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OFFICE OF INSURANCE REGULATION

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INSURANCE REGULATION  
Docketed by: 377

KEVIN M. McCARTY  
COMMISSIONER

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

Case No. 178146-15

**ORDER ON RATE FILING**

On August 19, 2015, the **NATIONAL COUNCIL ON COMPENSATION INSURANCE, INC.** ("NCCI") filed, pursuant to Section 627.091, Florida Statutes, revised Workers' Compensation Rates and Rating Values (herein after the "Filing") for consideration and review by the **FLORIDA OFFICE OF INSURANCE REGULATION** ("**OFFICE**"). The Filing proposed a 1.9% (1.9 percent) decrease in the overall rate level (2.2% decrease in the overall premium level), to be effective January 1, 2016, on new and renewal policies.

The **OFFICE**, having concluded that it would be in the public interest to hold a public hearing pursuant to Section 627.101, Florida Statutes, for the purpose of allowing the public an opportunity to speak or present evidence regarding the matters contained in the Filing, and by doing so assist the **OFFICE** in determining whether the Filing meets the applicable requirements of law, held a public hearing ("Hearing") on October 21, 2015, in Hearing Room 2 at the Division of Administrative Hearings, the DeSoto Building, 1230 Apalachee Parkway in Tallahassee, Florida.

The Commissioner of the Office of Insurance Regulation, having considered the Filing and additional information submitted by **NCCI**, the supporting data, oral and written statements presented at the Hearing, the analysis by the staff of the **OFFICE**, and being otherwise fully advised in the premises finds:

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

2. Notice of the Hearing was published in Vol. 41, No. 181, of The Florida Administrative Register on September 17, 2015, on page 4340. Notice was also sent directly to **NCCI** and to other persons requesting to be notified of such events.

3. Some of the proposed changes in the Filing have not been justified.

4. Since **NCCI** began including trend in its workers' compensation filings, it has displayed the on-level developed loss ratio trends based on fitting the data to either a linear or exponential curve. This loss ratio trend was the primary basis and for many years the only basis for **NCCI's** trend selection. In the more recent filings, **NCCI** expanded the trend section of the filings by including not only the loss ratio data, but also data showing frequency and severity. The loss ratio trend data in the Filing shows a long term downward trend in loss ratios for indemnity of -6.1% and for medical of -3.8%, using an exponential trend fit to the policy year data for the latest 15 years for Standard Coverage. However, the latest five years of data show a decreasing trend of -3.6% for indemnity and a downward trend of -1.3% for medical. The trend data in the Filing shows that the indemnity loss ratio has declined considerably from 2010 to 2013 resulting in shorter term loss ratio trends that are more negative than the **NCCI** selected indemnity trend of -2.0%. The indemnity loss ratio trend data in the Filing using a shorter term shows an annual trend ranging from -3.6% to -2.0% using an exponential

trend fit to the policy year data for the latest five years to the latest seven years for Standard Coverage. The trend data in the Filing reflects losses that have been adjusted to the current level using the **NCCI** initial estimate of the effect of the 2003 reforms. If the actual impact of the 2003 reforms is greater than the initial estimate (as is commonly believed), then the use of the longer term data in the Filing would produce trends that are too low. Recognizing that the 2003 reforms have affected the data in ways that will not be repeated in the future and the more recent, shorter term trends, the **NCCI** selected medical trend of 0.0% appears to be reasonable, while the selected indemnity trend of -2.0% has not been justified.

5. In this Filing, the internal rate of return model used by **NCCI** in selecting the profit and contingencies factor of +4.0% does not include anticipated policyholder dividends. **NCCI** indicated at the hearing that they would have chosen the same profit and contingencies factor of +4.0% even if policyholder dividends were considered. Florida workers' compensation rates have not previously included an explicit policyholder dividends provision greater than zero. Further, the failure to explicitly load an amount for policyholder dividends into the rates has not precluded insurers from paying policyholder dividends in Florida. Thus, policyholders in Florida have received substantial dividends without the explicit inclusion of a provision for policyholder dividends greater than zero.

