

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. 38, No. 37, of The Florida Administrative Weekly on September 14, 2012, on page 3881. 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. In this Filing **NCCI** uses the year to year average change in the loss ratio to determine both the long term trend and the short term trend. The loss ratio trend data in the Filing clearly shows a downward trend in loss ratios for indemnity, ranging from an annual trend of -1.3% to -7.1%, using an exponential trend fit to the policy year data for the latest 6 years through the latest 15 years for Standard Coverage. The loss ratio trend data in the Filing for medical shows a range of values from -0.6% to -3.8% for the same latest 6 years through the latest 15 years. However, the latest five years of data show an upward trend of +1.1% for indemnity and +2.1% for medical. 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 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 that both the long term and short term trends need to be considered, then the **NCCI** selected trends of -1.0% for indemnity and 0.0% for medical appear to be reasonable.

5. In this Filing the internal rate of return model used by **NCCI** in selecting the profit and contingencies factor of +2.5% does not include anticipated policyholder dividends. At the Hearing, **NCCI** presented the result of their IRR Model using policyholder dividends but did not specify the amount of policyholder dividends that were used in the calculation. **NCCI** indicated at the hearing that they would have chosen the same profit and contingencies factor of +2.5% 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 250 insurance carriers actively writing workers' compensation in Florida in calendar year 2011, only 97 carriers paid

policyholder dividends. Thus, if the rates are explicitly loaded for policyholder dividends, some employers will pay higher rates without any possibility of receiving a dividend, so that other employers can receive a policyholder dividend. This loading would likely result in unfairly discriminatory rates.

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

8. **NCCI** has estimated the investment yield at 2.311%, a yield that is almost a historic low. 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.

9. Based on Paragraphs 5., 6., 7., and 8. above, the input parameters to the **NCCI** internal rate of return model for policyholder dividends, and investment yield are not justified for this Filing. However, **NCCI** has selected a +2.5% profit and contingencies factor despite their indicated profit and contingencies factor being +10.47% for standard coverage and +10.97% for large deductible. Substituting more

appropriate numbers for the investment yield and using policyholder dividends of 0% shows that the proposed +2.5% profit and contingencies factor is justified for this Filing. The use of a +2.5% profit and contingencies factor in the Filing adequately reflects investment income on unearned premium and loss reserves as required by Sections 627.072 and 627.215(8), Florida Statutes. The proposed changes in "F" classification premiums also use a +2.5% profit and contingencies factor. Thus, the proposed overall increase for the "F" classifications adequately reflects investment income on unearned premium and loss reserves as required by Sections 627.072 and 627.215(8), Florida Statutes.

10. **NCCI** is proposing an increase in rates and an increase in the percentage of the premium dollar that is allocated to production expenses. This would result in an increase in expense dollars in the Filing greater than the 0.1% implied by the change in the production provision. The main component of the production expense that has caused the increase of the last few years is an increase in commissions. **NCCI** has not provided evidence that commissions need to be increased to keep the workers' compensation market functioning. Thus, **NCCI** has not justified the increase in production expenses.

11. **NCCI** is proposing an increase in minimum premiums by doubling the multiplier and increasing maximum minimum premiums by 25%. The combined effect of these two changes could double the premiums that very small employers pay to stay in business. It is not clear from the data provided that such an increase is justified.

12. At the October 4, 2012 Hearing, the adverse impact of physician dispensed drugs on the workers' compensation system was again discussed. There was written testimony and evidence submitted by the Workers' Compensation Research Institute

(WCRI) that physician dispensed prescription drugs represent 45% of all workers compensation prescriptions in Florida. According to the WCRI, Florida has the second highest percent of prescriptions that were physician dispensed for workers compensation patients among the 23 states included in the WCRI report. WCRI also advised that "The average price per pill of the 5 drugs that were most frequently dispensed by physicians was 55-151 percent higher than the average price paid to pharmacies in Florida for the same medication." WCRI also testified that "The data suggest that some physicians did write prescriptions for medications that physicians did not usually prescribe for injured workers." **NCCI** testified at the hearing that workers' compensation rates would be reduced 1.1% if the Florida Legislature addressed the markup of repackaged drugs.

13. **NCCI** testified that 68% of the total benefit costs in Florida are for medical benefits versus 32% for indemnity benefits. This compares to the countrywide average of 59% for medical benefits. Within the medical benefits, **NCCI** identified drugs, hospital inpatient, hospital outpatient and Ambulatory Surgical Centers (ASC) as being higher in Florida than the countrywide average. If the reimbursement for hospital inpatient, hospital outpatient and ASC, were reduced to the countrywide average then the savings would be 5.5%.

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

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

A. The +2.5 percent (+2.5%) allowance for profit and contingencies for the proposed rates in the Filing, and identified in Exhibit II-A of the Filing, is approved. The profit and contingencies factor on Exhibit II-A shall also apply to the "F" classifications.

B. The statewide overall rate level change for the Filing for new and renewal policies for other than the "F" classifications shall be +6.1 percent (+6.1%), effective January 1, 2013,

C. The statewide overall rate level change in the Filing for "F" classifications for new and renewal policies shall be adjusted to reflect a maximum change by classification of +30% and a minimum change of 0% effective January 1, 2013.

D. The proposed increase in production expense is disapproved.

E. The proposed changes in the minimum premiums have not been justified and are disapproved.

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.

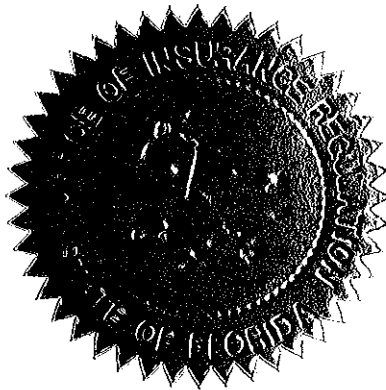
G. **NCCI** shall provide to the **OFFICE** a report for each quarter of calendar year 2013 showing the average intrastate experience modification factor for policies with effective dates in the year 2013 and for the same policies with effective dates for a comparable period in calendar year 2012. The report for each quarter shall be filed within 30 days of the end of the quarter. Thus, the first report will be due on May 1, 2013 for the first quarter of calendar year 2013. In addition to the quarterly report, the **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**

on the first day of the following month. Thus, the January 2013 report will be due February 1st.

To meet statutory timeframes for a January 1, 2013 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 2, 2012. 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 26th day of October, 2012.




Kevin M. McCarty, Commissioner
Office of Insurance Regulation

Copies furnished to:

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NOTICE OF RIGHTS

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

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

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

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

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

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

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