# Florida Office of Insurance Regulation

2006 Workers' Compensation Annual Report
January 2007

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# Executive Summary

Subsection 627.211(6), F.S., mandates the Office of Insurance Regulation (Office) provide an annual report to the President of the Senate and the Speaker of the House of Representatives which evaluates competition in the workers' compensation market in the state. The report is to contain an analysis of the availability and affordability of workers' compensation coverage and whether the current market structure, conduct and performance are conducive to competition, based upon economic analysis and tests. The report must also document the Office has complied with the provisions of Sec. 627.096, F.S., which require the office to investigate and study the data, statistics, schedules, or other information as it finds necessary to assist in its review of workers' compensation rate filings.

As mandated, the analysis presented in this report finds the following:

1. Based on a comparative analysis across a variety of economic measures, the workers' compensation market in Florida appears to be competitive.

    a. The workers' compensation market in Florida is served by a large number of independent insurers.

    b. None of the firms have sufficient market share to exercise any meaningful control over the price of workers' compensation insurance.

    c. The Herfindahl-Hirschman Index (a measure of market concentration) indicates that the market is not overly concentrated.

    d. There are no significant barriers for the entry and exit of insurers into the Florida workers' compensation market.

    e. Based on entries and voluntary withdrawals, it would seem that the Florida workers' compensation market is an attractive market for insurers.

2. Of the six most populous states, Florida is the largest market dominated by private market insurers, rather than a state sponsored residual market. This degree of private activity indicates that coverage should be generally available in the voluntary market. The residual market is small, suggesting that the voluntary market is absorbing the vast majority of demand.

3. There appear to be some continuing availability issues remaining in the voluntary market for certain employer groups such as small firms, new firms, and construction firms. Professional Employer Organizations (PEOs) continue to be a factor in making workers' compensation coverage available to these groups.

4. Affordability within the Florida Workers' Compensation Joint Underwriting Association, Inc. (FWCJUA), which is the residual market, has been an on-going

issue. Recently enacted legislative changes, Senate Bill 50-A in 2003 and House Bill 1251 in 2004, have addressed affordability in the voluntary and residual market respectively and both are having beneficial results.

5. With regard to the FWCJUA, the most immediate affordability issue is scheduled to occur in 2007. Currently, the tier 1 and tier 2 rates for most employers are more affordable than the previous sub-plans A, B and C. However, on January 1, 2007 the rates for tiers 1 and 2 are mandated to be "actuarially sound rates." Since the "below the line" assessments currently in effect end on July 1, 2007, there will be no funding mechanism for deficits occurring in tiers 1 and 2. This will necessitate conservative actuarial assumptions in ratemaking to prevent any deficits moving forward, implying upward pressure on rates.

6. The Office is in compliance with the requirements of Section 627.096, F.S.

# Purpose and Scope

Subsection 627.211(6), Florida Statues, mandates:

The office shall 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 insurance market in this state. The report must contain an analysis of the availability and affordability of workers' compensation coverage and whether the current market structure, conduct, and performance are conducive to competition, based upon economic analysis and tests. The purpose of this report is to aid the Legislature in determining whether changes to the workers' compensation rating laws are warranted. The report must also document that the office has complied with the provisions of s. 627.096 which require the office to investigate and study all workers' compensation insurers in the state and to study the data, statistics, schedules, or other information as it finds necessary to assist in its review of workers' compensation rate filings.

To accomplish these objectives, this report provides analysis of the following areas:

1.) The competitive structure of the workers' compensation market in Florida by comparing financial operating ratios, the numbers of entities and their respective market positions, and the number of entities entering and exiting the market.

2.) The availability and affordability of workers' compensation insurance in Florida; This includes an analysis of rate increases in Florida's admitted market, as well as the rating structure extant in the Workers' Compensation JUA.

3.) The market structure in Florida, which includes the market concentration in Florida compared with other states, the growth of leading companies, and entry and exit of carriers in Florida during 2006.

4.) Documentation of the Office's compliance with Section 627.096, Florida Statutes by investigating all workers' compensation carriers operating in Florida.

## Summary of the 2005 Annual Report

The 2005 Workers' Compensation Annual Report was the second report resulting from the statutory mandate, and concluded that the workers' compensation market is reasonably competitive. Specifically, the report showed that, during 2004:

- Florida's workers' compensation insurance market contained a large number of independent firms, none of which had enough market share to individually exercise market control in an uncompetitive nature.

- The Herfindahl-Hirschman Index indicated that Florida's market was not overly concentrated, and consequently exhibited a reasonable degree of competition.

- There were no significant barriers for entry and exit of insurers into and from the Florida workers' compensation insurance market.

- The residual market is small relative to the private market indicating that the voluntary market offers reasonable availability.

- There may be some small segments of the market that may have difficulty obtaining workers' compensation insurance including small firms and new firms.

The 2006 Workers' Compensation Annual Report continues to examine the workers' compensation insurance market from the same perspective. Last year's study introduced the Herfindahl-Hirschman Index (HHI) to compare Florida's market concentration versus the other 49 states. This year the report focuses the comparative analysis on the six most populous states. The five other states are: California, New York, Texas, Illinois, and Pennsylvania.

# Overview of the Workers' Compensation Insurance Market

To provide context for the analysis in this Annual Report, it is useful to compare Florida's workers' compensation insurance market to the workers' compensation markets in other highly populated states to compare availability, affordability, and competitiveness.

An initial challenge in structuring this analysis is that the six largest states have different regulatory structures regarding the provision of workers' compensation insurance. To address these differences, this report relies heavily on information from two sources.

One important organization that affects the nationwide pricing and rating structure is the National Council on Compensation Insurance, Inc (NCCI). This organization is the single largest source of information on workers' compensation, and is used as a major data source in this study. The National Association of Insurance Commissioners (NAIC) also collects financial data for admitted carriers, and the NAIC financial databases are also used throughout this report.

In 2005, the NCCI provided advisory ratemaking and statistical services in 33 states (including Florida) and the District of Columbia.[1] In 12 of the states, local ratemaking or advisory organizations supplied the information.[2] However, in the following six states and territories, the majority of workers' compensation insurance is provided through an exclusive state fund[3]:

- North Dakota
- Ohio
- Puerto Rico
- Washington
- West Virginia
- Wyoming

None of these states above are among the six most populous states used in the current analysis.

