

2014

Workers'  
Compensation  
Annual Report



FLORIDA OFFICE OF  
INSURANCE REGULATION

Kevin M. McCarty, Insurance Commissioner

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## Executive Summary

Subsection 627.211(6), Florida Statutes, mandates the Office of Insurance Regulation (Office) provide an annual report to the President of the Senate and the Speaker of the House of Representatives that 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 the Office has complied with the provisions of Section 627.096, Florida Statutes, which requires 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 comparative analysis across a variety of economic measures, the workers' compensation market in Florida is competitive.
  - a. The workers' compensation market in Florida is served by a large number of independent insurers and none of the insurers have sufficient market share to exercise any meaningful control over the price of workers' compensation insurance.
  - b. The Herfindahl-Hirschman Index (HHI) - a measure of market concentration - indicates the market is not overly concentrated.
  - c. There are no significant barriers for the entry and exit of insurers into the Florida workers' compensation market and based on the record of new entrants and voluntary withdrawals with no market disruptions, the Florida workers' compensation market is competitive, well capitalized and robust.
2. Of the six most populous states, Florida is one of only two where a private market insurer is the largest insurer rather than a state-created residual market entity. This degree of private activity indicates coverage should be generally available in the voluntary market. The residual market is small, suggesting the voluntary market is absorbing the vast majority of demand. Additionally, Florida's aggregate loss ratios are the second lowest among the six most populous states with only Texas having lower ratios.
3. Reforms to Section 440.34, Florida Statutes, which affected attorney's fee provisions, were a significant factor in the decline of workers' compensation insurance rates and continue to impact them.<sup>1</sup> It is also the case, however, that most of the improvements resulting from these legislative changes may have been realized as there were four rate

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<sup>1</sup> In *Murray v. Mariner Health*, (Florida Supreme Court October 23, 2008), the Florida Supreme Court held that the statute in the first part of the workers' compensation law did not limit attorneys' fees under a separate subsection (3) of the law, and therefore a lawyer representing a workers' compensation claimant is entitled to a "reasonable fee." House Bill 903 was passed into law during the 2009 Legislative Session. It restored the cap on attorney fees and clarified related statutory language that the Florida Supreme Court had determined to be ambiguous. As a result, workers' compensation rates have decreased even more.

increases from 2010 to 2014 after seven years of decreases following the 2003 reforms. This is the second year rates have been relatively stable with a rate increase of less than 1% for the 2014 rate filing and a rate decrease of -5.2% for the 2015 rate filing.

4. Medical cost drivers, particularly in the areas of drugs, hospital inpatient, hospital outpatient and ambulatory surgical centers (ASC) are noticeably higher in Florida than a countrywide average. Legislative reform in the reimbursement of these services could produce substantial savings for Florida employers.
5. Affordability within the Florida Workers' Compensation Joint Underwriting Association, Inc. (FWCJUA), which is the residual market, has been an ongoing issue. Senate Bill 50-A enacted in 2003 and House Bill 1251 enacted in 2004 addressed affordability in the voluntary and residual market, respectively, and both markets remain stable. It is worth noting, however, that over the last several years both policy count and premium at the FWCJUA increased significantly, though it still remains a very small portion of the overall workers' compensation market.
6. The Office is in compliance with the requirements of Section 627.096, Florida Statutes.

## Purpose and Scope

Subsection 627.211(6), Florida Statutes, mandates:

*“The office shall submit an annual report to the President of the Senate and the Speaker of the House of Representatives by January 1 of each year which evaluates competition in the workers’ compensation insurance market in this state. The report must 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 purpose of this report is to aid the Legislature in determining whether changes to the workers’ compensation rating laws are warranted. The report must also document that the office has complied with the provisions of s. 627.096 which require the office to investigate and study all workers’ compensation insurers in the state and to study the data, statistics, schedules, or other information as it finds necessary to assist in its review of workers’ compensation rate filings.”*

To meet these mandates, this report provides analysis of the following areas:

1. The competitive structure of the workers’ compensation market in Florida by comparing select key financial performance ratios, the number of insurers actively participating in the market along with their respective market positions, and the number of insurers entering and exiting the market.
2. The availability and affordability of workers’ compensation insurance in Florida. This includes an analysis of rate increases in Florida’s admitted market, as well as, the rating structure extant in the FWCJUA.
3. The market structure in Florida, which includes the market concentration in Florida compared with other states, and entry and exit of insurers from the Florida market.
4. Documentation of the Office’s compliance with Section 627.096, Florida Statutes, by investigating all workers’ compensation carriers operating in Florida.
5. A comparison of pure loss costs for the 10 largest workers’ compensation class codes for Florida compared to the other states using the National Council of Compensation Insurance (NCCI) as their statistical rating organization.

## Summary of the 2013 Annual Report

The 2013 Workers' Compensation Annual Report was the tenth report resulting from the statutory mandate and reached the same general conclusions as the previous annual reports. Specifically, the report showed that, during 2012:

- Florida's workers' compensation insurance market contained a large number of independent insurers, none of which had enough market share to individually exercise market control in an uncompetitive nature.
- The HHI indicated Florida's market was not overly concentrated, and consequently exhibited a reasonable degree of competition.
- There were no significant barriers for entry and exit of insurers into and from the Florida workers' compensation insurance market.
- The residual market is small relative to the private market indicating the voluntary market offers reasonable availability.
- There may be some small segments of the market which have difficulty obtaining workers' compensation insurance, including small firms and new firms.

The 2013 annual report does note that the Office approved a rate increase of 0.7% on October 30, 2013 which became effective on January 1, 2014.

The 2014 Workers' Compensation Annual Report continues to examine the workers' compensation insurance market from the same perspective and provides the HHI to compare Florida's market concentration versus the other major workers' compensation markets by providing a comparative analysis of key market characteristics among the six most populous states. The five other states are: California, Illinois, New York, Pennsylvania, and Texas.

Additionally, the 2014 Workers' Compensation Annual Report presents findings on the cost drivers in the Florida workers' compensation system.

## Snapshot of the Florida Workers' Compensation Market in 2013

Previous annual reports have documented the relative health and competitiveness of the Florida workers' compensation market following the legislative reforms implemented in 2003. This trend is evident in 2013 as well, though there may be some reason for caution moving forward.

In 2013, 254 privately-owned insurers actively wrote workers' compensation insurance in Florida. In total, these private sector insurers wrote \$2,296,680,613 of coverage. Moreover, during 2013, four insurers entered the Florida workers' compensation market, either as new companies or by adding the workers' compensation line of business to their certificate of authority. During 2013, three insurers voluntarily exited the Florida market. These new entrants and voluntary withdrawals had no disruptive impact on the marketplace, as should be the case in a competitive market.

### Ten Largest Insurers

The largest insurer, Bridgefield Employers Ins. Co., as measured by premium written in the chart below, had 11.34% of the market, and the largest 10 insurers had a cumulative 42.62% of the market. This spread of premium across insurers suggests no one firm can be seen to have an overly dominant impact on the market. These insurers are:

Company Name	State of Domicile	Workers' Compensation Direct Premium Written	Market Share (%)	Cumulative Market Share (%)
Bridgefield Employers Ins Co	FL	\$260,472,335	11.34	11.34
Zenith Ins Co	CA	126,704,658	5.52	16.86
FCCI Ins Co	FL	125,553,960	5.47	22.32
RetailFirst Ins Co	FL	82,947,816	3.61	25.94
Technology Ins Co Inc	NH	73,755,242	3.21	29.15
Twin City Fire Ins Co	IN	70,497,810	3.07	32.22
Amerisure Ins Co	MI	69,243,971	3.01	35.23
FFVA Mut Ins Co	FL	58,073,687	2.53	37.76
Comp Options Ins Co Inc	FL	58,042,277	2.53	40.29
Guarantee Ins Co	FL	53,439,563	2.33	42.62

Six of these companies are domiciled in Florida; the remaining four are domiciled in the eastern, mid-western and western United States. This shows the Florida workers' compensation market is not served exclusively by Florida-only companies; there is some geographical diversification.

