

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 1926

SPONSOR: Banking and Insurance Committee and Senator Atwater

SUBJECT: Workers' Compensation

DATE: March 9, 2004      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Johnson</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**I. Summary:**

As required by the workers' compensation legislation enacted in 2003, SB 50-A, the President of the Senate and the Speaker of the House of Representatives appointed members to the Joint Select Committee on Workers' Compensation Rating Reform to study the merits of requiring each workers' compensation insurer to individually file 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.<sup>1</sup> The committee was also charged with studying other 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 bill incorporates the committee recommendations by making the following changes:

- Revises the criteria the Office of Insurance Regulation (OIR) must use in considering an application by an insurer for a rate deviation from the approved rate for worker's compensation filed by a licensed rating organization. In determining whether to approve or disapprove the deviation, the OIR would continue to consider standards related to the actuarial soundness of the rate and the financial condition of the insurer, but would no longer consider the impact of the deviation on the composition of the market, the stability of rates, and the level of competition of market.
- Requires each workers' compensation insurer to notify the OIR of a significant underwriting change that materially limits or restricts the number of policies or premiums written in Florida.

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<sup>1</sup> Section 40 of ch. 2003-412, L.O.F.

- Allows workers' compensation insurers to use rates in excess of their filed rates with the written consent of the policyholder for a period of 3 years, for employers the insurer takes or keeps out of the Workers' Compensation Joint Underwriting Association, without these policies being subject to the current maximum limitation of 10 percent of an insurer's commercial policies.
- Requires the OIR to submit an annual report to the Legislature which evaluates competition in the workers' compensation market in Florida, including the availability and affordability of coverage and whether the current market structure and performance are conducive to competition, based upon economic analysis. The purpose of the report is to assist the Legislature in determining whether changes to the rating laws are warranted.

This bill substantially amends sections 627.171 and 627.211 of the Florida Statutes.

The bill creates section 624.4315, Florida Statutes.

## **II. Present Situation:**

### **Availability and Affordability of Workers' Compensation Insurance**

In 2000, a survey ranked Florida as having the highest workers' compensation premiums in the country, and in 2001, the same survey ranked Florida second only to California. For 2002, the Department of Insurance authorized a 2.7 percent increase in rates, and subsequently, in 2003, the Office of Insurance Regulation (OIR) approved a 13.7 percent increase. In 2003, some workers' compensation carriers had indicated that they were not issuing new policies, renewing policies, or were tightening their underwriting requirements in response to a downturn in the economy and uncertainties in the market place. The number of policies issued by the Florida Workers' Compensation Joint Underwriting Association (JUA), the insurer of last resort, increased from 522 in 2000 to 1,179 as of February 2003, while the volume of written premium increased from \$5 to \$26 million during this period.

Due to growing concerns regarding the availability and affordability of workers' compensation insurance in Florida, Senate Bill 50-A was enacted in 2003 that substantially revised and addressed many provisions of the workers' compensation law including the availability and affordability of coverage and the exemption from coverage provisions. As a result of this legislation, rates for new and renewal policies that are effective on or after October 1, 2003, were reduced by 14.0 percent.

Restrictions on exemptions in the construction industry, enacted by Senate Bill 50-A, were expected to increase the JUA volume even further, prompting the Legislature to address affordability of JUA coverage by creating a new subplan with capped rates. The bill created subplan D in the JUA and capped premiums at 25 percent above the voluntary market premium for small employers and 10 percent above the voluntary market premium for charitable organizations meeting certain criterion.<sup>2</sup> However, the bill also required these policies to be

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<sup>2</sup> An employer with an experience modification factor of 1.10 and either employs 15 or fewer employees or is a charitable organization that is exempt from federal income taxes pursuant to s. 501(c)(3) of the Internal Revenue Code is eligible for subplan D under the provisions of s. 627.311(5)(d), F.S.

assessable, meaning that any deficit in the subplan must be funded by assessing those JUA policyholders for additional premiums. As of January 19, 2004, there were 1,800 policyholders in subplan D. On February 27, 2004, the JUA notified the OIR that subplan D incurred a deficit of \$9,864,901 in 2003. According to the JUA's projected annual financial statements, subplan D will incur a deficit of more than \$36 million as of December 31, 2004, if no additional funding is provided.