[1] NCCI, Annual Statistical Bulletin, 2005 Edition. Page 4.
[2] NCCI, Annual Statistical Bulletin, 2005 Edition. Page 4.
[3] NCCI, Annual Statistical Bulletin, 2005 Edition. Page 4.

## Self-Insurance Funds

In addition to the private market, composed of admitted carriers and the residual market evidenced by the FWCJUA, workers' compensation insurance in Florida is also provided through self-insurance funds.

"Self-Insurance" groups are a broadly defined group of entities that include group self-insurance funds, commercial self-insurance funds and assessable mutual organizations. By the early 1990s, self-insurance funds were a dominant part of the Florida workers' compensation insurance market, capturing more than half of the voluntary market. Legislative reforms in 1993 transferred the regulation of group self-insurance to the Department of Insurance, which later became the Office of Insurance Regulation (Office). This legislative change occurred concurrently with the formation of the Florida Workers' Compensation Joint Underwriting Association, Inc. (FWCJUA). Together, these two changes transformed the Florida workers' compensation insurance market as self-insurance funds began converting into insurance companies. In 1994 there were 35 defined self-insurance funds, but by 2000 there were only four of these entities. As in the 2004 report, there continues to be four group self-insurance funds in 2005:

- Florida Rural Electric Self-Insurers Fund
- Florida Retail Federation Self-Insurers Fund
- Florida Roofing, Sheet Metal & AC Fund
- Florida Citrus, Business & Industries Fund

All four of these entities are domiciled in Florida, write exclusively in Florida, and together these Self-Insurance Funds (SIFs) represent only 6.4% of the workers' compensation insurance market in Florida.

## Comparisons to Other Populous States

The first part of the analysis is to provide an overview of the relative size of the various state workers' compensation markets. In order to facilitate subsequent comparisons, the analysis focuses on the six most populous states, and excludes SIFs. In addition to Florida, the five most populous state used in this analysis are California, New York, Texas, Illinois and Pennsylvania.

As expected, there is a strong correlation between state population and workers' compensation insurance written premiums. Below are the six most populous states in rank order of most workers' compensation insurance written in 2005:

| Rank | State | 2005 Written Premium |
|---|---|---:|
| # 1 | California | $14.6 billion |
| # 2 | New York | $3.8 billion |
| **# 3** | **Florida** | **$3.7 billion** |
| # 4 | Texas | $2.7 billion |
| # 5 | Illinois | $2.5 billion |
| # 6 | Pennsylvania | $2.2 billion |

The table shows that there is not a direct correlation between state population and premium in the admitted market as Florida is, by population, the fourth largest state, yet ranked third in the most workers' compensation insurance premium written in 2005. When compared to 2004 results, some differences are evident. While Florida's total written premium rose modestly, from $3.4 billion to $3.7 billion as did New York's, premium in California actually declined from $16.1 billion to $14.6 billion and the premium in Texas remained almost unchanged at $2.7 billion.

### Number of Entities

Another indication of the competitiveness of the market is the number of different insurance companies writing in the state. For the six large states, the number of insurance companies writing workers' compensation insurance varied between 213 and 289. As shown below, Florida ranked in the middle with 245 insurance companies writing workers' compensation insurance.

| Rank | State | Entities |
| --- | --- | ---: |
| # 1 | Illinois | 289 |
| # 2 | Pennsylvania | 280 |
| # 3 | Texas | 252 |
| **# 4** | **Florida** | **245** |
| # 5 | New York | 229 |
| # 6 | California | 213 |

By this measure, Florida has a comparable number of entities operating within its borders relative to other populous states.

## Written Premium per Entity

Another useful comparison measure is the average amount of premium per entity. As shown below, Florida ranks in the middle at third in the average premium per insurance entity among the six most populous states:

| Rank | State | Premium per Entity |
| --- | --- | ---: |
| # 1 | California | $68.5 million |
| # 2 | New York | $16.5 million |
| **# 3** | **Florida** | **$15.2 million** |
| # 4 | Texas | $10.8 million |
| # 5 | Illinois | $8.7 million |
| # 6 | Pennsylvania | $8.0 million |

This comparison suggests there are fewer "small" competitors in Florida than are present, on average, in the other most populous states, although except for California, the data is comparable. The analysis above closely mirrors the first table showing the largest voluntary workers' compensation markets in the country. A more sophisticated measurement of the competitive aspects of state market structures is to use the Herfindahl-Hirschman Index (HHI).

## Herfindahl-Hirschman Index Comparison by State

The Herfindahl-Hirschman Index (HHI) is a calculation constructed to determine market concentration. This ratio first appeared in A.O. Hirschman's *National Power and Structure of Foreign Trade* published in 1945. Hirschman limited its usage to export/import trade. O.C. Herfindahl applied the concentration index to industries in his Ph.D. dissertation in 1950.

The calculation is straightforward. The measured market share of every company operating in the market is squared. The highest index value is then defined as 10,000 (100% squared --- a monopoly), and the lowest outcome is close to zero. The U.S. Department of Justice (DOJ) uses this index when researching acquisitions and mergers for compliance with the anti-trust legislation most notably, the Sherman Anti-trust Act of 1890. DOJ considers a result of less than 1,000 to be a “competitive” marketplace. Results of 1,000 to 1,800 are considered “moderately concentrated.” Results of greater than 1,800 are considered “highly concentrated,” and consequently, not very competitive. These ranges are not necessarily relevant to lines of insurance business, but serve as a benchmark.

For the purposes of this report, comparing the HHI among states is difficult as the data for the self-insurance trust funds for other states must be calculated. Moreover, some states have their state funds reporting to the NAIC. Some states, such as Florida with its Florida Workers’ Compensation Fund, do not. The report includes a calculation of Florida’s HHI without the SIFs included to be comparable to the other populous states.

