

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 1241 w/CS Workers' Compensation Rating  
**SPONSOR(S):** Berfield  
**TIED BILLS:** None **IDEN./SIM. BILLS:** CS/SB 1926

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Insurance	20 Y, 0 N w/CS	Callaway	Cooper
2) Appropriations			
3)			
4)			
5)			

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### SUMMARY ANALYSIS

The Joint Select Committee on Workers' Compensation Rating Reform (Joint Select Committee) was created by chapter 2003-413, L.O.F., and charged with studying insurance rating options that would promote greater competition and would encourage insurers to write workers' compensation policies while protecting employers from rates that are excessive, inadequate, or unfairly discriminatory.

The Joint Select Committee recommended amending current law to revise the standards for approval and disapproval of deviation filings for workers' compensation rates to provide for disapproval of a filing if it results in premiums that are excessive, inadequate, or unfairly discriminatory. This bill implements the Joint Select Committee's recommendation. This should make it easier for an insurer to get a deviation approved by the Office of Insurance Regulation (OIR) which in turn should encourage insurers to write more policies or encourage more insurers to join the Florida market.

Another Florida law that allows some flexibility in rating is the "consent to rate" law that allows an insurer to use a rate in excess of its filed rate on any specific risk (employer) with the written consent of the insured. However, an insurer may not use excess rates pursuant to this law for more than 10 percent of its commercial insurance policies written or renewed in each calendar year (including workers' compensation). The Joint Select Committee recommended amending current law to exclude workers' compensation policies from the 10-percent limitation, if the policy issued takes an employer out of the Florida Workers' Compensation Joint Underwriting Association (FWCJUA). This bill implements that recommendation of the Joint Select Committee and provides an additional exclusion from the 10-percent limitation for insurers who write a policy for an employer who has been offered coverage by the FWCJUA. The exclusions provided by the bill are only valid for the first 3 years of the policy's coverage.

The Joint Select Committee recommended that OIR submit an annual report to the Legislature evaluating competition in the workers' compensation insurance market so the Legislature can determine whether any changes to the workers' compensation rating laws are warranted. The bill implements the recommendation of the Joint Select Committee.

Another recommendation of the Joint Select Committee was to require each workers' compensation insurer to notify OIR in writing of a significant underwriting change that materially limits or restricts the number of policies or premiums written in this state. This bill implements the Joint Select Committee's recommendation in this regard.

This bill has no fiscal impact on local government and nominal fiscal impact on the private sector. According to OIR, implementation of the bill will require a new FTE and a new web-based collection system.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

**STORAGE NAME:** h1241a.in.doc  
**DATE:** March 18, 2004

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. DOES THE BILL:

- |                                      |   |  |   |
|--------------------------------------|---|--|---|
| 1. Reduce government?                | Yes <input type="checkbox"/>            | No <input checked="" type="checkbox"/> | N/A <input type="checkbox"/>            |
| 2. Lower taxes?                      | Yes <input type="checkbox"/>            | No <input type="checkbox"/>            | N/A <input checked="" type="checkbox"/> |
| 3. Expand individual freedom?        | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/>            | N/A <input type="checkbox"/>            |
| 4. Increase personal responsibility? | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/>            | N/A <input type="checkbox"/>            |
| 5. Empower families?                 | Yes <input type="checkbox"/>            | No <input type="checkbox"/>            | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

This bill could be described as increasing government because it imposes requirements on workers' compensation insurers that do not exist in current law.

#### B. EFFECT OF PROPOSED CHANGES:

##### **JOINT SELECT COMMITTEE ON WORKERS' COMPENSATION RATING REFORM**

Pursuant to section 40 of chapter 2003-413, L.O.F., the Joint Select Committee on Workers' Compensation Rating Reform (Joint Select Committee) was created. The purpose of the Joint Select Committee was to study the merits of requiring each workers' compensation insurer to file individually its expense-and-profit portion of a rate filing, while permitting each insurer to use a loss-cost filing made by a licensed rating organization. The Joint Select Committee was also charged with studying rating options that would promote greater competition and would encourage insurers to write workers' compensation while protecting employers from rates that are excessive, inadequate, or unfairly discriminatory.