### **Overview of Worker's Compensation Rates and Premiums**

Workers' compensation *rates* are generally expressed as a specified dollar amount or "manual rate" per \$100 of an employer's payroll for a specified job or "risk" classification. The *premium* that an employer pays for workers' compensation is typically a function of: (1) the insurer's manual rate by job risk classification, (2) the employer's payroll, and (3) the employer's experience modification factor (experience mod).

In Florida, the National Council on Compensation Insurance (NCCI) is the rating organization that files rates on behalf of worker's compensation insurers in the state. The NCCI files more than 600 risk classifications that cover all types of employment. A manual rate per \$100 of payroll is developed for each risk classification that reflects the hazards associated with that particular job. This rate is multiplied by the employer's payroll to determine the unadjusted premium. This amount is further multiplied by the employer's experience modification factor to determine the adjusted premium. The experience mod is a factor that reflects the employer's loss history compared to other employers with similar risk characteristics.

### **Florida's Workers' Compensation Rating Law**

#### *Rates Must be Filed by Insurer or Rating Organization*

Florida law requires every workers' compensation insurer to file with the Office of Insurance Regulation (OIR) its rates and classifications which the insurer proposes to use.<sup>3</sup> However, the law allows an insurer to satisfy this obligation by becoming a member of a licensed rating organization which makes such filings on its behalf.<sup>4</sup> Currently, all workers' compensation insurers are members of the National Council on Compensation Insurance, the sole licensed rating organization in the state.

Florida's rating system that allows a rating organization to file a single, uniform rate for the entire industry, is similar to the approach that was taken by almost every state prior to 1980. The primary argument for this system is that excessive competition among insurance companies may cause carriers to set premiums too low, leading to insurer insolvencies. Since that time, most states have moved to "loss cost" rating systems that rely more heavily on market competition by requiring insurers to individually file their own expense and profit components of a rate filing while allowing a rating organization to file the loss costs portion of the rate.

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<sup>3</sup> Section 627.091(1), F.S. Formerly, workers' compensation rates were subject to the approval of the Department of Insurance, headed by the elected Treasurer and Insurance Commissioner. Effective January 7, 2003, all insurance rate regulation is within the jurisdiction of the Office of Insurance Regulation, headed by a director appointed by the Financial Services Commission, composed of the Governor and Cabinet. (chs. 2002-404 and 2003-261, L.O.F.)

<sup>4</sup> Section 627.091(4), F.S. (2003)

*Prior Approval of Rates*

Rate filings for workers' compensation must be approved by the OIR before they become effective.<sup>5</sup> This "prior approval" system is generally viewed as the most restrictive form of state insurance regulation, other than a state-promulgated rate. In comparison, the rating law in Florida for other lines of property and casualty insurance provides a "file and use" procedure under which a rate filing must be made at least 90 days before its is used, subject to approval or disapproval by the OIR, but which is deemed approved if not disapproved within this time period. Property and casualty insurers are also given a "use and file" option that allows an insurer to make a rate filing within 30 days after a rate is used, subject to the authority of the OIR to disapprove the filing and order refunds of any amount that is determined to be excessive.<sup>6</sup>

*Standards for Approval*

The standard for approving insurance rates in Florida and most states is that the rate may not be excessive, inadequate, or unfairly discriminatory.<sup>7</sup> In making this determination for a workers' compensation rate, the OIR is required to consider the following factors:<sup>8</sup>

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

*Methods Used to Adjust Premiums*

The current Florida law and the rating plans approved by the OIR allow for various ways for insurers to vary or adjust premiums. These methods include retrospective rating plans that adjust the premium at the end of the policy period to reflect the actual loss experience of the employer; dividend plans that allow insurers to provide refunds to participating policyholders; and premium credits for large deductible policies, approved safety programs, drug-free workplaces, and other standard credits. Florida's use of such aforementioned pricing methods appears to be consistent with their use in other states. However, certain other rating methods, such as deviations, that vary rates among insurers and employers are used less frequently in Florida, compared to other states.