The state ranked # 1 is the most concentrated, and conversely, least competitive, all else equal.

| Rank | State | HHI |
|---|---|---:|
| # 1 | New York | 1,909 |
| # 2 | California | 1,865 |
| # 3 | Texas | 841 |
| **# 4** | **Florida** | **404** |
| # 5 | Illinois | 200 |
| # 6 | Pennsylvania | 165 |

With an HHI of 404 in 2005, the Florida workers’ compensation insurance market ranks among the more competitive within the sample states. Within this state sample group, New York and California are not considered competitive markets as each has an entity that holds roughly 40% of the market share.

## Dominant Firms and Competition

Another interesting comparison is to review the largest competitor in each of the six most populous states, to determine if there is a "dominant firm." Below are the leading workers compensation carriers in 2005 for the six most populous states, and their market shares within those states:

| State | Leading Carrier | *Market Share* |
|---|---|---:|
| New York | State Insurance Fund | *42.3%* |
| California | State Comp Insurance Fund | *42.1%* |
| Texas | Texas Mutual Insurance Co. | *25.8%* |
| **Florida** | **Bridgefield Employers Inc.** | ***14.2%*** |
| Illinois | Commerce & Industry Insurance Co. | *6.5%* |
| Pennsylvania | Old Republic Insurance Co. | *4.7%* |

The most obvious difference between the states is the relative market size of the state sponsored workers' compensation insurance entity. In New York, California and Texas, the entity with the largest market share is the state sponsored entity, while in Florida, Illinois and Pennsylvania, the largest market share is not only considerably less but is also held by a private insurer. Put another way, Florida is the largest state in the country for which the private market insurance industry is the dominant provider of workers' compensation insurance.

Bridgefield Employers Inc.'s business in Florida has the largest market share of any private insurer in the six most populous states. However, it should be noted that at 14.2% of the market (which would be 13.0% if the SIFs and Workers Comp JUA were included) it would not appear that this is enough of a market share to create an uncompetitive marketplace.

### Profitability and Loss Ratios

Another goal of this report is to analyze the profitability of the Florida workers' compensation insurance marketplace. One measure that is reported on a state-by-state basis, in the statutory financial statements filed with the NAIC, is the loss ratio, which is calculated as the total losses divided by earned premium for each state for the line of business. The purpose of this ratio is two-fold: to assist in determining profitability, and, indirectly, to address premium sufficiency.  Among the six most populous states, the aggregate loss ratios for 2005 are:

| Rank | State | *Loss Ratio* |
|---|---|---:|
| # 1 | Illinois | *55.2%* |
| # 2 | New York | *55.1%* |
| # 3 | Pennsylvania | *45.5%* |
| **# 4** | **Florida** | ***39.9%*** |
| # 5 | Texas | *37.0%* |
| # 6 | California | *36.8%* |

While this is a very rough measure of profitability, it does show that for the workers' compensations markets in 2005, Florida's profitability compares favorably with  the other most populous states.

Adding reported defense cost and containment expense (DCC) to the loss ratio above provides a somewhat broader measure of profitability (or rate sufficiency). Companies with a ratio of 100%, by definition, are not considered profitable in their core business *(note that this is with respect to underwriting and does not consider investment income)*. The combined aggregate ratio data are as follows:

| State | *DCC Ratio* | *DCC+Loss Ratio* |
|---|---:|---:|
| Illinois | *4.6%* | *59.8%* |
| New York | *2.5%* | *58.0%* |
| Pennsylvania | *4.4%* | *49.9%* |
| **Florida** | ***5.9%*** | ***45.8%*** |
| California | *3.8%* | *40.6%* |
| Texas | *2.8%* | *39.7%* |

Because loss amounts generally greatly exceed the direct cost and containment expenses, it is not surprising that this list closely mirrors the list of states with the highest loss ratio. In fact, other than California and Texas swapping positions, the ranking is identical to the list that had the DCC ratios excluded. Although the differences are marginal, it should be noted that Florida has a DCC ratio higher than the other five most populous states, and almost double that of New York and Texas.

## Overview of Florida's Largest Carriers

In 2005, 250 companies reported writing workers' compensation business in the state of Florida, which is an increase of 16 companies over the 234 companies reporting writing workers compensation insurance in 2004.[4] The 10 largest companies were:

| Rank | Company | Written Premium | % of Market | CUM % |
|---|---|---|---|---|
| # 1 | Bridgefield Employers | $527,276,368 | 13.0% | 13.0% |
| # 2 | Commerce & Industry | $244,678,057 | 6.0% | 19.0% |
| # 3 | FCCI | $224,400,221 | 5.5% | 24.6% |
| # 4 | Zenith | $219,488,971 | 5.4% | 30.0% |
| # 5 | The Florida Retail Fed. SIF | $173,654,834 | 4.3% | 34.3% |
| # 6 | Zurich American | $107,981,617 | 2.7% | 36.9% |
| # 7 | First Commercial | $105,406,854 | 2.6% | 39.5% |
| # 8 | Amcomp Preferred | $103,320,177 | 2.5% | 42.1% |
| # 9 | American Home Assurance | $99,093,913 | 2.4% | 44.5% |
| # 10 | FFVA Mut Ins. Co. | $84,171,341 | 2.1% | 46.6% |
| | **TOTAL IN FLORIDA** | **$4,054,086,292** | | |

As was the case in last year's report, the 10 largest companies wrote almost 47% of the workers' compensation insurance premium in Florida in 2005. All of the companies with the exception of The Florida Retail Federation SIF (organized as a self-insurance fund), and FFVA Mutual (organized as a mutual company) are property & casualty companies, organized as stock companies. Of the top 10, two sets of companies are affiliated. Commerce & Industry and American Home are both in the AIG group. Bridgefield Employers is owned by Liberty Mutual which also administers the Florida Retail Fund

[4] This includes the Florida Workers' Compensation JUA.

SIF. Six of the top ten writers are domestics[5], while the foreign corporations have home offices in New York (three), and California.[6]

## Diversification

Another area of analysis is the diversification of Florida's leading providers of workers' compensation insurance. Diversification, both by geography and by line of business can present a different picture of an insurance company than merely examining a particular line of business within a particular state.

