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OFFICE OF INSURANCE REGULATION
Docketed by: [signature]

OFFICE OF INSURANCE REGULATION

DAVID ALTMAIER
COMMISSIONER

Revised Workers' Compensation Rates and Rating Values as Filed by the

NATIONAL COUNCIL ON COMPENSATION INSURANCE, INC.
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Case No. 213885-17

ORDER ON RATE FILING

On August 28, 2017, the **NATIONAL COUNCIL ON COMPENSATION INSURANCE, INC.** ("**NCCI**") filed, pursuant to Section 627.091, Florida Statutes, revised Workers' Compensation Rates and Rating Values ("Filing") for consideration and review by the **FLORIDA OFFICE OF INSURANCE REGULATION** ("**OFFICE**"). The Filing proposed a 9.3% (9.3 percent) decrease in the overall rate level (9.6% decrease in the overall premium level), to be effective January 1, 2018, on new and renewal policies.

This experience based Filing follows a separate law-only filing made by **NCCI** in 2016 to specifically address the projected cost impact of two Florida Supreme Court decisions, Marvin Castellanos v. Next Door Company, et al. ("*Castellanos*"), Case No. SC13-2082, and Bradley Westphal v. City of St. Petersburg, etc., et al. ("*Westphal*"), Case No. SC13-1930. The law-only filing also addressed the impact of Senate Bill 1402 (Chapter 2016-203, Laws of Florida) that ratified the Florida Division of Workers' Compensation's updates to the *Florida Workers' Compensation Health Care Provider Reimbursement Manual*, 2015 Edition. In the law-only filing, **NCCI** proposed a 19.6%

increase in the overall rate level. Following a public hearing and a review of the record for the law-only filing, the **OFFICE** approved a 14.5% increase in the overall rate level with an effective date of December 1, 2016.

Using new data, this experience based Filing proposes a decrease in rate level based on data from Policy Years 2014 and 2015 valued as of year-end 2016. While some of the experience used as the basis for this Filing occurred before the recent Florida Supreme Court decisions, a portion of the experience period includes claims that occurred after the decisions. Even after considering the impact of the *Castellanos* and *Westphal* decisions, other factors at work in the marketplace combined to contribute to the indicated decrease, which included reduced assessments, increases in investment income, decline in claim frequency, and lower loss adjustment expenses.

The **OFFICE**, pursuant to Section 627.101, Florida Statutes, held a public hearing ("Hearing") on October 18, 2017, in room 412 of the Knott Building, 404 South Monroe Street, Florida Capitol Complex, in Tallahassee, Florida to provide an opportunity for members of the public to comment on the Filing.

The **OFFICE**, having considered the Filing and additional information provided by **NCCI**, the supporting data, oral and written statements presented at the Hearing, additional testimony and public comment received, and the analysis by the staff of the **OFFICE,** and being otherwise fully advised in the premises finds:

1. The **OFFICE** has jurisdiction over the parties and the subject matter of these proceedings.

2. Notice of the Hearing was published in Vol. 43, No. 191, of <u>The Florida Administrative Register</u> on October 3, 2017, on page 4258. Notice was also sent directly to **NCCI** and to other persons requesting to be notified of such events.

3. **NCCI** is a licensed rating organization authorized to make rate filings on behalf of workers' compensation insurance companies in Florida pursuant to Section 627.091(4), Florida Statutes. Any insurer may make a filing to deviate from the **NCCI** rate level pursuant to Section 627.211, Florida Statutes, and Rule 69O-189.004, Florida Administrative Code.

4. **NCCI** provided on-level developed loss ratio data in the Filing which is the basis for the proposed annual indemnity and medical trend selections. **NCCI** also provided claim frequency (number of workplace injuries) and claim severity (average cost per injury) data but did not specifically select trends based on this data. An analysis of the data reveals there is a significant downward trend in the loss ratios from policy year 2001 to 2006. During this timeframe, the indemnity loss ratio declined by 46.4%, and the medical loss ratio declined by 35.2%. From 2007 to 2010, the loss ratios primarily increased, and the total increase in loss ratios during this period was 5.1% for indemnity and 9.6% for medical. The most recent policy years, 2011 to 2015, show a declining trend in the loss ratios, but the decline is much less substantial than that exhibited from 2001 to 2006. From 2011 to 2015, the cumulative decreases in the indemnity and medical loss ratios were 19.9% and 12.3%, respectively. The primary reason for the declining loss ratios is a significant reduction in the lost-time claim frequency which declined by 45% from 2001 to 2015 with over 8% of the decline occurring in 2014 and 2015. **NCCI** provided testimony at the Hearing that claim frequency decline for workers' compensation is not unique to Florida and that for numerous years frequency has been declining countrywide similar to Florida. **NCCI** also testified that claim frequency decline is due, in part, to safer workplaces, enhanced

efficiencies in the workplace, increased use of automation, and innovative technologies, and the decline is expected to continue in the future.