The Joint Select Committee met three times during October and November 2003. The Joint Select Committee heard testimony and received information from the Office of Insurance Regulation (OIR), the National Council on Compensation Insurance (NCCI), and interested parties.

The Joint Select Committee issued its report to the President of the Senate and the Speaker of the House of Representatives on November 18, 2003.<sup>1</sup> The report set forth the Joint Select Committee's findings based on the testimony received and its recommendations for amending existing workers' compensation ratings law. This bill implements all of the recommendations made by the Joint Select Committee.

##### **DEVIATIONS IN RATE FILINGS BY INSURERS**

One option to encourage insurers to write workers' compensation policies in Florida is by rate deviations. A rate deviation allows an insurer to charge the policyholder a rate higher than its filed rate. Current law permits insurers to file for approval of a rate deviation, by which the insurer proposes a uniform percentage increase or decrease to be applied to all rates charged or to rates for a particular class or classes of insurance. Deviations have been used very infrequently in Florida since 1996 when legislation (627.211, F.S.) revised the standards for approval and disapproval of deviation filings by the Department of Insurance (now, OIR).

In general, the standard for approving insurance rates in Florida and most states is that the rate may not be excessive, inadequate, or unfairly discriminatory.<sup>2</sup> In making this determination for a workers' compensation rate, OIR is required to consider the following factors:<sup>3</sup>

<sup>1</sup> A copy of the report can be obtained at: <http://www.flsenate.gov/data/committees/joint/jswr/finalreport.pdf>

<sup>2</sup> ss. 627.062(1), F.S. (2003); 627.151, F.S. (2003)

<sup>3</sup> s. 627.072, F.S. (2003). In addition to these factors, s. 627.151, F.S. states OIR must consider the factors in s. 627.062, F.S. that are generally applicable to other property and casualty insurance rate filings.

- The past loss experience and prospective loss experience within and outside the state;
- The conflagration and catastrophe hazards;
- A reasonable margin for underwriting profits and contingencies;
- Dividends, savings, or unabsorbed premium deposits allowed or returned by insurers to their policyholders, members, or subscribers;
- Investment income on unearned premium reserves and loss reserves;
- Past expenses and prospective expense, both countrywide and those specifically applicable to this state; and
- All other relevant factors, including judgment factors, within and outside of this state.

For rate deviations for workers' compensation insurance policies, the law requires OIR to consider "the impact of the deviation filing on the current market conditions including the composition of the market, the stability of rates, and the level of competition in the market," in addition to consideration of factors related to the actuarial soundness of the deviation filing, as are considered for rate filings generally. The OIR is specifically required to disapprove a deviation filing if it finds the resulting premiums "would adversely affect current market conditions including the composition of the marketplace, the stability of rates, and the level of competition in the market, or would result in predatory pricing."<sup>4</sup>

In contrast, the rate filing standards in Florida for other lines of property and casualty insurance, as well as for deviation filings for workers' compensation in most other states, provide for disapproval of rates that are excessive, inadequate, or unfairly discriminatory. This is primarily a function of the insurer's own loss-and-expense factors, although some state laws provide that rates cannot be considered excessive if a competitive market exists. Florida may be unique, or is at least in a distinct minority of states, in effectively using market conditions and the stability of rates as grounds for denying a rate decrease. This is more typically based on a finding that a rate is inadequate, defined in s. 627.062(2)(e), F.S., as being clearly insufficient, together with investment income, to sustain projected losses and expenses in the class of business to which they apply.

After hearing the testimony and reviewing the written materials, the Joint Select Committee recommended amending s. 627.211, F.S., to revise the standards for approval and disapproval of deviation filings for workers' compensation rates to be similar to the law, as it existed prior to 1996, to provide for disapproval of a filing if it results in premiums that are excessive, inadequate, or unfairly discriminatory.<sup>5</sup> Disapproval of a deviation filing should not be based on factors beyond the loss, expense, and related financial data of the insurer making the deviation filing.

This bill implements the Joint Select Committee's recommendations regarding approval and disapproval of rate deviations. The bill eliminates the subjective criteria of impact on the market, stability of rates and level of competition for approval of a rate deviation. This should make it easier for an insurer to get a deviation approved by OIR, which in turn should encourage insurers to write more policies or encourage more insurers to join the Florida market.