## Geographic Distribution

Although workers' compensation loss rates are likely more homogeneous geographically than other lines, such as homeowners' insurance, industry analysts generally believe that it is important for companies to have some geographic diversification within their book of business. Especially for workers' compensation insurance, where coverage and benefits are mandated by state legislatures, an understanding of the geographic distribution of premium can again provide a fuller understanding of the companies. For the top 10 companies presented above, the states where the companies had a majority of their business were calculated. The five leading states for each company are listed below:

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[5] Domestics and their locations include: Bridgefield Employers (Lakeland, FL), FCCI Ins. (Sarasota, FL), The Florida Retail Sales Federation (Lakeland, FL), First Commercial (Miami Lakes, FL), Amcomp Preferred (North Palm Beach, FL), and FFVA Mutual Insurance (Maitland, FL).

[6] Foreign companies and their locations include: Commerce & Industry (New York, NY), Zenith Ins. (Woodland Hills, CA), Zurich American (New York, NY), and American Home Assurance (New York, NY).

| Company | State 1 | State 2 | State 3 | State 4 | State 5 | All Other |
|---|---|---|---|---|---|---|
| Bridgefield Employers | **FL 100%** | | | | | 0% |
| Commerce & Industry | **FL 14%** | NY 13% | GA 9% | CA 8% | IL 6% | 49% |
| FCCI | **FL 79%** | GA 9% | IN 3% | NC 2% | IL 1% | 6% |
| Zenith | **FL 48%** | CA 42% | TX 2% | NC 1% | PA 1% | 0% |
| Florida Retail Fund | **FL 100%** | | | | | 0% |
| Zurich American | NY 17% | **FL 13%** | CA 7% | TX 7% | IL 3% | 52% |
| First Commercial | **FL 100%** | | | | | 0% |
| Amcomp Preferred | **FL 91%** | IN 6% | GA 2% | VA 1% | KY 0% | 0% |
| American Home Assurance | NY 23% | CA 17% | MA 9% | **FL 5%** | TX 4% | 43% |
| FFVA Mutual Ins. Co. | **FL 88%** | GA 11% | AL 0% | KY 0% | MS 0% | 0% |

In contrast to other market studies conducted by the Office for other lines of business, there is less geographic diversification among the top writers. Instead, five companies write almost exclusively in Florida. The leading states for these carriers other than Florida include: Georgia, California, Illinois and New York. Florida represents the state with the largest book of business for eight of these ten companies. For the two companies that do not write most of their workers' compensation insurance in Florida, both write the most workers' compensation insurance in New York.

## Line of Business Distribution

This report also examined the other lines of business written by the top 10 workers' compensation insurance carriers. For presentation purposes, the lines of business are segmented into six categories: 1) Workers' Compensation[7], 2) Other/Products Liability[8], 3) Commercial Multi-Peril[9], 4) Automobile (includes Private Passenger & Commercial for both damage and liability)[10], and 5) All Other:

[7] Annual Statement Exhibit of Premiums and Losses, Line 16.
[8] Annual Statement Exhibit of Premiums and Losses, Lines 17 & 18.
[9] Annual Statement Exhibit of Premiums and Losses, Lines 5.1 & 5.2.
[10] Annual Statement Exhibit of Premiums and Losses, Lines 19.1, 19.2, 19.3, 19.4, 21.1 & 21.2.

| Company | Workers' Comp | Other/Product Liability | Commercial Multi-Peril | Auto | All Other |
|---|---|---|---|---|---|
| Bridgefield Employers | **100%** | 0% | 0% | 0% | 0% |
| Commerce & Industry | **93%** | 2% | 0% | 5% | 1% |
| FCCI | **89%** | 1% | 0% | 10% | 0% |
| Zenith | **100%** | 0% | 0% | 0% | 0% |
| Florida Retail Fund | **100%** | 0% | 0% | 0% | 0% |
| Zurich American | **33%** | 33% | 4% | 12% | 18% |
| First Commercial | **90%** | 1% | 0% | 10% | 0% |
| Amcomp Preferred | **100%** | 0% | 0% | 0% | 0% |
| American Home Assurance | **36%** | 20% | 1% | 14% | 29% |
| FFVA Mutual Ins. Co. | **100%** | 0% | 0% | 0% | 0% |

The table shows that eight of the ten top writers of workers' compensation insurance focus on this specific line of business having nearly 90% of their total book of business in that line.  Other lines of business commonly written include auto, commercial multi-peril, and other/product liability.  Zurich American is unique in having a more diverse book of business which includes lines such as fire & allied lines, ocean and inland marine, medical malpractice and earthquake insurance..

# Trends in Florida’s Workers’ Compensation Insurance Market

### Entry and Exit from the Workers’ Compensation Market

Another measure of the competitiveness of a marketplace is the ease of entry and exit from the market.