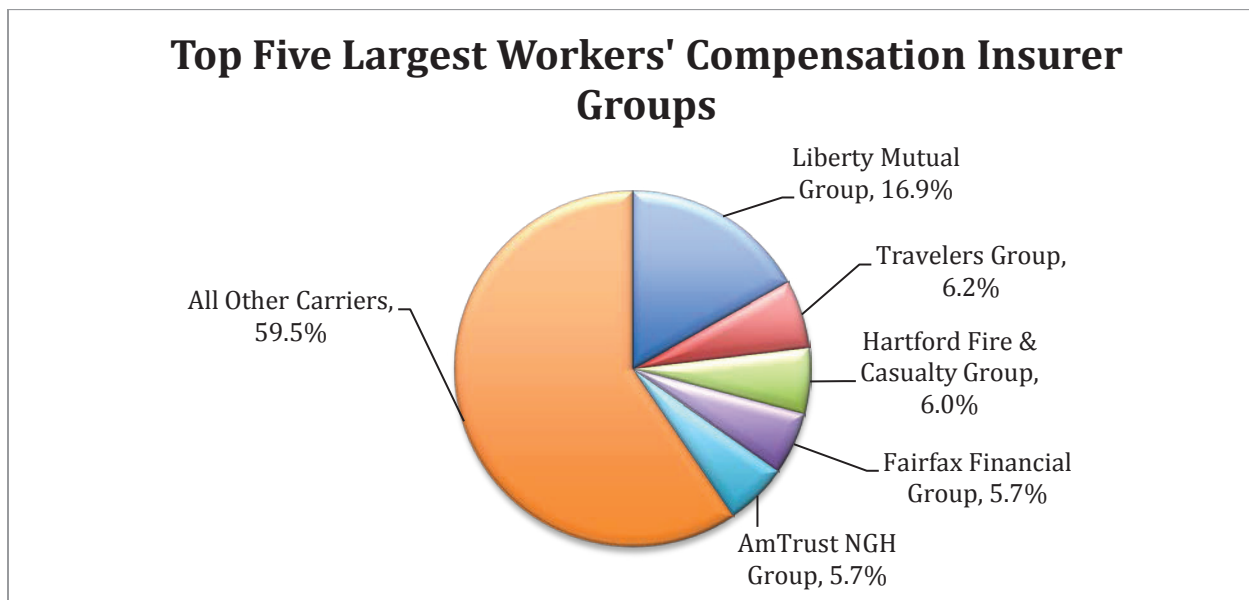
The 10 largest companies also display a range of product line diversification. Some, such as Bridgefield, RetailFirst, and Comp Options write all, or nearly all, of their business in the Florida workers' compensation market, while the others write a broader mix of workers' compensation

in other states, other lines of business, or both. The table below highlights the relative size of the Florida workers' compensation market to each of the 10 largest firm's portfolio mix of business. This mix of business by geography and line of business adds to the stability of the Florida market.

Company	Florida Workers' Comp Premium Written	Florida Workers' Comp/All Workers Comp Premium Written	Florida Workers' Comp /All Premium Written	All Workers' Comp/All Premium Written
Bridgefield Employers Ins Co	\$260,472,335	94.41%	94.41%	100.00%
Zenith Ins Co	126,704,658	22.53%	21.29%	94.50%
FCCI Ins Co	125,553,960	70.34%	43.58%	61.96%
RetailFirst Ins Co	82,947,816	100.00%	100.00%	100.00%
Technology Ins Co Inc	73,755,242	11.01%	9.51%	86.38%
Twin City Fire Ins Co	70,497,810	8.93%	4.98%	55.71%
Amerisure Ins Co	69,243,971	38.99%	21.15%	54.23%
FFVA Mut Ins Co	58,073,687	56.06%	56.06%	100.00%
Comp Options Ins Co Inc	58,042,277	100.00%	100.00%	100.00%
Guarantee Ins Co	53,439,563	24.78%	24.78%	100.00%

### Largest Insurer Groups

In 2013, the five largest insurer groups comprised 40.5% of the market. Liberty Mutual Group is the largest provider of workers' compensation insurance in Florida with 16.9% of the total market based on 2013 NAIC Annual Statement data. The largest individual company in Florida, Bridgefield Employers Ins Co, is a member of the Liberty Mutual Group.





Seven of the top 10 insurers found on page seven belong to one of the top 10 insurer groups in Florida. The top 10 largest insurer groups are as follows:

Insurer Group Name	Workers' Compensation Direct Premium Written	Market Share (%)	Cumulative Market Share (%)
Liberty Mutual Group	\$389,029,905	16.9	16.9
Travelers Group	142,504,818	6.2	23.1
Hartford Fire & Casualty Group	137,408,376	6.0	29.1
Fairfax Financial Group	131,150,895	5.7	34.8
AmTrust NGH Group	130,542,455	5.7	40.5
FCCI Mutual Insurance Group	127,555,044	5.6	46.1
American International Group	108,669,604	4.7	50.8
RetailFirst Group	105,831,942	4.6	55.4
Zurich Insurance Group	96,716,434	4.2	59.6
Amerisure Company Group	90,270,759	3.9	63.6

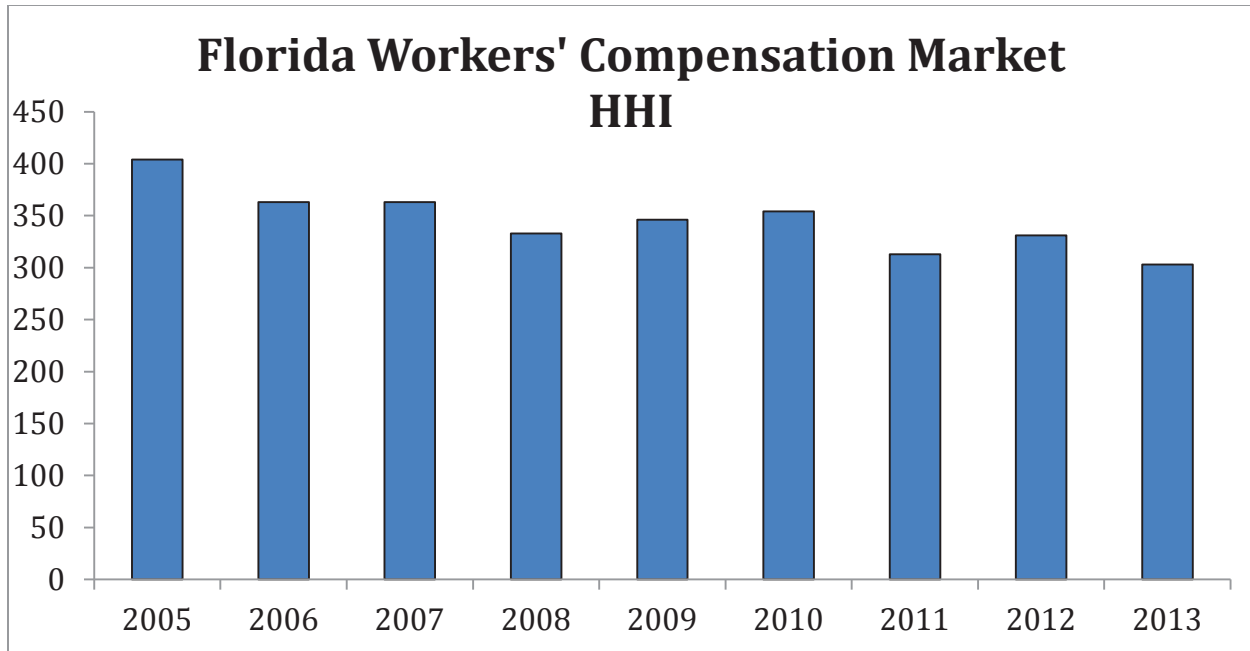
This spread of premium among insurer groups suggests no one group can be seen to have a prevailing impact on the market. This again supports the competitive aspects of the Florida workers' compensation market.

**Measured Market Concentration: The Herfindahl-Hirschman Index**

A widely recognized measure of market concentration can be applied to the Florida workers' compensation market. The Herfindahl-Hirschman Index (HHI) is a calculation designed to determine market concentration and first appeared in A.O. Hirschman's *National Power and Structure of Foreign Trade* published in 1945.

The HHI calculation is straightforward. The measured market share of every company operating in the identified market is squared. The highest index value is then defined as 10,000 (100 percent squared --- a monopoly), and the lowest outcome is close to zero. The U.S. Department of Justice (DOJ) uses this index when researching acquisitions and mergers for compliance with the anti-trust legislation, most notably, the Sherman Anti-Trust Act of 1890. DOJ considers a result of less than 1,000 to be a "competitive" marketplace. Results of 1,000 to 1,800 are considered "moderately concentrated." Results over 1,800 are considered "highly concentrated," and consequently, not very competitive.

The calculated HHI for the Florida workers' compensation insurance market in 2013 is 302.83. Following DOJ guidelines, this measure suggests a competitive market. Moreover, the Florida workers' compensation market has become progressively more competitive following the legislative reforms at least as given by the HHI measure. As the chart on the next page shows, the calculated HHI of 404 in 2005 has declined to the 2013 value of 302.83.



### Underwriting Strength

An important measure of the health of an insurance market is the underwriting performance of the insurers in the market; that is, the combination of pricing, risk management and application of effective underwriting guidelines that contribute to a viable and sustainable market. Two commonly used measures are employed in this report; the loss ratio (defined as direct losses incurred divided by direct premiums earned) and a broader measure that includes direct losses incurred and defense cost containment costs (DCC) incurred as a percentage of direct premiums earned. Ratios approaching or exceeding 100 for either measure are not considered profitable in their core business.