### **CONSENT TO RATE PROVISIONS**

Another Florida law that allows some flexibility in rating is the "consent to rate" law<sup>6</sup>, which allows an insurer to use a rate in excess of its filed rate on any specific risk (employer) with the written consent of the insured. However, an insurer may not use excess rates pursuant to this law for more than 10 percent of its commercial insurance policies written or renewed in each calendar year for any line of commercial insurance. Workers' compensation policies are considered commercial insurance. Thus, the 10-percent limit applies to those policies.

<sup>4</sup> s. 627.211(3), F.S. (2003)

<sup>5</sup> Report from the Joint Select Committee on Workers' Compensation Rating Reform, November 18, 2003, page 4.

<sup>6</sup> s. 627.171, F.S. (2003)

Section 627.311(5)(c)23., F.S. restricts the premium for policies written by voluntary market carriers taking policies out of the WCJUA to the WCJUA premium plus surcharge. The premium is restricted for the first 2 years of the policy written by the voluntary market carrier. The voluntary market carrier does not have to get approval for the premium even though it will be higher than the carrier's filed rate, and the premium will not be considered "excess premium."<sup>7</sup>

In recent months, an increasing number of employers have been forced to obtain coverage from the Florida Workers' Compensation Joint Underwriting Association (FWCJUA), the insurer of last resort. Premiums for coverage in the FWCJUA are typically three to four times as costly as premiums charged by insurers in the voluntary market. The 2003 workers' compensation act imposed a premium cap on some workers' compensation policies issued by the FWCJUA.<sup>8</sup> However, these policies are assessable, so if the premium turns out to be inadequate, policyholders will be assessed an additional amount to fund the deficit.<sup>9</sup> In fact, since the law was amended in 1993 to eliminate assessments against carriers in the voluntary market to fund FWCJUA deficits, all policies sold by the FWCJUA are subject to either assessment or increased renewal premiums to cover all claims and expenses of the FWCJUA.

Insurers may be willing to offer coverage to an employer in the FWCJUA at a premium above the insurers' filed rate on a consent-to-rate basis, but may not do so for more than 10 percent of an insurer's policies under current law. This limitation may prevent some employers from electing to purchase coverage from an insurer at a rate in excess of the standard rate, but would allow the employer to avoid having to purchase an assessable policy.

After hearing the testimony and reviewing the written materials, the Joint Select Committee recommended amending s. 627.171, F.S., to allow workers' compensation insurers to use rates in excess of their filed rates with the written consent of a policyholder, without being subject to the current maximum limitation of 10 percent of an insurer's commercial policies, for policies issued to employers who the insurer takes out of the FWCJUA.<sup>10</sup> Such employers should be given the option of knowingly and voluntarily accepting such coverage as an alternative to obtaining an assessable policy from the FWCJUA.

This bill implements the recommendation of the Joint Select Committee regarding workers' compensation policies that take an employer out of the FWCJUA. The bill also provides an exclusion from the 10-percent excess rate limitation for insurers who write a workers' compensation policy for an employer who has been offered coverage by the FWCJUA.<sup>11</sup> The exclusions provided by the bill are only valid for the first 3 years of the policy's coverage.

The effect of the consent-to-rate provisions in the bill should be to depopulate the FWCJUA. Depopulation will reduce the number of employers in the FWCJUA and increase the number of employers in the voluntary market. Insurers will have an incentive to write policies for employers currently in the FWCJUA or offered a policy in the FWCJUA, because they can charge a premium in excess of their filed rate for the policies they write for current and potential FWCJUA policyholders. Employers will have an incentive to obtain policies from a voluntary market carrier even though the premium is above the premium that may be charged to other policyholders of the carrier, because unlike FWCJUA policies, policies written by a voluntary carrier are not assessable. Thus, once the employer pays the premium, the carrier cannot seek additional monies from it. With an assessable FWCJUA policy, an employer pays the premium and can later be assessed an additional charge an unlimited number of times during the policy period, depending on the FWCJUA's financial situation.