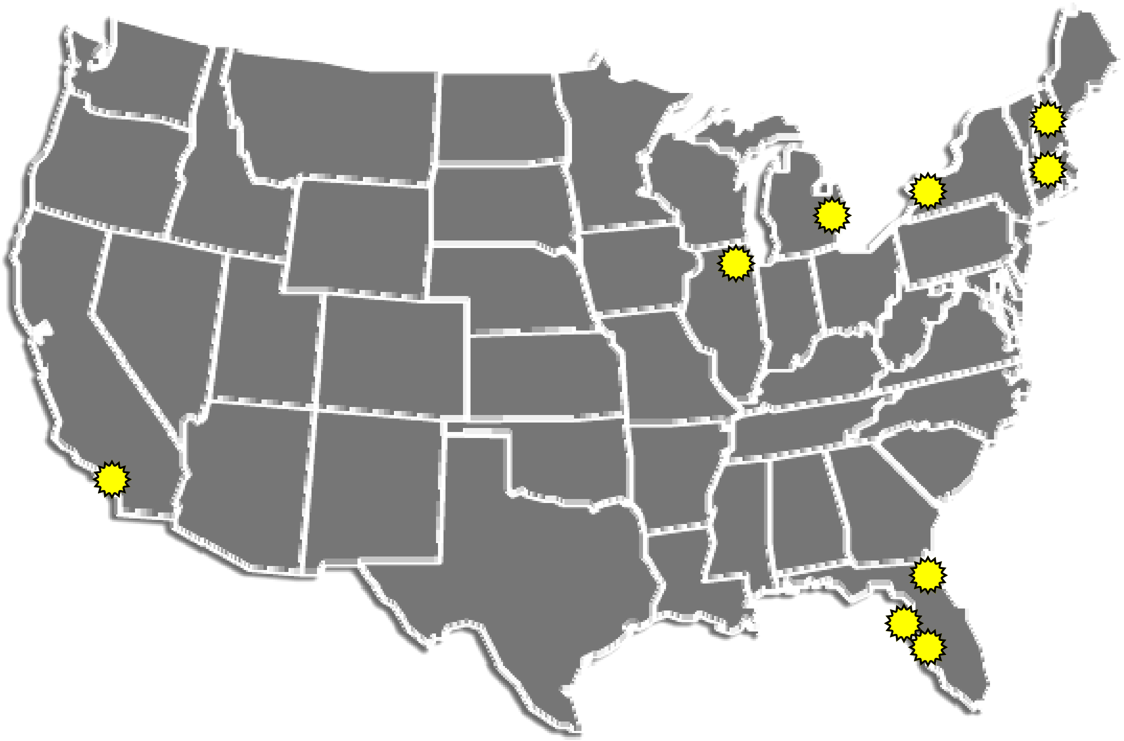
The data suggest the market has remained stable. As of December 31, 2004, Florida had 398 entities with a certificate of authority, while there were 25 miscellaneous entities. Of these, 230 companies in the voluntary market along with the four self-insurance funds and the Florida Workers’ Compensation JUA were actively writing business. As of December 31, 2005, Florida had 397 entities with a certificate of authority, with 23 miscellaneous entities. These 397 entities included 391 property & casualty companies, 1 reciprocal, 1 residual market company (the Florida Workers’ Compensation JUA), and 4 group self-insurance funds. Of these, 245 companies in the voluntary market along with 4 self-insurance funds, and the Florida Workers’ Compensation JUA were actively writing business.[11]

All 10 of the new entities were property and casualty companies. Of the 10, four were domiciled in Florida. The other six companies were domiciled in California, Connecticut, Michigan, New Hampshire, New York, and Illinois. The new entities that were accepted to operate in the Florida workers’ compensation insurance market in 2005 were:

- Cherokee Insurance Co.
- First Non-Profit Insurance Co.
- Insurance Company of the West
- Main Street American Assurance Co.
- Memic Indemnity Co.
- NGM Insurance Co.
- Nova Casualty Insurance Co.
- Quadrant Indemnity Co.
- Southern Eagle Insurance Co.
- Sunz Insurance Co.

[11] As of December 31, 2003, Florida had 407 eligible regulated entities in the workers’ compensation market, of which 382 had certificates of authority, while there were 25 other miscellaneous entities. Of these entities, 237 companies in the voluntary market and 4 self insurance funds were actively writing business.

As the map below shows, the 10 new workers' compensation insurers are domiciled in nine (9) different cities in seven (7) different states. This is potentially beneficial to Florida's economy, as well as the market itself, as six (6) companies represent investment capital coming from outside the region, and that capital is roughly evenly distributed throughout the United States:



During the same period, a number of entities did leave the market. In 2005, two (2) companies that had a license to write workers' compensation insurance had their certificate of authority suspended;[12] ten (10) companies that had a license to write workers' compensation insurance had their certificate of authority surrendered.[13] However, this may be misleading as all but one company (Florida Preferred) were merged into other companies. One (1) company continues to have an active certificate of authority, but specifically withdrew its authority to write workers' compensation insurance in Florida.[14] These data suggest that there is freedom to both enter and exit the

[12] Providence Washington, and Union American.
[13] American & Foreign, American Protection, Connecticut Indemnity, Fire & Casualty of CT, Florida Preferred, Globe Indemnity, Gulf Insurance, Phoenix Assurance, Royal Insurance, Safeguard.
[14] Service Insurance Company.

market, again supporting the competitive aspects of the Florida workers' compensation insurance market.

## Statistical Trends

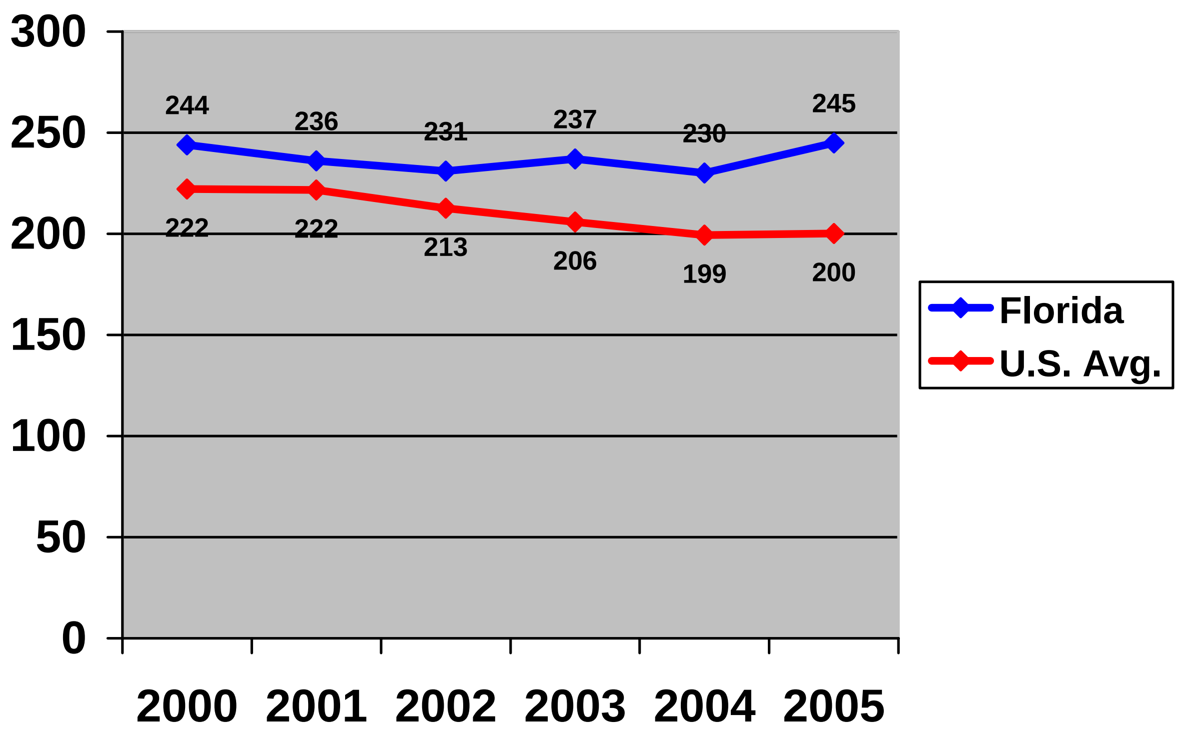
The analysis to this point compares the workers' compensation market in Florida to the markets of the other most populous states in terms of total amount of premium, number of entities operating in the state, premium per entity, and various financial ratios. Generally, Florida compares favorably to other states, having a significant number of entities in the state, low loss ratios, and a low loss + defense containment cost ratio. Further, Florida is a "competitive" market as measured by the Herfindahl-Hirschman Index (HHI).