*Limited Allowance for Rate Deviations by Individual Insurers*

Workers' compensation insurers that are members of a rating organization are required to adhere to the rate filing made on their behalf, but an insurer may apply to the OIR for a uniform percentage decrease or increase, known as a rate "deviation." Until 1990, the standards for reviewing a rate deviation filing were the same as that for a rate filing generally, i.e., the rate

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<sup>5</sup> Section 627.101(2), F.S. (2003)

<sup>6</sup> Section 627.062(2)(a), F.S. (2003)

<sup>7</sup> Sections 627.062(1) and 627.151, F.S. (2003)

<sup>8</sup> Section 627.072, F.S. (2003) In addition to these factors, s. 627.151, F.S., states that the OIR must consider the factors in s. 627.062, F.S., that are generally applicable to other property and casualty insurance rate filings

deviation would be approved unless the regulator determined that it resulted in rates that were excessive, inadequate, or unfairly discriminatory.

In 1990, the law was amended to discontinue the use of previously approved deviations and to prohibit any new rate deviations for an indefinite period. This was part of a major rewrite of the workers' compensation laws in 1990, which also required a 25 percent rate reduction to reflect the savings of the act.<sup>9</sup> This moratorium on rate deviations was applied for 2 years, 1990 and 1991. Afterwards, from 1992-1996, the Department of Insurance approved only a few deviations in limited circumstances.

In 1996, the Legislature tightened the standards for reviewing deviation filings which made it more difficult for an insurer to obtain approval, which remains the law today.<sup>10</sup> The OIR is specifically required to disapprove a deviation if it finds that the 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." In addition to considering the factors that apply to a rate filing generally, the OIR may consider the insurer's audited financial statements and whether the statements contain significant qualifications, an independent actuarial certification of the insurer's loss reserves and whether the reserves are above the midpoint or best estimate of the actuary's reserve range estimate, the historical profitability of the insurer, and whether the insurer has adequate reinsurance coverage.

The 1996 amendments imposed hurdles on an insurer seeking a rate deviation for workers' compensation, beyond those for a rate filing for other lines of insurance. These changes were apparently in response to concerns that if some insurers charged lower rates it could have a disruptive impact on the market, possibly driving smaller, domestic carriers out of business. Actuarial justification alone for a rate deviation filing is not sufficient, since the OIR must also determine that the rate will not adversely affect current market conditions.

The following table shows the history of approved rate deviations in Florida. Deviations were common in the 1980's, peaking in 1983-1985, when insurers representing approximately 50 percent of the market had rate deviations averaging about 15 percent. However, since 1990, rate deviations have been minimal to non-existent.

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<sup>9</sup> Chapters 90-201, s. 57, L.O.F.

<sup>10</sup> Chapters 96-405, L.O.F.; s. 627.211, F.S. (2003). The 1996 act, effective July 1 of that year, also prohibited any new deviation filings for the remainder of the year, until January 1, 1997.

Workers' Compensation Rate Deviations in Florida (All Downward)							
1981 - 2003							
Year	Number of Insurers	Market Share	Average Deviation	Year	Number of Insurers	Market Share	Average Deviation
1981	1	1.2%	10.0%	1993	0	0%	0%
1982	41	23.6%	12.8%	1994	0	0%	0%
1983	89	46.6%	14.2%	1995	3	unavail.*	11.6%
1984	122	54.0%	16.5%	1996	4	unavail.*	11.2%
1985	121	40.8%	15.9%	1997	3	unavail.*	11.6%
1986	79	18.3%	12.7%	1998	3	unavail.*	11.6%
1987	57	11.5%	10.4%	1999	3	unavail.*	11.6%
1988	55	11.3%	10.0%	2000	5	unavail.*	12.0%
1989	43	8.8%	10.3%	2001	4	unavail.*	10.8%
1990	0 (moratorium)	0%	0%	2002	3	unavail.*	10.8%
1991	0 (moratorium)	0%	0%	2003	3	unavail.*	8.3%
1992	0	0%	0%				

Source: For 1981-1997 data, Department of Insurance, Workers' Compensation Section Deviation Study (1996), cited in *Deregulation of Worker's Compensation Pricing*, Florida House of Representatives Committee on Financial Services (Oct., 1998). For 1998-2003 data, Office of Insurance Regulation.

\*Note: For the period 1995-2003, the deviations apply only to a limited portion of the company's total written premium, so the market share is not available. Generally, deviations were continued for former policyholders of group self-insurance funds acquired by authorized insurers.