For the Florida workers' compensation market in 2013, these aggregate ratios are:

- Direct Loss Ratio                      50.77%
- Direct plus DCC Ratio                57.10%

While there is natural year-to-year variation in these ratios and too much importance should not be given to year over year changes, it is worthwhile to note both of these measures are lower than reported for the Florida market in 2012 (55.53% and 62.89%, respectively).

### Self-Insurance Funds

In addition to the private market described above, which writes over 95% of the workers' compensation insurance in Florida, coverage is also provided by the residual market, as represented by the FWCJUA, and through self-insurance funds (SIFs)<sup>2</sup>.

<sup>2</sup> "Self-Insurance" groups are a broadly defined group of entities that include group self-insurance funds, commercial self-insurance funds and assessable mutual organizations. By the early 1990s, self-insurance funds were a dominant part of the Florida workers' compensation insurance market, capturing more than half of the voluntary market. Legislative reforms in 1993 transferred the regulation of group self-insurance to the

## Comparison of the Six Major Market States

Florida is a large economically and demographically diverse state. To provide meaningful context on the Florida workers' compensation market as described above, it is instructive to provide comparison to similarly situated states. This section of the report focuses on the six most populous states, and excludes SIFs. In addition to Florida, the five most populous states used here are California, New York, Illinois, Texas, and Pennsylvania.

The table below highlights some of the key comparisons between the Florida workers' compensation insurance market and those of the other five states considered in this peer group.

State	Direct Premium Written 2013	Rank By Direct Premium Written	HHI	Number of Entities Collecting Premium in 2013	Largest Provider	Largest Provider Market Share (%)	State Population Rank*
CA	\$10,292,655,402	1	309.15	241	State Fund	10.81	1
NY	5,191,491,995	2	1995.98	285	State Fund	43.98	3
IL	2,685,243,081	3	112.75	333	Private Insurer	4.09	5
TX	2,673,605,679	4	1553.46	287	[1]	38.58	2
PA	2,578,575,309	5	168.69	332	State Fund	8.48	6
FL	2,296,680,613	6	302.83	254	Private Insurer	11.34	4

[1] The largest writer is Texas Mutual Insurance, an insurer created originally by the Texas Legislature in 1994. It was granted independence in 2001, but still responsible for the residual market.

\*Based on July 2013 estimates from the U.S. Census Bureau released in December 2013. As of the latest Census estimates, Florida's population of 19,552,860 is slightly below New York's population of 19,651,127. Florida's average annual growth rate of 1.2% per year from 2010 to 2013 has outpaced New York's average annual growth rate of 0.4% for the same period. Given these average growth rates continue, it is anticipated that Florida will become the third most populous state with the December 2014 release of the Census estimates based on July 2014 data.

As might be expected, there is a positive correlation between state population and workers' compensation insurance written premiums. However, while Florida is the fourth largest state by population, it ranks sixth in terms of total workers' compensation premium written.

In terms of the number of insurance entities writing in each market, Florida ranks fifth with 254 private firms (not considering the FWCJUA or the two SIFs identified earlier). By this measure,

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Department of Insurance, which later became the Office of Insurance Regulation. This legislative change occurred concurrently with the formation of the FWCJUA. Together, these two changes transformed the Florida workers' compensation insurance market as self-insurance funds began converting into insurance companies. In 1994 there were 35 defined self-insurance funds, but by 2000 there were only four of these entities. There were four group self-insurance funds at the start of 2010 but the largest fund, Florida Retail Federation Self Insurer's Fund converted to a stock company in November 2010. As a result of legislation passed in 2009, the Florida Rural Electric SIF is governed by section 624.4626, F.S., which does not require the Fund to file an annual statement with OIR. Thus, the Florida Rural Electric SIF is no longer included in this report. See Appendix A for the Florida Statutes that govern SIFs that are not subject to OIR regulation. The remaining SIFs are the Florida Citrus, Business, & Industries Fund and the FRSA Self Insurer's Fund.

Florida has a comparable number of entities operating within its borders relative to other populous states.

From the perspective of market competition, the six states are compared using their calculated HHI's. For the purposes of this report, comparing the HHI among states is difficult, as the data for the self-insurance trust funds for other states must be calculated. Moreover, while some states have their state funds report financial information to the National Association of Insurance Commissioners (NAIC), other states, such as Florida with its FWCJUA, do not. This report includes a calculation of Florida's HHI without the SIFs included to be comparable to the other populous states. Of the six most populous states, only Illinois (112.75) and Pennsylvania (168.69) have lower HHI indices than Florida (302.83), suggesting Florida has one of the three most competitive workers' compensation markets of the major populous states.

### **Dominant Firms and Competition**

A particularly interesting comparison is to review the largest competitor in each of the six most populous states to determine if there is a "dominant firm." This review yields only Florida and Illinois with markets where the largest insurer is a private entity. In the other four states, the largest provider is either a state fund, or in the case of Texas, a mutual company originally created by the state and still responsible for the provision of residual market workers' compensation insurance.

Bridgefield Employers Insurance Co.'s business in Florida has the largest market share of any private insurer in the six most populous states. However, at 11.34% of the market, it is unlikely this is enough market share to create an uncompetitive marketplace.

### **Underwriting Strength in the Most Populous States**

Finally, to provide context for the Florida market results presented earlier, a comparison of aggregate loss ratios across the six most populous states was conducted. The results are presented below:

<b>State</b>	<b>Direct Loss Ratio</b>	<b>Direct Loss +DCC</b>
CA	69.99%	82.29%
NY <sup>3</sup>	72.13%	78.93%
PA	63.26%	70.43%
IL	60.50%	67.26%
FL	50.77%	57.10%
TX	47.63%	52.12%

<sup>3</sup> The State Insurance Fund, which is the leading provider of workers' compensation insurance in New York with a 44.0% market share, was excluded from the Loss Ratio figures due to a one time reserve adjustment of \$2.2 billion that occurred in 2013. The reserve adjustment is impacting the data in a way not representative of typical reserve adjustments in New York, and therefore, it is not appropriate to include the State Insurance Fund in the calendar year 2013 analysis.

For 2013, Florida's aggregate loss ratios, using either measure, are the second lowest among the six most populous states. As such, the Florida market compares favorably to the other five largest states as a healthy, likely profitable market for insurers.

## Workers' Compensation Rates

A comprehensive slate of reforms was passed into law during the 2003 Legislative Session. The package known as Senate Bill 50-A (Chapter 2003-412 Laws of Florida) dramatically impacted Florida's workers' compensation insurance rates. Some of these reforms included a reduction (cap) in attorneys' fees, tightening of construction industry requirements, doubling impairment benefits for injured workers, increasing the medical fee schedule, and eliminating the Social Security disability test.<sup>4</sup>

Subsequently, workers' compensation rates declined by 64.7% in Florida as of July 1, 2010. In 2000, Florida had the highest workers' compensation insurance rates in the country. In 2003, the Office approved a 14% rate reduction, with an additional reduction of 5.1% effective January 1, 2005. These annual rate reductions continued unabated through the rate reduction of 6.8% that took effect on January 1, 2010. The rate changes during this seven-year period include the three largest decreases ever in Florida, namely -18.6% for 2009, -18.4% for 2008, and -15.7% for 2007. These seven filings represent the state's largest consecutive cumulative decrease on record for workers' compensation rates – dating back to 1965.

Before the reforms, Florida consistently ranked as the first or second state with the highest workers' compensation rates in the country. Post-reform, Florida dropped out of the top 10 rankings. By 2008, Florida dropped to 28<sup>th</sup> place and by 2010 Florida had fallen to 40<sup>th</sup> place according to the biennial report, *Oregon Workers' Compensation Premium Rate Ranking*, published by the Oregon Department of Consumer and Business Services. However, with rate increases from 2010 to 2014, Florida has moved in the opposite direction in more recent reports. The latest Oregon report released in 2014 and based on January 1, 2014 Florida rates shows a rise to 28<sup>th</sup> highest; thus, there are 27 states with a lower average rate than Florida. The 2014 report also reflects that while Florida has risen in the rankings, the average Florida rate still remains below the national median rate at 98% of the study median rate.

On August 22, 2014, NCCI proposed an overall workers' compensation rate level decrease of 2.5% for the voluntary market to be effective January 1, 2015. NCCI subsequently amended the filing on September 22, 2014, to reflect a revised overall rate level decrease for the voluntary market of 3.3% which included an additional 0.8% decrease to reflect a change to the *Florida Workers' Compensation Reimbursement Manual for Hospitals*. The hospital manual was revised to update the reimbursement schedules for hospital inpatient and outpatient services. More specifically, it established maximum reimbursement allowances for certain qualifying procedure codes for hospital outpatient services and increased both the per-diem reimbursement amount and stop-loss amount for hospital inpatient services.