However, another aspect of the market that is important to examine are trends over the last five years to determine if Florida's market is consistently moving in the right direction as a vibrant market and to compare these trends to the other comparison states. For the comparative purposes here, the four self-insurance trust funds were again excluded.

## The Nature of the Market

One of the first indicators of the robustness of the market is to simply look at the number of companies actively engaged in the market. The chart below shows the number of entities writing in Florida from 2000 through 2005 and compares that to the average number of entities writing in the voluntary market across the remaining states.

**Entities Writing Work Comp Insurance Premium by Year**
**Florida vs. U.S. state average**




Over the last five years the number of writers in Florida has remained relatively stable, although 15 new writers appeared on the list in 2005. Meanwhile, on the national level, the number has steadily decreased, although appears to have remained constant between 2004 and 2005. From a state perspective, the split has become even wider --- in 2000 there were roughly 22 more insurance companies writing in Florida than the average U.S. state. In 2005, the difference was 45 companies.

Another area to consider is the overall growth of the workers' compensation insurance market. Like other sectors of the insurance industry, with a growing population, and a growing economy, it is not surprising to have an increase in the overall amount of insurance written:

**Workers' Compensation Insurance Written Premium**
**(Expressed in $ Billions)**

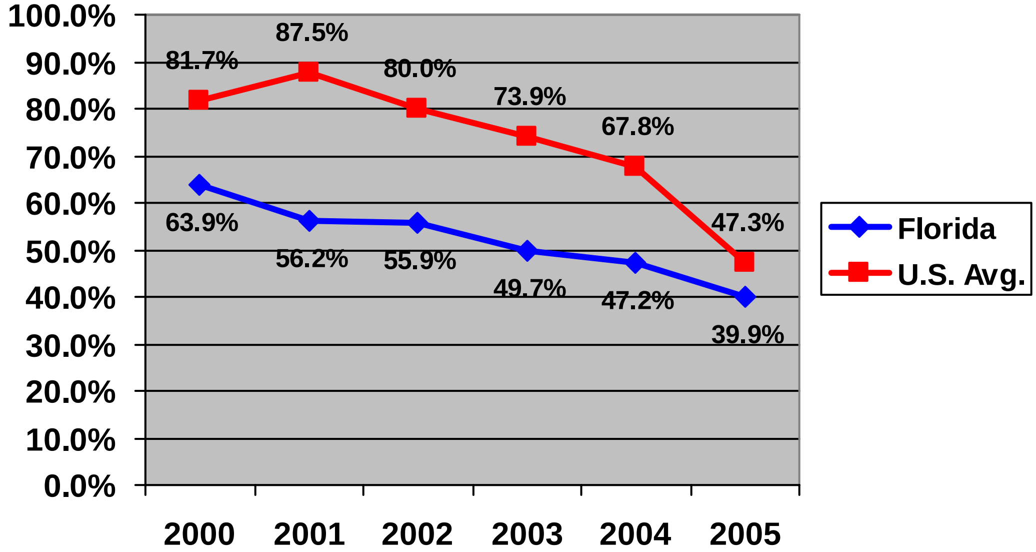
| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| **Florida** | $2.66 | $2.78 | $2.97 | $3.19 | $3.35 | $3.72 |
| **Avg. U.S. State** | $0.65 | $0.74 | $0.84 | $0.95 | $1.02 | $1.10 |

From 2000 to 2005 the increase in the total workers' compensation insurance premium paid for the average U.S. state has increased 69%, which outdistances the 40% increase in Florida, even though Florida's working population grew at a rate much faster than the national average. Once again, this may not include a complete picture of the entire market as it only includes activity in the voluntary market, but it is a broad indication of what is transpiring in the workers' compensation market.

**Financial Aspects of the Market:**
This report also reviews the financial statistics to determine trends in loss ratios and loss + defense containment cost ratios. This indirectly measures the profitability, competitiveness, and premium adequacy of the market. As shown in the national comparisons, in 2004 Florida had a much lower than average loss ratio, although this gap narrowed significantly in 2005.