### **ANNUAL REPORT BY OIR**

Florida is one of eight states that continues to use what is known as an "administered pricing" system under which a rating bureau or statistical agency files the full workers' compensation rate, subject to the

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<sup>7</sup> s. 627.311(5)(c)23, F.S. (2003)

<sup>8</sup> s. 627.311(5)(b)22.d., F.S. (2003)

<sup>9</sup> s. 627.311(5)(d)2., F.S. (2003)

<sup>10</sup> Report from the Joint Select Committee on Workers' Compensation Rating Reform, November 18, 2003, page 4.

<sup>11</sup> also known as a "keep-out" policy

prior approval of the insurance regulatory agency that, in Florida, is OIR. The full rate is then used by all workers' compensation carriers. In comparison, 37 states have adopted a "loss-cost" system under which a rating bureau or statistical agency files the portion of the rate that is needed to pay losses and, typically, the loss adjustment expenses associated with adjusting and defending specific claims, while each insurer must independently file a "loss-cost multiplier" that reflects the insurer's general expense-and-profit portion of the rate. The trend among states in recent years has been to move from an administered-pricing system to a loss-cost system and similar variations intended to rely more heavily on competitive market forces in the setting of workers' compensation rates. A loss-cost system seeks to promote competition among insurers and maximize benefits to consumers.

The Joint Select Committee determined the evidence presented to it did not demonstrate any obvious benefit or detriment as a result of changing from an administered-pricing (full rate) system to a loss-cost system. The director of OIR stated he knew of no evidence that clearly indicated that Florida would be better served under a loss-cost system as compared to the current system, and that any such change should not be made until the reforms of Senate Bill 50-A<sup>12</sup> have been in effect for at least 18 months and the insurance market has stabilized. This testimony and the fact that 37 states have adopted a loss-cost system, which is also recommended by the National Association of Insurance Commissioners as a way to promote price competition among insurers, led the Joint Select Committee to encourage the Legislature to explore such a modification at a time when the impact of SB 50-A, and the market stability that it should bring, allow for a more conducive environment to revisit such a topic.

To assist the Legislature in evaluating stability in Florida's market and a possible modification of workers' compensation rating laws in the future, the Joint Select Committee recommended requiring OIR to submit an annual report to the Legislature that evaluates competition in the workers' compensation insurance market.<sup>13</sup> The purpose of the annual report would be to determine if the state of the market ensures the availability of workers' compensation coverage and affordability of coverage at reasonable levels that are not inadequate, excessive, or unfairly discriminatory. The report would evaluate whether the current market structure, conduct, and performance are conducive to competition, based upon analysis and economic tests. Upon submission of the report, the Legislature would consider the findings of the report to determine whether any changes to the workers' compensation rating laws are warranted. The report would also document that OIR has complied with the provisions of s. 627.096, F.S., which requires OIR to investigate and study all workers' compensation insurers in the state and to study the data, statistics, schedules, or other information as it may deem necessary to assist in its review of workers' compensation rate filings.

The bill implements the recommendation of the Joint Select Committee regarding submission of an annual report to the Legislature by OIR. Currently, OIR is not required to submit a report on competition in the workers' compensation insurance market or to document that it has complied with s. 627.096, F.S.

### **NOTIFICATION OF UNDERWRITING CHANGE**

Another recommendation of the Joint Select Committee was to require each workers' compensation insurer to notify OIR in writing of a significant underwriting change that materially limits or restricts the number of policies or premiums written in this state.<sup>14</sup> This bill implements the Joint Select Committee's recommendation in this regard and gives OIR authority to adopt rules to administer the recommendation.

#### **C. SECTION DIRECTORY:**

Section 1: Adds s. 624.4315, F.S., requiring workers' compensation insurers to notify OIR of a significant underwriting change materially limiting or restricting the number of policies written.

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<sup>12</sup> Chapter 2003-412, L.O.F.

<sup>13</sup> Report from the Joint Select Committee on Workers' Compensation Rating Reform, November 18, 2003, page 4.

<sup>14</sup> Report from the Joint Select Committee on Workers' Compensation Rating Reform, November 18, 2003, page 5.

Section 2: Amends s. 627.171, F.S., providing a 3-year exclusion to the 10-percent limitation on consent to rate policies for workers' compensation policies written by an insurer to take an employer out of the WCJUA or to keep an employer out of the WCJUA.