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<sup>4</sup> "Florida Cracks Down on Construction Sites without Workers' Compensation Insurance," *Best Wire*, August 2, 2005, which utilizes information from an earlier article in *BestWire*, July 15, 2003.

The Office conducted a hearing on October 14, 2014, and heard testimony from NCCI, industry experts and the public about NCCI's rate filing. On November 5, 2014, Commissioner Kevin McCarty issued an order requesting NCCI submit an amended filing for a decrease of 5.2% in overall rate level for the voluntary market. NCCI submitted an amended filing on November 11, 2014 in accordance with the Office order. The Commissioner approved the amended filing for an average rate decrease of 5.2% on November 12, 2014. This rate filing reflects the first annual decrease in rates since 2010, and with the rate decrease, Florida's rates are 58.3% below what the rates were prior to the 2003 reforms.

With the implementation of the 5.2% decrease, the rate impact for the main industry groups will be as follows in the chart below:

<b>Industry Sector</b>	<b>Rate Adjustment 1/1/2015</b>
Manufacturing	-5.9%
Contracting	-5.6%
Office and Clerical	-4.1%
Goods and Services	-5.3%
Miscellaneous	-5.1%
<b>TOTAL</b>	<b>-5.2%</b>

Florida rates remain competitive with neighboring states. However, Florida's recent advantage over other states in attracting employers based on the lowest workers' compensation rates has disappeared.

## **Cost Drivers for Workers' Compensation**

There are several cost drivers in the Florida workers' compensation system that could be addressed legislatively to induce cost savings. NCCI compared the medical cost distributions for Florida versus all states combined to show that based on recent experience Florida has a higher portion of cost paid for drugs, hospital inpatient, hospital outpatient and ambulatory surgical center (ASC). A summary of the NCCI findings is provided in the Table on the next page with data as of December 2014.

## Medical Cost Distributions

### Florida vs. Countrywide

	Florida <sup>1</sup>	Countrywide <sup>2</sup>	Difference
Physicians	30.5%	39.7%	-9.2%
Drugs	15.7%	11.5%	+4.2%
Supplies	6.5%	7.7%	-1.2%
Other	1.9%	4.4%	-2.5%
Hospital Inpatient	18.9%	13.7%	+5.2%
Hospital Outpatient	18.6%	17.2%	+1.4%
Ambulatory Surgical Center	7.9%	5.8%	+2.1%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>0%</b>

<sup>1</sup> Source: Derived from data provided by the Florida Division of Workers' Compensation (FLDWC) for Service Year 2013

<sup>2</sup> Source: Derived from NCCI Medical Data Calls for Service Year 2013 for the following 37 states: AK, AL, AR, AZ, CO, CT, DC, FL, GA, HI, IA, ID, IL, IN, KS, KY, LA, MD, ME, MO, MS, MT, NC, NE, NH, NM, NV, OK, OR, RI, SC, SD, TN, UT, VA, VT, and WV

Substantial rate reductions would occur if the costs in Florida were brought in line with other states for drugs, inpatient hospital, outpatient hospital and ASC reimbursement rates.

### Physician Drug Dispensation

Since 2008, more than 95% of the reimbursement dollars spent on repackaged drugs in Florida has been the result of physician dispensing; and, in 2012, 97.1% of the dollars spent were the result of physician dispensing.<sup>5</sup>

A by-product of repackaging/relabeling has been the average unit price of a repackaged drug can be many times that of the drug in its non-repackaged form.<sup>6</sup> A July 2013 study released by the Workers Compensation Research Institute (WCRI) titled *Physician Dispensing in Workers' Compensation* shows that in states like Florida and Illinois, physician dispensed drugs have been priced between 60% and 300% more than what is charged by pharmacies.

Since 2007, a number of states have addressed this developing issue by placing either an outright ban on physicians dispensing drugs (e.g. Massachusetts, New York, Texas, Montana, and Utah) or by placing price controls and using other regulatory tools to address the price disparity between repackaged and non-repackaged drugs (e.g. Arizona, California, Colorado, Georgia, and South Carolina).

In Florida, the drug repackaging issue was partially addressed by passing Senate Bill 662 effective July 1, 2013 which reduced rates by 0.7%. The primary cost reducing component of

<sup>5</sup> See *Florida Department of Financial Services, Division of Workers' Compensation, 2013 Results and Accomplishments*, at page 86

<sup>6</sup> The per unit markup can be as much as 679% according to the NCCI testimony provided at the August 18, 2011 workers' compensation public rate hearing. This same testimony was again provided at the November 16, 2011 Three-Member Panel meeting.

Senate Bill 662 linked the reimbursement rate of 112.5% for repackaged or relabeled drugs dispensed by a dispensing practitioner to the Average Wholesale Price (AWP) set by the original manufacturer of the underlying drug plus an \$8.00 dispensing fee. Other options to reduce drug costs are:

- Restrict physician dispensing
- Lower reimbursement rate
- Lower dispensing fee
- Introduce drug formulary
- Strengthen prescription drug monitoring program

## Hospital Reimbursement

Florida has a charge-based system for reimbursing hospital outpatient services. Currently, these services are, by statute, reimbursed at 75% of “usual and customary charges” for non-scheduled surgeries and 60% for scheduled surgeries<sup>7</sup>. The term “usual and customary charge” is not defined by Florida statute and its meaning can and does vary from state to state and among insurers. In addition, Florida workers' compensation law provides the maximum reimbursement allowances for inpatient hospital care shall be based on a schedule of per diem rates to be approved by the Three-Member Panel no later than March 1, 1994.<sup>8</sup>

Per Section 440.13(12)(a), Florida Statutes, the Three-Member Panel is charged with adopting schedules of maximum reimbursement allowances (MRAs) for physicians, hospital inpatient care, hospital outpatient care, ambulatory surgical centers, work-hardening programs, and pain programs. The *Florida Workers' Compensation Reimbursement Manual for Hospitals* contains the schedule of MRAs adopted by the Three-Member Panel for hospitals and establishes policy, procedures, principles and standards for implementing statutory provisions regarding reimbursement for medically necessary services and supplies provided to injured workers in a hospital setting.

Since 2007, the Division of Workers' Compensation (Division), in conjunction with the Three-Member Panel, has attempted to revise the *Florida Workers' Compensation Reimbursement Manual for Hospitals* in order to synchronize case law and statute relating to the calculation of “usual and customary charges” for hospital outpatient services. Numerous “usual and customary charge” methodologies were developed and subsequently challenged by various hospital interests<sup>9</sup>. However, in July 2014, a settlement agreement was reached between the Division and the hospital interests, which resulted in the hospital interests withdrawing their rule challenge and a 2014 edition of the manual effective on January 1, 2015 will replace the 2006 edition. The manual was adopted by reference as part of Rule 69L-7.501, Florida Administrative Code.

Highlights of the revised manual include:

- Establishing MRAs for certain qualifying procedure codes for hospital outpatient services. The maximum reimbursement allowances incorporate the major components of the Division's and the Three-Member Panel's methodology for calculating a “usual and

<sup>7</sup> Section 440.13(12)(a) and (b), Florida Statutes

<sup>8</sup> Section 440.13(12)(a), Florida Statutes

<sup>9</sup> See *Three-Member Panel 2013 Biennial Report*, at page 6



customary charge” approved at a January 9, 2013 meeting held by the Three-Member Panel.

- For hospital inpatient services, the per-diem reimbursement amount increased at trauma centers from \$3,305 to \$3,850.33 for surgical stays, and from \$1,986 to \$2,313.69 for non-surgical stays,
- For hospital inpatient services, the per-diem rates at acute care hospitals increased from \$3,304 to \$3,849.16 for surgical stays, and from \$1,960 to \$2,283.40 for non-surgical stays, and
- For hospital inpatient services, the Stop-Loss Reimbursement threshold was increased from \$51,400 to \$59,891.34.

For more details regarding the “usual and customary charge” methodology, see the *Three-Member Panel Biennial Report*, 2015 Edition.

Other states have moved away from charge-based reimbursement and have adopted other methodologies seen to provide more predictability and offer greater opportunity for cost containment. States such as Oregon, California, Colorado, North Dakota, South Carolina, Tennessee and Washington use the Medicare Outpatient Prospective Payment System (OPPS) as a basis for reimbursement.