The trends in the loss ratios are shown below:

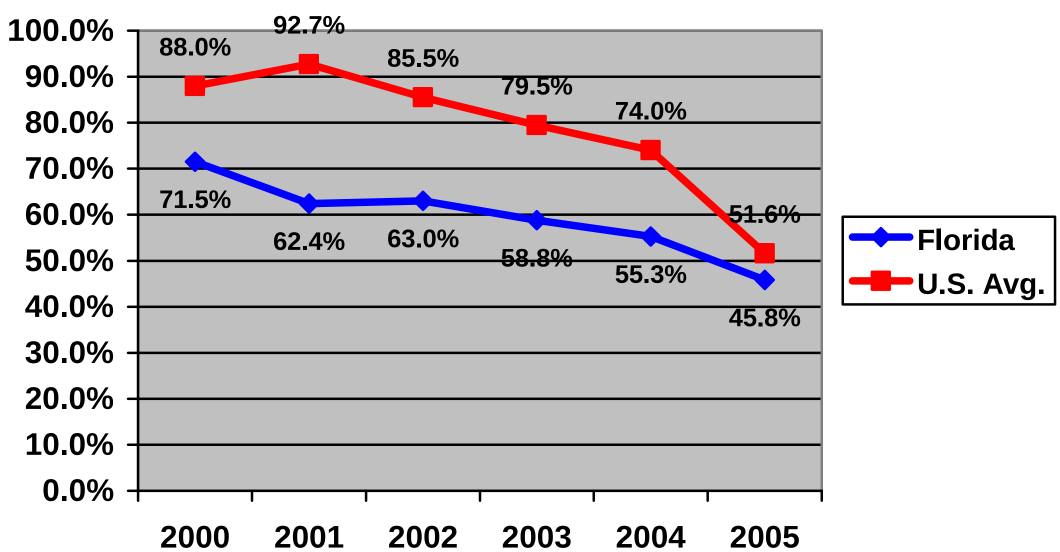
## Work Comp Insurance Loss Ratios
## Florida vs. U.S. state average[15]




*Source: NAIC Annual Statements*

As a broader measure, the loss + defense and containment cost ratio shows a similar pattern:

## Work Comp Insurance Loss + DCC Ratios[16]




*Source: NAIC Annual Statements*

[15] This includes companies that reported a positive amount of written premium. The Loss Ratio component included paid losses divided by earned premium.
[16] This includes companies that reported a positive amount of written premium. The Loss Ratio component included paid losses divided by earned premium.

## Workers' Compensation Rates

A new law passed during the 2003 Legislative Session (known as SB 50-A) continues to dramatically impact Florida's workers' compensation insurance rates. Some of these reforms included a reduction in attorneys' fees, tightening construction industry requirements, doubling impairment benefits for injured workers, increasing the medical fee schedule, and eliminating the Social Security disability test.[17]

Consequently, workers' compensation rates have declined in Florida, which is atypical for the rest of the country. In 2003, the Office approved a 14% rate reduction, with an additional reduction of 5.2% in 2004. In 2000, Florida had the highest workers' compensation insurance rates in the country. By 2004, Florida had fallen to fifth.[18]

In 2006, the Commissioner approved a rate reduction of 15.7% to become effective January 1, 2007. When implemented, the reductions for the five major industry groups will be as follows:

| Industry Sector | Rate Adjustment | Cumulative since 2003 |
|---|---|---|
| **Contracting** | **- 16.0%** | **- 41.6%** |
| **Goods & Services** | **- 15.3%** | **- 40.2%** |
| **Manufacturing** | **- 15.4%** | **- 36.6%** |
| **Miscellaneous** | **- 15.7%** | **- 44.6%** |
| **Office & Clerical** | **- 16.2%** | **- 37.5%** |

This rate reduction is the fourth rate reduction since the 2003 workers' compensation reforms, giving Florida businesses a cumulative decrease of 40.6%. In a press release dated October 31, 2006, Commissioner McCarty remarked that the cumulative rate decreases was "nothing short of remarkable."

There have been two primary reasons for the continued rate reductions. The national data continue to show the claims frequency for workers' compensation claims have been

[17] "Florida Cracks Down on Construction Sites Without Workers' Compensation Insurance," Best Wire, 8/2/2005, which utilizes information from an earlier article in BestWire, July 15, 2003.
[18] "Workers' Comp Rates Expected to Drop," Palm Beach Post, 08/30/2005. The article specifically quotes Lori Lovgren, State Relations Executive for NCCI.

decreasing faster than medical costs have increased.[19] Another reason is the continued crackdown on companies fraudulently avoiding payment for workers' compensation insurance.

During the summer of 2005, state investigators for the Florida Department of Financial Services made a total of 848 site visits that resulted in 100 stop-work orders issued for Florida businesses.[20] Under a stop-work order, companies must cease doing business until they have obtained workers' compensation insurance for all employees and paid civil penalties in the order of 1.5 times the premiums avoided. This requires a significant number of employers to increase the number of workers covered under workers' compensation insurance, and raises the premium collected, which can result in an overall premium rate decrease per employee.

## Florida's Workers' Compensation JUA

One of the most significant indicators of an availability problem in an insurance market is the size of the residual market mechanism. In Florida, the Florida Workers' Compensation Joint Underwriting Association, Inc. (FWCJUA) is the market of last resort. Only employers that cannot find coverage in the voluntary market are eligible for coverage in the FWCJUA. Thus, the size of the FWCJUA is a measure of availability of coverage in the voluntary market.

The Florida Workers' Compensation Insurance Plan (FWCIP) was the residual market for Florida until the FWCJUA was created on January 1, 1994. All insurance companies writing workers' compensation in Florida funded the FWCIP. If there was a deficit in the FWCIP, then those workers' compensation carriers were assessed to cover the deficit. In 1993 the FWCIP issued 48,430 policies with written premiums of $328 million. The FWCJUA in contrast has varied from 13,933 policies to 522 policies, with written premium varying from $73 million to $5 million. In 2005, the FWCJUA had 4,483 policies on its book and generated $77.5 in written premium. The FWCJUA's written

[19] "Workers' Comp Rates Expected to Drop," Palm Beach Post, 08/30/2005.
[20] "Florida Cracks Down on Construction Sites Without Workers' Compensation Insurance," Best Wire, 8/2/2005.

premium as a percent of total market has not exceeded 2% since 1995 and has been below 1% for most years.

The FWCJUA was created to be self-sufficient with no ability to obtain funding from the voluntary market. The only funding mechanism for any shortfall is through the assessment of FWCJUA policyholders to fund any deficits. Assessing policyholders after their policy has expired can create a financial hardship for the policyholders and should be avoided if possible. Thus, the FWCJUA Board has a goal of avoiding assessments and this has contributed to the level of rates and surcharges.

