage loss” reform of the workers’ compensation law. The language in this section has remained virtually unchanged since 1979. Section 627.096, F.S. basically requires three separate but related activities, which correspond to the three sentences in subsection (1).

1. The first activity is “...an investigation and study of all insurers authorized to issue workers’ compensation and employers liability coverage in this state.” This is accomplished by performing limited scope market conduct examinations focused on the quality and integrity of the data submitted to the National Council on Compensation Insurance (NCCI). For the specific activities undertaken this year see the market conduct section below.
2. The second activity requires the study of “...the data, statistics, schedules or other information as it may deem necessary to assist and advise the office in its review of filings made by or on behalf of workers’ compensation and employers’ liability insurers.” There is a very thorough review of the data and calculations contained in every NCCI rate filing. In addition to the staff review, the Consumer Advocates’ office hires an independent actuary to review the filing and make recommendations. Also, there is a public hearing on the annual rate filing to allow an opportunity for interested parties to provide input. All of these activities were performed this year for the NCCI filing that was submitted on August 24, 2004 and a hearing was held on October 5, 2004.
3. The third sentence in subparagraph (1) gives the commission (Financial Services Commission) the authority to require all insurers to submit any “data, statistics, schedules, and other information deemed necessary...” NCCI has been collecting workers’ compensation data in Florida for more than 50 years. The department and subsequently OIR have continued to use NCCI for data collection rather than implement a duplicative data collection program within government. Beginning in 1997, the department formalized this process by issuing a Request for Proposals (RFP) and subsequently entering a written contract starting on January 1, 1998. A second RFP was issued in 2001 and currently NCCI is under contract to perform designated statistical agent services through June 2005 with an additional year at the option of OIR.

Market Conduct Examinations

The Bureau of Market Investigations conducted the following activities in 2004 related to the quality and integrity of the data submitted to NCCI.

An investigation was conducted to determine which companies were writing workers’ compensation insurance in Florida. The most current data available at the time that was

specific to Florida was from the insurers' 2002 annual statements. Companies with direct premiums written in Florida were recorded and sorted by market share.

The top thirty-six companies, by market share, were examined to verify timeliness and accuracy of unit statistical reporting. This represented 79% of the market. The reviews of all companies except two indicated that any inconsistencies noted were not substantive and fell within generally acceptable margins. All companies with errors took corrective actions and/or implemented revisions to their procedures to bring them into compliance.

Two hundred twenty-one companies representing the remaining 21% of the market were identified for the purpose of conducting desk audits to verify timeliness and accuracy of unit statistical reporting. Twenty-five investigations were opened and desk audits are being performed. OIR will proceed with groups of twenty-five until all have been audited.

Another investigation was conducted to determine companies writing workers' compensation insurance in Florida, this time using 2003 annual statements. Companies were again sorted by market share and are being evaluated to determine market share variances. Additional data is being gathered that will be used to identify potential areas of concern or specific companies to further investigate.

Conclusion

The Office of Insurance Regulation has complied with all the requirements of section 627.096, F.S.

Office of Insurance Regulation

2004 Workers' Compensation Annual Report

January 2005

Appendix

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Exhibit 1

<u>Year</u>	<u>Top Writer</u>		<u>Top 4</u>		<u>Top 8</u>		<u>Top 20</u>	
	<u>Company</u>	<u>Group</u>	<u>Companies</u>	<u>Groups</u>	<u>Companies</u>	<u>Groups</u>	<u>Companies</u>	<u>Groups</u>
1994	13.5%	13.5%	36.9%	36.9%	52.2%	54.0%	73.1%	77.8%
1999	9.2%	13.5%	23.2%	34.3%	36.2%	50.8%	56.6%	79.7%
2000	11.3%	12.7%	26.9%	36.7%	39.1%	55.4%	58.7%	81.9%
2001	11.3%	12.1%	28.9%	37.9%	40.4%	55.7%	60.6%	82.4%
2002	9.3%	14.7%	28.1%	38.7%	39.6%	59.3%	62.6%	85.6%
2003	6.7%	12.3%	23.4%	37.3%	36.5%	57.0%	61.5%	83.0%

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Exhibit 2

	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Total</u>
Companies												
Admitted	9	13	5	22	12	7	13	10	3	13	11	118
Companies Exiting												
Market	14	18	13	12	10	18	4	14	11	16	13	143
Liquidated	2	3	1	3	2	0	2	5	5	1	0	24
Merged	0	8	3	0	2	0	1	4	1	0	0	19
Suspended	3	1	2	3	0	1	1	3	5	6	6	31
Withdrawn	9	6	7	6	6	17	0	2	0	9	7	69
Total Companies												
Exiting Market	14	18	13	12	10	18	4	14	11	16	13	143

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Exhibit 3

	Calendar Year					
	2003	2002	2001	2000	1999	1998
FWCJUA Written Premium	64,462,672	25,645,248	6,696,022	5,035,549	6,431,378	14,182,389
Total Market Premium**	3,392,822,590	3,113,462,973	2,850,340,254	2,723,276,953	2,525,725,125	2,230,687,335
FWCJUA Percent of Market	1.9%	0.8%	0.2%	0.2%	0.3%	0.6%
FWCJUA No. of Policies Issued	4,178	1,140	662	522	623	1,427

	Calendar Year				
	1997	1996	1995	1994	1993*
FWCJUA Written Premium	13,862,990	27,748,666	69,102,344	73,305,743	328,159,749 *
Total Market Premium**	2,177,848,643	2,290,956,549	2,108,253,553	2,307,610,033	954,029,579 *
FWCJUA Percent of Market	0.6%	1.2%	3.3%	3.2%	34.4% *
FWCJUA No. of Policies Issued	3,171	6,654	10,339	13,933	48,430 *

*1993 data is for the Florida Assigned Risk Plan, which was the residual market before the FWCJUA was created, and the 1993 total market premium is for insurance companies only.

** Total Market Premium for years 1994 to 2003 includes insurance companies, self-insurance funds and assessable mutuals.

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Exhibit 4

<u>Date</u>	FWCJUA Rate Differential to the Voluntary Market	Estimated Average Surcharge*	FWCJUA Premium Differential to the Voluntary Market Including Surcharges
July 1, 2004	2.700	1.3%	2.713
October 1, 2003	1.429	76.2%	2.191
April 1, 2003	1.429	76.2%	2.191
November 1, 2002	1.639	82.8%	2.467
January 1, 2002	2.534	82.8%	3.362
June 1, 2001	2.164	66.1%	2.825
July 1, 2000	2.160	64.8%	2.808
January 1, 2000	3.172	64.8%	3.820
January 1, 1999	3.278	66.7%	3.945
January 1, 1998	2.210	65.7%	2.867
January 1, 1997	1.750	36.5%	2.115
September 1, 1995	1.450	53.2%	1.982
January 1, 1994	1.260	44.2%	1.702

* Estimated Average Surcharge is for the 99% surcharge and the \$475 flat surcharge related to the average FWCJUA premium.

Note: For July 1, 2004 the differential is for Tier 3 only.