In March 2014, based on proposed Florida Senate Bill 1580/House Bill 1351, NCCI estimated rates could be reduced by 3.8% if Florida reimbursed hospital outpatient care at 140% of the Medicare OPPS rates. Additionally, if Florida were to reimburse hospital inpatient care at 140% of the Medicare inpatient prospective payment system (IPPS) rates, workers' compensation rates could be reduced by 3.2% according to NCCI. The total estimated cost savings to the system of both changes is -7.0% [= -3.8% + -3.2%], but note NCCI issued this cost estimate prior to the approval of the 2014 edition of the *Florida Workers' Compensation Reimbursement Manual for Hospitals*; therefore, NCCI's estimated cost savings does not reflect any savings from the revised hospital manual.

More details on all the medical issues can be found in the *Three-Member Panel 2013 Biennial Report*<sup>10</sup>. The Report contains additional scenarios of using Medicare OPPS and IPPS rates as a basis for reimbursing hospital inpatient, hospital outpatient and ASC care. The reduction to Florida workers' compensation rates depends on the percentage above Medicare used for each type of care. According to the Report, the savings would be 7.5% [= -3.0% + -4.5%] at 140% of Medicare OPPS for hospital outpatient and ASC services and 140% of Medicare IPPS for hospital inpatient services. The savings would be 8.3% [= -3.4% + -4.9%] at 120% of Medicare OPPS for hospital outpatient and ASC services and 120% of Medicare IPPS for hospital inpatient services. Appendix C and Appendix G in the *Three-Member Panel 2013 Biennial Report* contain the NCCI cost estimates for the alternate scenarios. Again, since these cost estimates were developed prior to the approval of the 2014 edition of the *Florida Workers' Compensation Reimbursement Manual for Hospitals*, the NCCI estimated cost savings do not reflect any savings from the revised hospital manual.

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<sup>10</sup> See *Three-Member Panel 2013 Biennial Report*, at page 6, Appendix C at page 24, Appendix G at page 76

## Workers' Compensation Court Cases

Several court cases making their way through the judicial system have the potential to affect workers' compensation rates in Florida. The top four cases are as follows:

1) *Westphal v. City of St. Petersburg*. In September 2013, on rehearing en banc, the First District Court of Appeal withdrew a panel decision in which the court declared the 104-week statutory cap on temporary total disability (TTD) benefits unconstitutional and revived prior law allowing up to 260 weeks of TTD benefits. The court held that "a worker who is totally disabled as a result of a workplace accident and remains totally disabled by the end of his or her eligibility for temporary total disability benefits is deemed to be at maximum medical improvement (MMI) by operation of law and is therefore eligible to assert a claim for permanent and total disability benefits." In this case, the claimant exhausted TTD benefits without having reached MMI, creating a "gap" period where the injured claimant would no longer receive benefits but also not be at MMI for purposes of receiving permanent disability benefits. In its opinion, the en banc court certified this case to the Florida Supreme Court for review. The Supreme Court accepted jurisdiction over the case on December 9, 2013, and held oral arguments on June 5, 2014. Decision pending.

2) *Castellanos v. Next Door Company*. In October 2013, in *Castellanos v. Next Door Co.*, the First District Court of Appeal declared the statutory attorney fee formula (s. 440.34, F.S.) unconstitutional and certified the question for review by the Florida Supreme Court. In this case, the judge of compensation claims, constrained by the statutory formula set forth in section 440.34(1), Florida Statutes (2009), awarded claimant's counsel an attorney's fee of only \$164.54 for 107.2 hours of legal work.

*440.34(1) ... Any attorney's fee approved by a judge of compensation claims for benefits secured on behalf of a claimant must equal to 20 percent of the first \$5,000 of the amount of the benefits secured, .... The judge of compensation claims shall not approve a compensation order... which provides for an attorney's fee in excess of the amount permitted by this section...*

The award was calculated in strict accordance with the statutory formula applied to the \$822.70 value of benefits secured by the claimant's attorney. The court upheld the constitutionality of the statute and affirmed the fee award. However, the court certified the question of "whether the award of attorney's fees in this case is adequate, and consistent with the access to courts, due process, equal protection, and other requirements of the Florida and federal constitutions." The Supreme Court accepted jurisdiction over the case on March 14, 2014, and held oral arguments on November 5, 2014. In 2008, the Supreme Court found the predecessor 2003 law vague and ambiguous and vacated the law in the Murray case. In 2009, the legislature changed one word and restored it. Decision pending.

3) *Morales v. Zenith Insurance Company* (Substantial excerpts from Law360 April 15, 2012). The Eleventh Circuit in April 2013 asked the Florida Supreme Court to determine whether the family of a landscaping employee killed on the job can collect a \$9.5 million judgment from his employer's insurer, which issued a two-part policy capping workers' compensation coverage. A three-judge panel certified the question to the Florida Supreme Court, saying the issue of standing needed to be settled before it could rule on an appeal of a lower court finding that a

workers' compensation exclusion in Part 2 of the liability policy barred Zenith Insurance Co. from having to cover the \$9.5 million judgment Morales won in a wrongful death action in 2005. "Under Florida law, it is unclear whether a workers' compensation exclusion in an employer liability policy — which is intended to protect employers from tort liability to their employees — bars coverage of an employee's tort judgment obtained in a separate negligence suit against the employer," the panel said.

Morales received a separate settlement from Zenith for workers' compensation benefits, but sued Zenith in 2010 to force it to pay the \$9.5 million judgment won against Lawns Nursery in the earlier wrongful death suit. If Morales does have standing, the panel said, Florida's high court should also determine whether the provision in the employer liability policy, which excludes from coverage "any obligation imposed by workers' compensation ... law" operate to exclude coverage of the estate's claim against Zenith for the tort judgment, according to the opinion. While the wrongful death suit was still pending, the estate and Zenith reached a settlement in which the insurer agreed to pay the estate more than \$100,000 in workers' compensation benefits under Part 1 of the Lawns Nursery policy.

The United States Court of Appeals for the Eleventh Circuit certified the following questions of Florida law: (1) does the estate have standing to bring its breach of contract claim against Zenith under the employer liability policy? (2) if so, does the provision in the employer liability policy which excludes from coverage "any obligation imposed by workers' compensation . . . Law" operate to exclude coverage of the estate's claim against Zenith for the tort judgment? and (3) if the estate's claim is not barred by the workers' compensation exclusion, does the release in the workers' compensation settlement agreement otherwise prohibit the estate's collection of the tort judgment?<sup>11</sup> In a unanimous opinion issued on December 4, 2014, the Florida Supreme held that, under Florida law, the estate has standing, but that the workers' compensation exclusion and the release prevent it from collecting the tort judgment from Zenith. Accordingly, the court answered all three certified questions in the affirmative.<sup>12</sup> Having answered the certified questions, the Florida Supreme Court returned this case to the United States Court of Appeals for the Eleventh Circuit.

4) *Julio Cortes v. Velda Farms LLC; also captioned Florida Workers' Advocates, Workers' Injury Law & Advocacy Group, Elsa Padgett v. State of Florida*<sup>13</sup> On August 13, 2014, the circuit court judge entered an Order on Amended Motion for Summary Final Judgment, declaring the exclusive remedy provision of the Workers' Compensation Act (the Act) unconstitutional. According to the judge, the current workers' compensation law is unconstitutional because it does not provide adequate benefits to injured workers giving up their right to sue and is therefore inadequate as an exclusive remedy for all injured workers. The State of Florida, through the Attorney General, appealed the circuit court decision to the Third District Court of Appeal of Florida, on August 26, 2014. On October 16, the 3rd DCA denied appellee's motion to certify question requiring immediate resolution by the Supreme Court pursuant to

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<sup>11</sup> *Morales v. Zenith Ins. Co.*, 714 F.3d 1220, 1234 (11th Cir. 2013).

<sup>12</sup> *Morales v. Zenith Insurance Company*, No. SC13-696 (December 4, 2014)

<sup>13</sup> *Julio Cortes v. Velda Farms LLC*, Case No. 2011-13661-CA-25 (Fla. 11th Cir. Ct. Aug. 13, 2014) ; also captioned *Florida Workers' Advocates, Workers' Injury Law & Advocacy Group, Elsa Padgett v. State of Florida, Office of the Attorney General*, Case No. 2011-13661-CA-25 (Fla. 11<sup>th</sup> Cir. Ct. Aug. 13, 2014)

Florida Rule of Appellate Procedure. The case has its genesis in a 2012 instance where a state government worker, Elsa Padgett, sustained an on-the-job injury. After a fall, Padgett had to have a shoulder surgically replaced and was forced to retire due to complications. Padgett argued that her workers' compensation benefits were inadequate and the law unfairly blocked her constitutional right to access the court. Decision pending.

## Comparative Rates and Premiums

Comparing rates and premiums among states for the workers' compensation line of business is complicated by several factors. State law varies as to coverage and payment for claims, tort restrictions, and the basis for rate determination. Nonetheless, such a comparison, noting the above difficulties, can be useful.