6. Policyholder dividends are, by definition, a non-guaranteed return of profits, which means the payment of policyholder dividends is left strictly to the discretion of the insurers. In order for a policyholder to be eligible for a policyholder dividend, the insurance carrier files a participating endorsement that is attached to and becomes part of the policy. Many insurance carriers do not intend to pay policyholder dividends and

have not filed such endorsements. Of the 259 insurance carriers actively writing workers' compensation in Florida in calendar year 2014, only 96 carriers paid policyholder dividends. Thus, if the rates are explicitly loaded for policyholder dividends, some employers will pay higher rates without any possibility of receiving a dividend, so that other employers can receive a policyholder dividend. This loading would likely result in unfairly discriminatory rates.

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

8. **NCCI** has estimated the "static" investment yield at +1.90%, a yield near historic long term lows. This estimate is significantly below the average representative portfolio yields over the recent past and below expected yields in the near future as economic performance continues to improve. **NCCI** has estimated the "dynamic" investment yield to range from +2.50% to +4.10%. The "dynamic" yields are forecasted, forward looking estimates and are more likely to capture general market trends than the "static" investment yield which assumes that the return on investments do not change

over time. A common belief among economists is that interest rates are mean reverting suggesting that the “static” estimate is very likely underestimating any reasonable estimation of investment yields looking forward.

9. **NCCI** modified the data source used to estimate the investment yield which is an input in the Internal Rate of Return model. No conclusive evidence was provided that indicates the data source change is appropriate and necessary.

10. **NCCI's** expert witness testified at the Hearing that unprecedented economic conditions have caused interest rates to remain near historic lows for an extended period. He also testified that low interest rates negatively impact the industry's ability to earn investment income and that this situation is expected to continue for the foreseeable future. **NCCI** presented no data in the Filing or at the Hearing regarding the actual investment income realized by property and casualty insurers in the recent past.

11. The analysis and data underlying the 2014 Office of Insurance Regulation Workers' Compensation Annual Report (hereinafter the “Report”) finds the Florida workers' compensation market to be stable, competitive, and robust. Based on data from 2013, the Report indicates that the market is served by a large number of independent insurers with no significant barriers to entry or exit. The number of companies writing workers' compensation in the state has remained stable, and the residual market remains one of the smallest in the country as a percentage of premium. Additionally, the Report specifies that the 2013 Herfindahl-Hirschman Index (HHI), a measure of market concentration, for Florida is 302.83, which suggests a competitive market. Moreover, the Florida workers' compensation market has become progressively more competitive following the 2003 legislative reforms as indicated by a declining HHI from 404 in 2005 to 302.83 in 2013. Also noted in the report is the fact that the 2013

Florida aggregate loss ratios are the second lowest among the six most populous states. Nothing presented in the Report suggests any market wide or systemic issues in the Florida workers' compensation market.

12. Based on Paragraphs 5. through 11. above, the +4.0% profit and contingencies provision is excessive. The use of a +4.0% profit and contingencies provision in the Filing does not adequately reflect investment income on unearned premium and loss reserves as required by Section 627.072, Florida Statutes. Significantly, **NCCI** has not provided evidence that the profit and contingencies provision needs to be increased above the current approved provision of +2.5% to keep the workers' compensation market functioning while taking into consideration current economic conditions. The record does not reflect any appreciable change in economic conditions that would justify an increase in such provision. As discussed above, the Florida workers' compensation market is functioning very well while taking into account current economic conditions. Therefore, a +4.0% profit and contingency provision has not been justified.

13. **NCCI** proposes to decrease the expense constant from \$200 to \$160. The revised expense constant is based on a recent study **NCCI** performed to analyze expenses by size of risk. The results of the study were not compelling evidence to justify the decrease in the expense constant.

14. **NCCI** is proposing an increase in minimum premiums by increasing the multiplier by 17.6% and increasing maximum minimum premiums by 8.3%. It is not clear from the data provided in the Filing that an increase to both the minimum premium multiplier and maximum minimum premium are justified.

15. A revised version of the *Florida Workers' Compensation Reimbursement Manual for Ambulatory Surgical Centers* ("ACS Manual") is effective on January 1, 2016. **NCCI** did not include an impact in the Filing for the ACS Manual changes since the manual was not adopted as of the filing date. Revised Rule 69L-7.100, Florida Administrative Code, became effective as of September 28, 2015. On October 13, 2015, **NCCI** submitted in the Filing a cost impact analysis for the revisions to the ASC Manual, and the estimated impact is a 0.1% decrease.