5. Fitting the historical data provided in the Filing to an exponential curve allows for an analysis of the loss ratio trends, but 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 could produce trends that are too low. Excluding data prior to the 2003 reforms, the loss ratio trend data in the Filing provides a range of trend values for indemnity from -4.4% to -2.4% and for medical from -2.7% to -0.3% using various exponential trend fits (12-point through 5-point) to the latest 12 years of policy year data for Standard Coverage. It is also apparent that nonrecurring events such as the Great Recession and subsequent recovery are likely impacting the data provided by **NCCI** for the trend analysis. In a trending procedure, it is proper to consider the impact of any events which may be influencing the data and determine if the observed trends affected by these events will continue into the projected period when the rates will be effective. Recognizing that the 2003 reforms have affected the data in ways that will not be repeated in the future and other considerations such as the economic events impacting the data used for the trend analysis, the **NCCI** selected annual indemnity trend of -3.0% and the selected annual medical trend of -0.5% appear to be reasonable.

6. In this Filing, the internal rate of return model used by **NCCI** in selecting the profit and contingencies provision of +2.0% does not include anticipated policyholder dividends. 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.

7. 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 248 insurance carriers actively writing workers' compensation in Florida in calendar year 2016, only 104 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.

8. 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.

9. **NCCI** estimated the "static" investment yield at +2.38%, a yield near historic long term lows. This estimate is 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 +2.74% to +4.00%. 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.

10. Based on Paragraphs 6. through 9. above, the +2.0% profit and contingencies provision is excessive. The use of a +2.0% 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. Investment yields have increased since the profit and contingencies provision of +2.75% underlying the current rates was approved, and it is appropriate to decrease the profit and contingencies factor to reflect this change.

11. **NCCI** proposes to decrease the expense constant from $200 to $160. The revised expense constant is based on a study **NCCI** performed to analyze production and general expenses by size of risk. In the Final Order for Case No. 178146-15, the **OFFICE** reserved consideration as to the validity or persuasiveness of the study conducted by **NCCI** for review in future rate filings. For this Filing, in addition to

providing the study as justification for the decrease in the expense constant, **NCCI** provided additional information and explanation regarding the proposed change to the expense constant and the study used as support. Using an error metric, **NCCI** examined a comparison of estimated and actual expenses for each individual company and year included in the analysis. After analyzing numerous alternatives, **NCCI** determined which expense constant value minimized the difference between the estimated and actual expenses. The $160 expense constant was the value that provided the best fit to the actual data. The results of the study indicate that less expense dollars should be included in the fixed expenses collected with each policy regardless of premium size and more expense dollars vary with premium size and should be included in the manual rates. On an overall statewide basis, the $160 expense constant combined with the expense provisions included in the manual rates and the appropriate premium discount tables provide adequate funding for insurer expenses in total and by size of risk.

12. The **OFFICE** received testimony regarding the uncertainties associated with the recent Florida Supreme Court decision, *Castellanos.* To ensure workers' compensation rates are not excessive, inadequate or unfairly discriminatory in compliance with Section 627.062, Florida Statutes, it is imperative that additional quantitative analysis be conducted to determine the effect the *Castellanos* decision is having on the Florida workers' compensation market and the data used to support future rate filings. The analysis may include alternative data sources and should examine changes to the Florida workers' compensation market that are attributed to or observed as a result of the recent court decision. These changes include, but are not limited to, reopening of claims from older years, changes in reserves or payment

patterns, changes to claim closure or settlement rates, changes to claim frequency and severities, increasing attorney involvement, and fees paid to attorneys.

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 practical.

A. Effective January 1, 2018, for new and renewal policies for other than the "F" classifications, the statewide overall rate level change shall be -9.5% (-9.5 percent) and the statewide overall premium level change shall be -9.8% (-9.8 percent) for the Filing.

B. The +2.0% (+2.0 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 +1.85% (+1.85 percent). The +1.85% (+1.85 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 approved. The **OFFICE** received testimony that the reduction to the expense constant from $200 to $160 could affect the availability of workers' compensation coverage for small employers. Section 627.1615, Florida Statutes, provides "Insurers shall not refuse to provide workers' compensation coverage on the basis of the applicant's premium volume." **NCCI** shall advise their member companies of this statutory requirement.

D. In future rate filings, **NCCI** shall provide a detailed explanatory memo and quantitative analysis regarding the effect the recent Florida Supreme Court decision of

Castellanos is having on the Florida workers' compensation market and the data used to support future rate filings.

E. For any filing submitted to the **OFFICE**, **NCCI** shall list and explain each and every change in the proposed manual pages, including but not limited to the rating plan manual, 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.

F. **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 2018 report will be due no later than February 7, 2018.

Section 627.4133, Florida Statues, requires insurers to give at least 45 days' notice of renewal premium. Therefore, to meet statutory timeframes for a January 1, 2018 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 practical but no later than November 7, 2017. No rate change shall be implemented until such amendments are properly filed and final approval is issued by the **OFFICE**. If **NCCI** fails to file the necessary amendments to the Filing to implement the terms of this Order, the **OFFICE** will initiate proceedings under section 627.141, Florida Statutes, to disapprove the current rates.

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 31 day of October, 2017.

David Altmaier

David Altmaier, 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.

Revised 02/04/2008