In 2014, the Office requested from NCCI a comparison of loss cost estimates for the 10 largest class codes of workers' compensation insurance in force in the Florida market with the loss costs for the same class codes in the other 36 jurisdictions for which NCCI is the statistical rating agent. The pure loss cost was considered the metric of choice chosen as it is calculated in a consistent manner across class codes and jurisdictions. Final allowed rates begin with the loss costs as a foundation, and are then modified for risk loads and profit factors in different manners across jurisdictions.

Initially, there are two commonly used definitions of calculating the "largest" class codes; by exposure amounts (e.g. the amount of insured exposure in dollars) and by policy count. The analysis below is repeated for each definition.

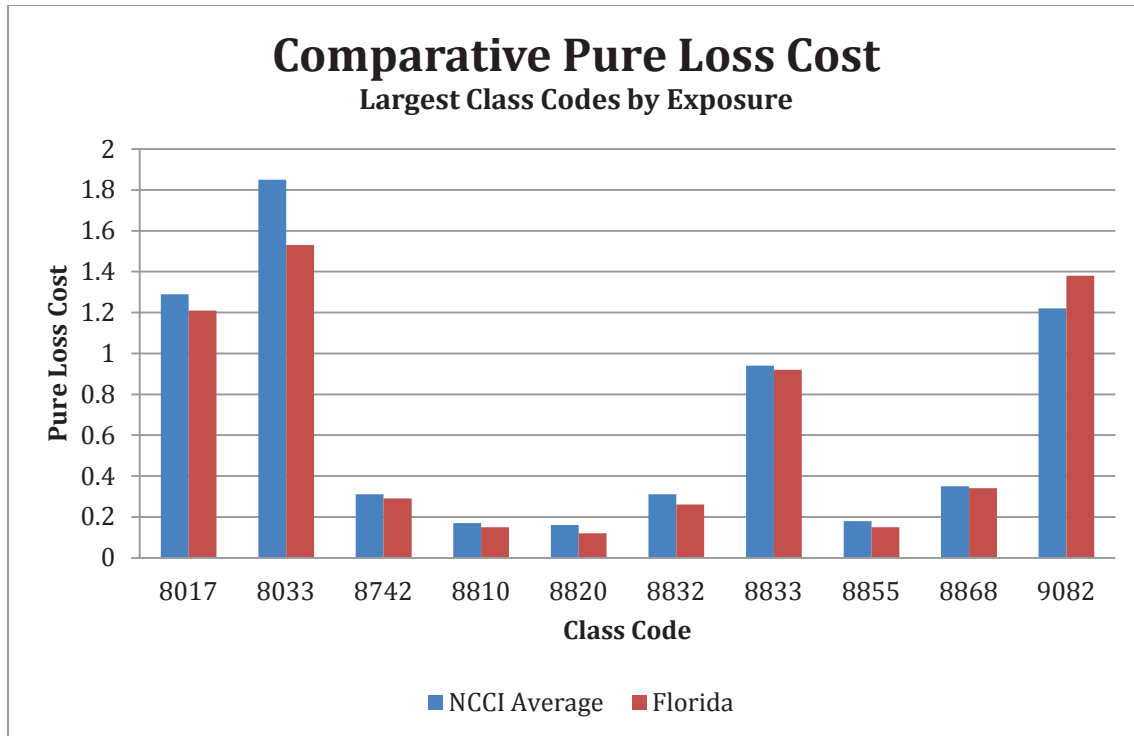
When measured by exposure, the following are reported in the next chart:

- The 10 largest class codes based on Florida exposure for Policy Years 2011 and 2012 with a description of the class code,
- The average loss cost across NCCI jurisdictions based on the most recent approved loss cost or rate filings available as of November 5, 2014 and the approved January 1, 2015 Florida rate filing,
- Florida's loss cost, and
- Florida's rank among jurisdictions (1 being highest, 37 being lowest)

<b>Comparative Pure Loss Cost: Largest Class Codes by Exposure</b>				
<b>Class Code</b>	<b>Class Description</b>	<b>NCCI Average</b>	<b>Florida</b>	<b>Florida Rank</b>
8017	STORE: RETAIL NOC	1.29	1.21	21
8033	STORE: MEAT, GROCERY AND PROVISION STORES COMBINED-RETAIL NOC	1.85	1.53	27
8742	SALESPERSONS OR COLLECTORS-OUTSIDE	0.31	0.29	23
8810	CLERICAL OFFICE EMPLOYEES NOC	0.17	0.15	19
8820	ATTORNEY-ALL EMPLOYEES & CLERICAL, MESSENGERS, DRIVERS	0.16	0.12	27
8832	PHYSICIAN & CLERICAL	0.31	0.26	21
8833	HOSPITAL: PROFESSIONAL EMPLOYEES	0.94	0.92	17
8855	BANKS AND TRUST COMPANIES - ALL EMPLOYEES, SALESPERSONS, DRIVERS & CLERICAL	0.18	0.15	22
8868	COLLEGE: PROFESSIONAL EMPLOYEES & CLERICAL	0.35	0.34	17
9082	RESTAURANT NOC	1.22	1.38	11

For this report's top 10, class code 8855 is a new addition, while class code 8803 (Auditor, Accountant, or Computer System Designer or Programmer—Traveling) has dropped out.

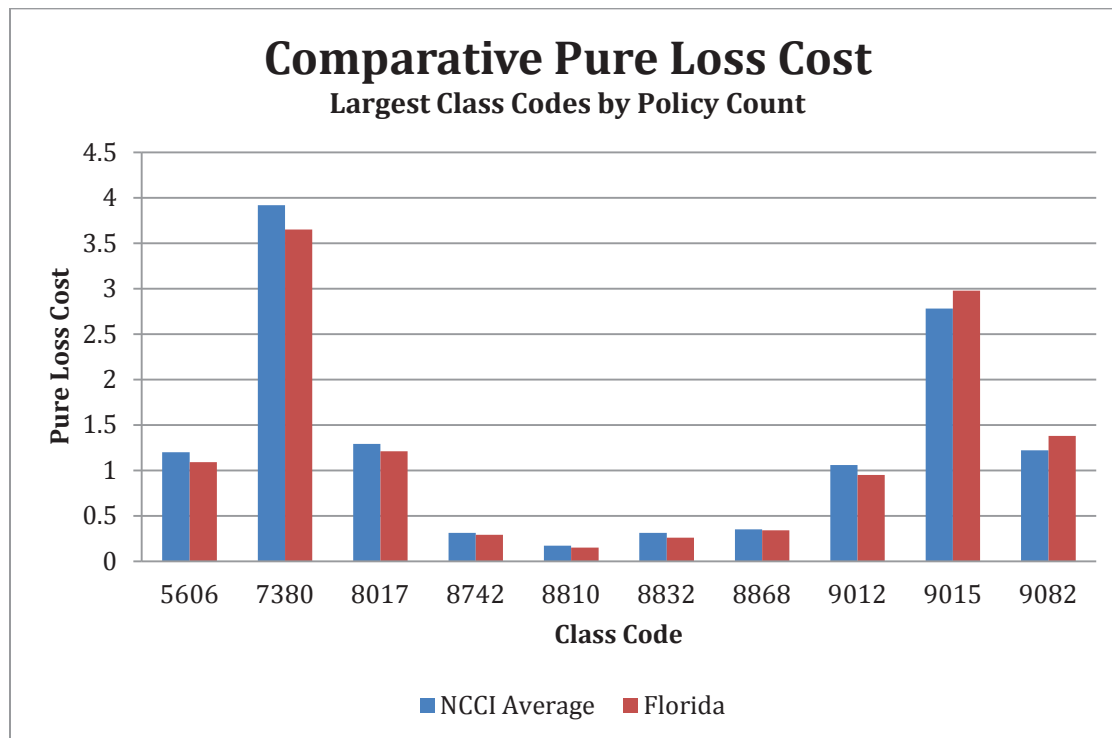
Graphically, this data shows in nine of the 10 class codes, Florida's loss cost is below the NCCI average. This is an improvement over last year's analysis which showed Florida's loss cost was above or equal to the average for three class codes. The movement in the Florida rankings for this report when compared to last year's report is mixed, and the change in ranking for all codes was minor (0 to 2 rankings). Four class codes had their rank deteriorate (8810, 8820, 8832, 8833), two class codes experienced no change in their rank (8017, 8868), and three class codes had their rank improve (8033, 8742, 9082). While there is natural year-to-year variation in loss costs, these comparisons will be observed for future trend.



When the same analysis is completed using the results generated by defining the 10 largest classes by policy count based on Florida exposure for Policy Years 2011 and 2012, the results are similar to the above, but more pronounced.