16. At the Hearing, testimony was heard regarding Professional Employer Organizations (PEOs), their impact on Florida workers' compensation rates, value to the marketplace and the potential for fraudulent behavior in some aspects of this industry. Testimony was received from construction and roofing industry representatives and a PEO industry representative. The **OFFICE** values the testimony received at the Hearing which serves to further enhance the **OFFICE's** awareness concerning PEOs and the potential issues with some PEOs operating in the Florida marketplace.

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

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

A. The statewide overall rate level change for the Filing for new and renewal policies for other than the "F" classifications shall be -5.1% (-5.1 percent), effective January 1, 2016, which includes the -0.1% decrease due to the change to the ASC Manual, a -2.5% annual trend for indemnity and a +0.0% annual trend for medical.

B. The +4.0% (+4.0 percent) allowance for profit and contingencies for the proposed rates in the Filing and identified in Exhibit II of the Filing is disapproved. Exhibit II of the Filing shall be re-filed containing a profit and contingencies provision no greater than +2.5% (+2.5 percent). The +2.5% (+2.5 percent) profit and contingencies provision shall also apply to the "F" classifications.

C. The expense constant of \$160 in the Filing and identified in Exhibit II of the Filing is disapproved. The +0.3% offset for the change in the expense constant from \$200 to \$160 is disapproved. Exhibit II of the Filing shall be re-filed containing an expense constant of \$200, a production expense provision no greater than +17.9% (+17.9 percent), and a general expense provision no greater than +5.2% (+5.2 percent). The \$200 expense constant, the +17.9% (+17.9 percent) production expense provision and the +5.2% (+5.2 percent) general expense provision shall also apply to the "F" classifications.

D. The statewide overall rate level change in the Filing for "F" classifications for new and renewal policies shall be adjusted to reflect the +2.5% (+2.5 percent) profit and contingencies provision, a production expense provision no greater than +17.9% (+17.9 percent), a general expense provision no greater than +5.2% (+5.2 percent), a -2.5% annual trend for indemnity, a +0.0% annual trend for medical and the -0.1% decrease due to the change to the ASC Manual effective January 1, 2016. The statewide overall rate level change for "F" classifications shall not include an offset for the change in the expense constant from \$200 to \$160.

E. The proposed change in the maximum minimum premium is disapproved, and the minimum premium multiplier shall be 90.



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

G. **NCCI** shall provide to the **OFFICE** a report for each quarter of calendar year 2016 showing the average intrastate experience modification factor for policies with effective dates in the year 2016 and for the same policies with effective dates for a comparable period in calendar year 2015. The report for each quarter shall be filed within 30 days of the end of the quarter. Thus, the first report will be due no later than May 1, 2016 for the first quarter of calendar year 2016. In addition to the quarterly report, **NCCI** shall provide a monthly report to the **OFFICE** of the average intrastate mod for the policies effective during the month. This monthly report shall be filed with the **OFFICE** within 7 days of the end of the month. Thus, the January 2016 report will be due no later than February 7<sup>th</sup>.

To meet statutory timeframes for a January 1, 2016 effective date, **NCCI** shall file the necessary amendments to the Filing as may be required to implement the terms of this Order as soon as practicable but no later than November 9, 2015. No rate change shall be implemented until such amendments are properly filed and final approval is issued by the **OFFICE**.

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

DONE and ORDERED this 3<sup>rd</sup> day of November, 2015.



  
Kevin M. McCarty, Commissioner  
Office of Insurance Regulation

Copies furnished to:

NATIONAL COUNCIL ON COMPENSATION INSURANCE, INC  
901 Peninsula Corporate Circle  
Boca Raton, FL 33487

THOMAS J. MAIDA, ESQUIRE  
Foley & Lardner  
106 East College Avenue, Suite 900  
Tallahassee, FL 32301

SHA'RON JAMES  
INSURANCE CONSUMER ADVOCATE  
DEPARTMENT OF FINANCIAL SERVICES  
OFFICE OF THE INSURANCE CONSUMER ADVOCATE  
200 East Gaines Street  
Tallahassee, FL 32399

## NOTICE OF RIGHTS

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

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

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

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

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

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

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