### Consent to Rate Law

Another Florida law that allows flexibility in rating is the "consent to rate" law (s. 627.171, F.S.), which allows an insurer to use a rate in excess of its filed rate on any specific risk 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.

Senate Bill 50-A authorized workers' compensation insurers to take policies out of subplan D of the worker's compensation JUA at rates no greater than the subplan D rates for two years following the take-out. The act also provided that the premiums for these policies taken out of the JUA would not be considered excess rates for purposes of the count towards the "consent to rate" limitations under s. 627.171, F.S.

### The Joint Select Committee on Workers' Compensation Rating Reform

The President of the Senate and the Speaker of the House of Representatives appointed members to the Joint Select Committee on Workers' Compensation Rating Reform, pursuant to Senate Bill 50-A,<sup>11</sup> to study the merits of requiring each insurer to individually file 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 committee was also charged with studying other 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.

<sup>11</sup> Section 40, ch. 2003-412, L.O.F.

The Joint Select Committee on Workers' Compensation Rating Reform met three times during October and November of 2003. The committee heard testimony and received written information from the OIR, the National Council on Compensation Insurance (NCCI), and interested parties. The Joint Select Committee issued their report and recommendations in the form of a memorandum to the President of the Senate and the Speaker of the House of Representatives on November 18, 2003.

The committee concluded that a loss cost system should not be adopted at this time, stating:

*The evidence presented to the committee 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 the Office of Insurance Regulation stated that 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 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 NAIC as a way to promote price competition among insurers, leads us 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.*

However, the committee did make recommendations for changes to the rating law that may promote a greater degree of competition, as follows:

*Amend 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. 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.*

*Amend 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 Florida Workers' Compensation Joint Underwriting Association. 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. The Legislature should evaluate additional potential incentives to effect the depopulation of the FWCJUA, such as premium tax credits, Workers' Compensation Administrative Trust Fund assessment abatement, or Special Disability Trust Fund assessment abatement.*

*To assist the Legislature in evaluating stability in Florida's market, require the Office of Insurance Regulation to submit an annual report to the Legislature that evaluates competition in the workers' compensation insurance market. The purpose of this annual report is 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. The Legislature should consider the findings of this report to determine whether any changes to the workers' compensation rating laws are warranted. The report should 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.*

*Require each workers' compensation insurer to notify the Office of Insurance Regulation in writing of a significant underwriting change that materially limits or restricts the number of policies or premiums written in this state.*

### **III. Effect of Proposed Changes:**

**Section 1** creates s. 624.4315, F.S., to require each workers' compensation insurer to notify the Office of Insurance Regulation (OIR) of a significant underwriting change that materially limits or restricts the number of policies or premiums written in Florida. The bill authorizes the Financial Services Commission to adopt rules to administer this requirement. The Financial Services Commission is the agency head of the OIR for purposes of rulemaking under s. 20.121(3), F.S.

**Section 2** amends s. 627.171, F.S., which currently allows insurers to charge rates in excess of their filed rates with the written consent of the policyholder, for up to a maximum of 10 percent of the insurer's commercial policies in each calendar year. Under the bill, the 10 percent limitation would exclude any workers' compensation policy written for an employer who had coverage in the Florida Workers' Compensation Joint Underwriting Association (JUA) immediately prior to the insurer's policy or for an employer who had been offered coverage in the JUA but who was written a policy by the insurer in lieu of accepting the JUA policy. Currently, s. 627.311(5), F.S., authorizes an insurer to take subplan D policies out of the JUA, if the insured agrees, at the subplan D rates for a period of two years and provides that these policies do not count towards the 10 percent "consent to rate" limitation of s. 627.171, F.S. The subplan D rate is 25 percent above the voluntary market for certain small employers and 10 percent above the voluntary market for certain charitable organizations.