Comparative Pure Loss Cost: Largest Class Codes by Policy Count				
Class Code	Class Description	NCCI Average	Florida	Florida Rank
5606	CONTRACTOR--PROJECT MANAGER, CONSTRUCTION EXECUTIVE, CONSTRUCTION MANAGER OR CONSTRUCTION SUPERINTENDENT	1.20	1.09	22
7380	DRIVERS, CHAUFFEURS, MESSENGERS AND THEIR HELPERS NOC-COMMERCIAL	3.92	3.65	19
8017	STORE: RETAIL NOC	1.29	1.21	21
8742	SALESPERSONS OR COLLECTORS-OUTSIDE	0.31	0.29	23
8810	CLERICAL OFFICE EMPLOYEES NOC	0.17	0.15	19
8832	PHYSICIAN & CLERICAL	0.31	0.26	21
8868	COLLEGE: PROFESSIONAL EMPLOYEES & CLERICAL	0.35	0.34	17
9012	BUILDING OR PROPERTY MANAGEMENT - PROPERTY MANAGERS AND LEASING AGENTS & CLERICAL, SALESPERSONS	1.06	0.95	21
9015	BUILDING OR PROPERTY MANAGEMENT - ALL OTHER EMPLOYEES	2.78	2.98	13
9082	RESTAURANT NOC	1.22	1.38	11

The data for the 10 largest classes by policy count reveals Florida's loss cost was lower than the NCCI average in eight of 10 class codes. This is an improvement over last year's analysis which showed Florida's loss cost was above or equal to the average for three class codes. The movement in the Florida rankings for this report when compared to last year's report is mostly improving, and the change in ranking for all codes was minor (0 to 3 rankings). Six class codes had their rank improve (5606, 7380, 8742, 9012, 9015, 9082), two class codes experienced no change in their rank (8017, 8868), and two class codes had their rank deteriorate (8810, 8832).



## Florida Workers' Compensation Joint Underwriting Association

One of the most significant indicators of an availability problem in an insurance market is the size of the residual market mechanism. In Florida, the Florida Workers' Compensation Joint Underwriting Association (FWCJUA) is the market of last resort for workers' compensation insurance. 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.

While the FWCJUA had significant increases in the number of policies and in written premium for the past several years, the FWCJUA is still a very small portion of the total workers' compensation market in Florida. At its 2014 Florida State Advisory Forum, NCCI presented an analysis of residual market size for 26 states based on calendar year 2013 data. The NCCI analysis showed Florida had the smallest residual market as a percent of premium for the 26 states except for Idaho. The NCCI presentation also showed the FWCJUA had fewer policies than all states included in the analysis except four: Idaho, the District of Columbia, South Dakota and Alabama. Only 1.8% of Florida policyholders obtain coverage through the FWCJUA, which

represents only 1.2% of the Florida voluntary market direct written premium excluding self-insurance funds.

The Florida Workers' Compensation Insurance Plan (FWCIP) was the residual market for Florida until the FWCJUA was created on January 1, 1994. All insurance companies writing workers' compensation in Florida funded the FWCIP. If there was a deficit in the FWCIP, then those workers' compensation carriers 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 in calendar year 1994 to only 522 policies in calendar year 2000, with written premium varying from \$77.5 million in calendar year 2005 to \$1.2 million in calendar year 2009. At the end of November 2014, the FWCJUA had 2,082 policies on its book with corresponding premiums of \$31.3 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.

From 1994 to 2003, the rate differential for FWCJUA rates versus voluntary market rates varied from 1.26 to 3.278 and was 1.429 in 2003 prior to the reforms. Post reform, the rate differential has varied considerably. From 2004 to 2014, the Tier 1 rate differential varied from 1.05 to 1.35, Tier 2 varied from 1.20 to 2.26, and Tier 3 varied from 1.70 to 3.10. There are surcharges in addition to the rate differential affecting 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 known 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 House Bill 1251 resulted in a restructuring of the rates and surcharges used by the FWCJUA. Tier 1 is for employers with good loss experience; Tier 2 for employers with moderate loss experience and non-rated new employers; and, Tier 3 for employers not eligible for Tiers 1 or 2 (specific eligibility requirements can be obtained from the FWCJUA). At the end of November 2014, the in-force policy count by tier is as follows: Tier 1 has 376 policies, Tier 2 has 785 policies and Tier 3 has 921 policies. While Tier 3 accounts for 44% of the total FWCJUA policies, it accounts for 74% of the total premium.

As of January 1, 2015, the premium for Tier 1 is 5% above voluntary rates, Tier 2 is 20% and Tier 3 is 65% (1.65 times the voluntary rates). Tier 3 is also subject to the ARAP surcharge. Additionally, all three tiers have a flat surcharge of \$475. Tier 3 policyholders have a burden Tiers 1 and 2 do not have. Tier 3 policies are assessable if premiums are not sufficient to cover losses and expenses. The tier surcharges effective January 1, 2015 are at an all time low since the tier structure was created in 2004.

It is unrealistic to expect an actuary's best estimate, which is a prediction of future contingent events, will always coincide with future results. It is understood and usually explicitly acknowledged 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 an insurance entity has substantial financial resources, 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 predictions 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 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 actual 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 appropriate in the actuary's selection.

The FWCJUA has been in a situation where the consequences of reserving too low or having rates too low (i.e. retroactive assessments to policyholders) have been greater than the consequences of reserves being too high or rates too high. If the rates are too high, there may be some complaints from policyholders and others but, if there are assessments due to the rates being too low, every policyholder is affected, even those whose policy has expired. 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 1990s. As a result of all these factors and others, the FWCJUA rates have historically been very high in comparison to the residual markets in other states where the residual market is administered by NCCI. In recent years, the FWCJUA rate differentials by tier have declined and other states have increased the rate differentials/surcharges for their residual market such that at least eight states now have higher rate differentials/surcharges than the weighted average FWCJUA rate differential for all three tiers.

Currently, the Tier 1 and Tier 2 rates for most employers are much more affordable than the previous sub-plans A, B and C. In addition, the Tier 3 rates have become much more affordable in recent years relative to prior years when the rate differential reached a high of more than three times the voluntary rates. Notably, while the Tier 3 rate differential has declined considerably in recent years, the Tier 3 rate differential remains high compared to the residual market rate differentials in other states.

A small residual market is desirable, but it needs to be balanced with having an affordable residual market. The FWCJUA has been small in comparison to the total voluntary market from 1997 to the present. In the recent past, the residual market share was low because 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 decided to close their business, go without coverage (which may be unlawful), or sought the services of a Professional Employer Organization (PEO). Coupled with a very competitive market by insurers who aggressively sought new policyholders, this 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, although affordability may be somewhat of an issue for employers utilizing the FWCJUA.

## Composition of the Buyer

Analysis of the workers' compensation market is typically done at a high level, either at the insurer level or in market aggregates. In reality, 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 markedly different. The market for construction risks is different from employers with office workers. New businesses typically face noticeable frictions in obtaining coverage owing to their lack of historical experience, which can be a measure of not only the insurance exposure but also the credit worthiness of the insured.

Employers with a combination of these characteristics can sometimes be 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. The Division of Workers' Compensation (Division), within the Department of Financial Services, monitors and enforces compliance with the workers' compensation laws.

In fiscal year 2013-2014, the Division's Bureau of Compliance conducted 35,294 on-site inspections of an employer's job-site or business location to determine compliance with workers' compensation coverage requirements. The Bureau also issued 3,075 enforcement actions against non-compliant employers, which resulted in \$8.7 million in insurance premium generated and 15,372 in new employees covered by workers' compensation insurance, a 17% increase from the previous fiscal year. The Bureau conducted 59 free training sessions and 25 webinars on workers' compensation coverage, compliance requirements and workplace safety for over 3,026 employers statewide.

The Bureau of Workers' Compensation Fraud, within the Division of Insurance Fraud, made 477 workers' compensation fraud-related arrests for fiscal year 2013-2014, an increase of 14.1% from the previous fiscal year. Workers' compensation premium fraud being facilitated by non-traditional money service businesses or check cashing stores continues to be a major focus of the Division's Bureau of Workers' Compensation Fraud. In excess of \$500 million in fraudulent transactions have been identified, and 15 money service business owners, 18 facilitators, and 14 shell company owners engaged in these schemes have been criminally charged.

## Professional Employer Organizations

According to the National Association of Professional Employer Organizations (NAPEO)<sup>14</sup>, "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

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<sup>14</sup> See [www.napeo.org](http://www.napeo.org)

client of NAPEO members is a small business with an average of 20 employees” though larger businesses also find value in a PEO arrangement.

The PEO industry has grown rapidly since its inception several decades ago. NAPEO estimates “the PEO industry grew by \$8 billion to \$92 billion in gross revenues in 2012 (The industry defines gross revenues as the total of its clients' payrolls and the fees PEOs charge them for taking on their human-resource activities.)” and “approximately 700-900 PEOs are operating in 50 states”.