Section 3: Amends s. 627.211, F.S., deleting a requirement for rate deviation consideration by OIR, and requiring an annual report by OIR to the Legislature evaluating the competition in the workers' compensation market.

Section 4: Amends s. 627.311, F.S., deleting a requirement for the premium charge for insurers taking policyholders out of the WCJUA and deleting a provision relating to excess premium for premium charges of insurers taking policyholders out of the WCJUA.

Section 5: Provides an effective date of July 1, 2004.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

#### EXPENDITURES BY OIR

	FY 2004-2005	FY 2005-2006	FY 2006-2007
Recurring for Salaries & Benefits for 1 FTE	\$87,535 (only needed if FTE is given)	\$89,149 (only needed if FTE is given)	\$90,795 (only needed if FTE is given)
Recurring for OPS (in lieu of 1 FTE requested)	\$125,000 (only needed if FTE is not given)	\$125,000 (only needed if FTE is not given)	\$125,000 (only needed if FTE is not given)
Nonrecurring for Expense/OCO Package For 1 FTE	\$4,561 (only needed if FTE is given)	0	0
Nonrecurring for OPS (creation of collection system)	\$650,000	0	0

OIR is requesting \$650,000 for the design and development of a web-based collection system for insurers to submit changes to their underwriting guidelines required by the bill. The cost estimate is based on similar systems. OIR will contract with a state information technology consultant to develop a collection system for insurers. Creation of a collection system will require staff time to meet with the selected vendor and development of business rules. OIR's systems may need to be re-engineered to accept a new database for the collection system.<sup>15</sup>

To comply with the report submission requirement of the bill, OIR is requesting one FTE (Senior Research Economist – SES) with recurring and non-recurring cost for FY 04/05 of \$92,096. This FTE

<sup>15</sup> Legislative Analysis from OIR dated February 10, 2004; Legislative Fiscal Analysis from OIR dated February 27, 2004.

will prepare statistical data relating to the workers' compensation market, complete the annual report, determine OIR's compliance with s. 627.096, F.S., evaluate trends in the economy and their affect on workers' compensation policy issuance practices, maintain statistics on national economic indicators that could affect the workers' compensation market, and provide guidance on economic strategies that carriers could utilize in their ratemaking methodologies. If OIR is not allocated the one FTE (Senior Research Economist at 15% above minimum), the OIR is requesting recurring OPS funds in the amount of \$125,000 to comply with the annual report requirements of the bill. OIR should be able to use the collection system needed to implement section 1 of the bill for the reporting required by section 3 of the bill.<sup>16</sup>

OIR will incur expenses associated with rulemaking.

**B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

1. Revenues:

None.

2. Expenditures:

None.

**C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:**

There may be administrative costs to insurers for providing notification to OIR of underwriting changes required under section 1 of the bill. However, any administrative cost should be nominal.

Employers should benefit from the bill, which creates more options for workers' compensation coverage in the voluntary market.

**D. FISCAL COMMENTS:**

None.

**III. COMMENTS**

**A. CONSTITUTIONAL ISSUES:**

1. Applicability of Municipality/County Mandates Provision:

This bill does not appear to require counties or municipalities to take an action requiring the expenditure of funds, does not appear to reduce the authority that counties or municipalities have to raise revenue in the aggregate, and does not appear to reduce the percentage of state tax shared with counties or municipalities.

2. Other:

None.

**B. RULE-MAKING AUTHORITY:**

The Financial Services Commission is given authority to adopt rules to administer the bill's requirement that workers' compensation insurers notify OIR of any significant underwriting change materially limiting or restricting the number of workers' compensation policies written.

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<sup>16</sup> Legislative Fiscal Analysis from OIR dated February 27, 2004.

OIR believes it may need rulemaking authority to implement the annual report required by the bill.<sup>17</sup>

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

**IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES**

On March 15, 2004, the Committee on Insurance adopted one amendment, and reported the bill favorably with a CS. The amendment amended s. 627.311, F.S., and revised the provisions governing the depopulation program of the WCJUA. Specifically, the amendment removed the restriction on the rate a workers' compensation carrier can charge a policyholder when it takes a policyholder out of the WCJUA or keeps a policyholder out of the WCJUA.

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<sup>17</sup> Legislative Analysis from OIR dated February 10, 2004.