**Section 3** amends s. 627.211, F.S., relating to deviations from rates, to revise the criteria the OIR uses in considering an application for a rate deviation by an insurer above or below the approved rate filed by NCCI. (Historically, all rate deviation applications have been for rates below the NCCI rate.) The OIR would continue to use applicable ratemaking principles under ss. 627.062 and 627.072, F.S., and consider the financial condition of the insurer which includes an evaluation of financial and actuarial data and other factors the OIR deems relevant to the financial condition of the insurer. However, the section eliminates the requirement that the OIR evaluate the impact of the deviation on the current market conditions, including the composition of the market, the stability of rates, and the level of competition of market in approving or disapproving the deviation. Although the OIR is currently required to evaluate an application for a deviation in the context of current market conditions, the OIR is not required to conduct any



type of formal market analysis to use in evaluating applications for deviations. The section continues to provide the OIR the authority to approve a deviation if it does not endanger the financial condition of the insurer and to disapprove a deviation if the OIR finds that the resulting premium would be excessive, inadequate, or unfairly discriminatory, would endanger the financial condition of the insurer, or would result in predatory pricing.

The section is also amended to require the OIR to 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 market in Florida. The report would evaluate the availability and affordability of coverage and determine whether the current market structure, conduct, and performance are conducive to competition, based upon economic analysis. The purpose of the report is to assist the Legislature in determining whether changes to the rating laws are warranted. The report must also document the OIR's compliance with the provisions of s. 627.096, F.S., which requires the OIR to evaluate workers' compensation insurers and to study data as it finds necessary to assist in the evaluation of rate filings.

**Section 4** amends s. 627.311(5), F.S., to delete the current provision of the Florida Workers' Compensation Joint Underwriting Association (JUA) that authorizes workers' compensation insurers to take policies out of subplan D of the JUA at rates no greater than the subplan D rates for two years following the take-out, and that these premiums would not be considered excess premiums and, therefore, not count towards the 10 percent of policies limitation in s. 627.171, F.S. This is deleted due to the authority is provided in Section 2 of the bill which provides that the 10 percent limitation for the percentage of commercial policies written by an insurer excess of the insurer's filed rate (regardless of the premium charged), excludes policies written for an employer who had coverage in the JUA immediately prior to the insurer's policy or for an employer who had been offered coverage in the JUA but who was written a policy by the insurer in lieu of accepting the JUA policy.

**Section 5** provides that this act shall take effect July 1, 2004.

#### **IV. Constitutional Issues:**

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

**V. Economic Impact and Fiscal Note:****A. Tax/Fee Issues:**

None.

**B. Private Sector Impact:**

The bill may encourage greater competition in workers' compensation rates, by making it somewhat easier for an insurer to have a rate deviation approved by OIR. By eliminating consideration of factors related to the impact of the proposed rate deviation on market conditions, approval by OIR of a rate deviation may be more likely, assuming the insurer is able to actuarially justify the proposed rate. As such, employers may have the opportunity for lower premiums. Larger, national insurers are more likely to be able to justify a lower rate, which would detrimentally impact smaller insurers that may not be financially able to aggressively compete on rates.

By providing insurers greater flexibility on rates on policies taken out of the JUA, it is anticipated that more insurers will be motivated to take policies out of the JUA since any take-out policy could be issued at a rate in excess of the filed rate (if the insured agreed) and would not be subject to the 10-percent limitation for purposes of using excess rates for commercial policies for the first three years. A JUA policyholder would have the option of consenting to an excess rate, which may be lower than the JUA rate or, for subplan D policyholders, may be higher than the JUA rate but would not be an assessable policy.

Insurers may incur indeterminate administrative costs to compile and report significant underwriting changes to the OIR.

**C. Government Sector Impact:**

The Office of Insurance Regulation provided the information concerning the fiscal impact of the bill on the OIR:

- Since Section 1 of the bill requires insurers to report to the OIR significant underwriting changes that materially limits or restricts the number of workers' compensation policies or premiums written in this state, the OIR is requesting \$650,000 for the design and development of a web-based collection system to compile this data submitted by insurers. (The bill authorizes the Financial Services Commission to adopt rules to administer this reporting requirement.)
- Section 3 of the bill requires the OIR to prepare an annual report to the Legislature that evaluates competition in the workers' compensation insurance market and to document compliance with s. 627.096, F.S., relating to the evaluation of workers' compensation insurers and data. To comply with this section, the OIR is requesting one full-time position (Senior Research Economist – Select Exempt Service) with recurring and non-recurring cost for

FY 2004-05 of \$92,096. As an alternative, the OIR is requesting recurring OPS funds of \$125,000 to comply with the annual report requirements of this bill.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Amendments:**

None.

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This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

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