PEOs have been a part of the Florida workers' compensation market since the early 1990s, especially for small employers. The PEO market is not, however, always without challenges regarding availability of coverage from workers' compensation insurers (see the *Workers' Compensation Large Deductible Study*, National Association of Insurance Commissioners/ International Association of Industrial Accident Boards and Commissions Joint Working Group, March 2006). PEOs have had an erratic history of being able to obtain coverage in the workers' compensation insurance market. In the early 1990s, coverage was difficult to obtain. By the mid-1990s, coverage was broadly available and relatively easy to obtain. In the early 2000s, coverage became scarce, and in 2003, after CNA stopped writing PEOs, coverage was nearly impossible to find. Additionally, PEOs were also a factor in several recent insurer insolvencies in Florida due to insufficient collateral on large deductible policies.

PEOs are a source of workers' compensation coverage for many employers in Florida unable to obtain coverage in the voluntary market, particularly small employers. When the premiums for the FWCJUA are considered too high by employers, the PEO market is often the only option for many employers who want to remain in business and comply with the law. A survey, conducted by the Florida Association of Professional Employment Organizations (FAPEO) in 2010 found they provided more than 69,000 companies with more than 900,000 work-site employees, representing a payroll in excess of \$25 billion.<sup>15</sup>

## 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 found to be reasonably competitive. This section concentrates on the ability of the market to promote competition.

## Mandatory Rating Plans

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

- 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), Florida

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<sup>8</sup>The Florida Association of Professional Employer Organizations (FAPEO) [2010 Census Brochure](#)

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

- Drug-Free Workplace Premium Credit – A 5% premium credit provided to employers certifying the establishment of a drug-free workplace program.
- Employer Safety Premium Credit – A 2% premium credit provided to employers certifying the establishment of a safety program.
- 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.
- Florida Contracting Classification Premium Adjustment Program – A premium credit is provided for policies with one or more contracting classifications paying 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.
- Premium Discounts by Size of Policy – The premium discount plan adjusts the employer's premium to reflect 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 costs are not 10 times as high.
- 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), Florida Statutes. An insurer may refuse to issue a policy with a deductible based on the financial stability of an employer.

## Optional Plans Used by Insurers to Compete Based on Price

Insurers use the following plans to compete on price:

- 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.
- Deviations – Section 627.211, Florida Statutes, allows insurers to file a uniform percentage increase or decrease applicable 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 a standard premium of at least \$500,000.

- Large Risk Alternative Rating Option (LRARO) – LRARO is a flexible retrospective rating plan mutually agreed to by the employer and carrier.<sup>16</sup>
- 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.
- 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 ceased to be a meaningful factor in the workers' compensation marketplace in Florida.

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 and one of these was the transfer of an existing deviation. The Office has disapproved seven deviations since July 1, 2004 for lack

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<sup>16</sup> Prior to Florida House Bill 785 becoming law effective July 1, 2014, LRARO could not be used in Florida despite being available for use in most, if not, all other states. The bill revised Section 627.072(2), Florida Statutes, to allow a retrospective rating plan to contain a provision for negotiation of a workers' compensation premium between an employer and insurer if the employer has: (1) exposure in more than one state; (2) an estimated annual standard workers' compensation premium in Florida of \$100,000 or more; and (3) an estimated annual countrywide standard workers' compensation premium of \$750,000 or more. Only insurers with at least \$500 million in surplus may engage in the negotiation of premiums with eligible employers. These retrospective rating plans are exempted from Section 627.072(1), Florida Statutes, which specifies factors used in determining workers' compensation rates. The bill requires such retrospective rating plans and associated forms to be filed by a rating organization (e.g. NCCI) and approved by the Office. However, an individual employer's premium negotiated under an approved retrospective rating plan does not have to be filed with the Office.

of justification. All three insurers with rate deviations effective in 2013 filed for renewal and received approval for continued use of the deviation. Consequently, on January 1, 2015, there will be three insurance companies with a deviation in Florida (two of the deviations are downward 10% and the other one is downward 5%).

## Large Deductibles

In the early 1990's, insurers approached the Department of Insurance (Department) about filing a rating plan for large employers (defined as having \$500,000 in standard premium) with more flexibility 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. Generally, these employers would be eligible to be individually self-insured.
- Rating is similar to rating for excess insurance purchased by individual self-insureds.
- The minimum deductible is \$100,000 and could be in the millions. Thus, the employer would be responsible for the vast majority of claims.

The Department ultimately agreed to these types of plans with restrictions 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 ranging 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 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 increased, the effect has been to lower the base for assessment and taxes such that Section 440.51(1)(b), Florida Statutes, has been revised to require reporting premiums 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.

In recent insolvencies from 2009-2011, there have been problems with large deductible policies and the lack of collectible collateral. This will result in the Florida Workers' Compensation Insurance Guaranty Association (FWCIGA) paying over \$50 million that will ultimately be assessed to all workers' compensation policyholders in the state of Florida. During 2012, the FWCIGA established a workgroup to study this problem and make recommendations for corrective action. The FWCIGA Board adopted the workgroup's report and submitted recommendations for legislative changes to strengthen the collateral requirements and limit the size of the deductible assumed by policyholders.

## Conclusion

Based on the number of entities and market shares of actively writing companies in the market, the number of entities entering and exiting the market and the financial performance of the entities in the market, Florida's workers' compensation market can readily be characterized as a competitive market.

Availability does not appear to be a significant concern in the aggregate. The residual market is small, suggesting the voluntary market is absorbing the vast majority of demand. While not without risk, the growth of PEO usage among smaller employers has, as well, helped availability by making coverage affordable.

For an employer, availability is not particularly important if the coverage is not affordable. As of January 1, 2015, the voluntary market rates have declined by 58.3% since the 2003 reform legislation was passed indicating the reform has delivered the desired result and lowered costs dramatically in the state. It is likely, however, the impact of these reforms has reached its limit. There is some concern, however, about the direction of workers' compensation rates in Florida and the ability of the state to retain its important economic competitive advantage in this area.

While the workers' compensation rate filing effective January 1, 2015 decreases Florida rates, medical cost drivers, particularly in the areas of drug costs, hospital inpatient, hospital outpatient and ASC's are noticeably higher in Florida than a countrywide average. NCCI estimates substantial savings could be achieved with legislative reforms for the reimbursement of hospital inpatient care, hospital outpatient care, and ASC care. Furthermore, Senate Bill 662 was passed in 2013 and partially addressed the drug repackaging issue, but there are additional legislative options that could be explored to further reduce drug costs in Florida. Lastly, several pending court cases have the potential to increase costs materially.

## **Office Certification of Compliance with Section 627.096, Florida Statutes**

Section 627.096, Florida Statutes, was created in 1979 as part of the “wage loss” reform of the workers’ compensation law. This statute has three basic requirements as it pertains to this report:

1. An investigation and study of all insurers authorized to write workers’ compensation in Florida. The Office has accomplished this objective by its thorough review of the quality and integrity of the data submitted in the most recent NCCI filing.
2. A study of the data, statistics or other information to assist and advise the Office in its review of filings made by or on behalf of workers’ compensation insurers. Also, there are public hearings regarding the NCCI filing which further allow an opportunity for third parties to register their opinions and input.
3. The statute gives the Financial Services Commission the authority to require all insurers to submit data to the Office. The NCCI has been collecting workers’ compensation data in Florida for more than 50 years; therefore, the Office has contracted with NCCI to perform these statistical services for the state of Florida.



## **Appendix A: Florida Statutes Governing Workers' Compensation Self-Insurance Funds Not Subject to Office Regulation**

### **Section 624.4622 – Local government self-insurance funds**

- Must be comprised entirely of local elected officials
- Limited financial reporting only

### **Section 624.46226 – Public housing authorities self-insurance funds**

- Must be a public housing authority as defined in Chapter 421
- Has a governing body which is comprised entirely of commissioners of public housing authorities who are members of the fund
- Limited financial reporting only

### **Section 624.4623 – Independent educational institution self-insurance funds**

- Must be an independent nonprofit college or university accredited by the Commission on Colleges of the Southern Association of Colleges and Schools or independent nonprofit accredited secondary educational institution
- Has a governing body which is comprised entirely of independent educational institution officials
- Limited financial reporting only

### **Section 624.4625 – Corporation not for profit self-insurance funds**

- Must be a not for profit corporation located in and organized under Florida law
- Must receive at least 75% of revenue from local, state or federal governmental sources
- Has a governing body which is comprised entirely of officials from not for profit corporations that are members of the fund
- Limited financial reporting only

### **Section 624.4626 – Electric cooperative self-insurance fund**

- Must be an electric cooperative organized pursuant to Chapter 425 and operates in Florida
- Must subscribe to or be a member of a rating organization prescribed in Section 627.231
- Has a governing body comprised of a representative from each member of the fund
- No reporting requirements



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