There are surcharges in addition to the rate differential that affect the total premium paid by FWCJUA policyholders. There was a 99% surcharge applied to Sub-plan "C" premiums in excess of $2,500, an Assigned Risk Adjustment Program (commonly known as, “ARAP”) surcharge for experience rated policies and a $475 flat surcharge added to every policy. The creation of Tiers 1, 2 and 3 by HB 1251 has resulted in a restructuring of the rates and surcharges used by the FWCJUA.

Currently, the premium for tier 1 is 25% above the voluntary rates, tier 2 is 50% above voluntary and tier 3 is 170% above (2.70 times the voluntary rates), plus the ARAP surcharge applies for tier 3. Additionally, all three tiers have a flat surcharge of $475. Tier 3 policyholders have a burden that tiers 1 and 2 do not have. Tier 3 policies are assessable if premiums are not sufficient to cover losses and expenses.

It is unrealistic to expect that an actuary’s best estimate, which is a prediction of future contingent events, will always coincide with future results. It is understood and usually explicitly acknowledged that the results for a particular year can be higher or lower than the actuary’s estimate. The consequences of the results being higher or lower than the estimate affect the actuary’s judgment and ultimate selections.

In a situation with substantial financial resources, it may be acceptable for the actuary’s estimate to be high half of the time and low half of the time, as long as over time the predictions coincide with the average result. In other words, if there is a billion dollars in surplus, the company may not be concerned if the actuary's estimate is $50 million high or low in a particular year as long as it balances over a number of years.

If, however, there is only $10 million in surplus, the company cannot afford for the estimate to be $10 million lower than the estimate because they will be bankrupt. In this latter situation the consequences of being low are more important than the consequences of being high and this will impact the degree of conservatism that is appropriate in the actuary's selection.

The FWCJUA has been in a situation where the consequences of reserving too low or having rates that are too low (i.e. retroactive assessments to policyholders) have been greater than the consequences of reserves being too high or rates too high.  If the rates are too high, there may be some complaints from policyholders and others (and there could be federal income taxes that have to be paid) but, if there are assessments due to the rates being too low, every policyholder is affected, even those whose policy expired. At the extreme, some of the policyholders could face severe financial distress or even be put out of business as a result of the assessment.

As a result of these circumstances, the degree of conservatism used in determining FWCJUA rates and surcharges has contributed to the level of rates needed. The main contributor to the FWCJUA rates, however, has been the level of expenses and losses incurred. Both of these were adversely impacted when the volume of FWCJUA business decreased in the late 1990s. As a result of all these factors and others, the FWCJUA rates have been very high in comparison to the residual markets in other states.

Currently, the tier 1 and tier 2 rates for most employers are more affordable than the previous sub-plans A, B and C. However, on January 1, 2007 the rates for tiers 1 and 2 are to be "actuarially sound rates." Since the "below the line" assessments end on July 1, 2007, there will be no funding mechanism for deficits in tiers 1 and 2. This will undoubtedly require very conservative actuarial assumptions to prevent any deficit. This will likely mean higher rates for these two tiers.

Having the goal of a small residual market is desirable, but it needs to be balanced with having an affordable residual market. The FWCJUA was very small in comparison to the total voluntary market from 1997 through 2005. This occurred during a period when the FWCJUA rates were not very affordable to many employers and the voluntary market was very competitive. The high premiums in the FWCJUA discouraged many employers from even applying to the FWCJUA. These employers decided to close their business, go without coverage (which may be unlawful), or sought the services of a Professional Employer Organization (PEO). Coupled with a very competitive market by insurers who aggressively sought new policyholders, this created an extremely small residual market.

Ultimately, availability should not be an issue as coverage can be found in either the voluntary market or the FWCJUA, although affordability may well remain an issue for employers utilizing the FWCJUA.

## Composition of the Buyer

Much of the analysis of the worker's compensation market, owing to a lack of more detailed data, is done at a high level by insurer or in total. The reality is that the workers' compensation market is segmented based on a number of characteristics, such as size of employer, type of industry, past experience of the employer or the lack of experience. The market for large employers versus small employers can be markedly different. The market for construction risks is different from employers with office workers. New businesses typically have trouble obtaining coverage due to the lack of historical experience that can be a measure of not only the insurance exposure but also the credit worthiness of the insured.

The majority of complaints about not being able to get coverage in the voluntary market come from small employers, new businesses and construction employers. Employers with a combination of these characteristics are especially difficult to place in the voluntary market. In some cases, coverage is related to the availability of agents in the local area and the number of insurers the local agents represent.

“A Study of the Availability and Affordability of Workers’ Compensation Coverage for the Construction Industry in Florida” dated January 31, 2003 and provided to the Florida Legislature concluded that construction employers, especially small construction employers, are having difficulty finding affordable workers’ compensation coverage. While the restructuring of the FWCJUA has helped this situation, the problem still exists as documented by the number of employers found by the Department of Financial Services (DFS) to have no coverage.

The Department’s workers’ compensation division conducts random sweeps at construction sites to ensure compliance with workers’ compensation laws. In Fiscal Year 2005-2006 the Bureau of Compliance within the Department of Financial Service’s Division of Workers’ Compensation issued almost 2,700 stop-work orders to companies that were not carrying insurance for all of their workers. As a further result of their efforts, an additional 12,366 new employees received coverage under Florida’s workers’ compensation law adding over $30 million to the premium base.

According to the National Association of Professional Employer Organizations (NAPEO), “Professional employer organizations (PEOs) enable clients to cost-effectively outsource the management of human resources, employee benefits, payroll and workers’ compensation. A PEO provides integrated services to effectively manage critical human resource responsibilities and employer risks for clients. A PEO delivers these services by establishing and maintaining an employer relationship with the employees at the client's worksite and by contractually assuming certain employer rights, responsibilities, and risk.” Also according to NAPEO, the average client customer of a PEO is a small business with 16 worksite employees, though larger businesses also find value in a PEO arrangement.

PEO’s have been a significant part of the Florida workers’ compensation market since the early 1990s. PEO’s have had an erratic history of being able to obtain coverage in the workers’ compensation insurance market. In the early 1990s coverage was difficult to obtain. By the mid-1990s coverage was broadly available and relatively easy to obtain. In the early 2000s coverage became scarce and in 2003 after CNA stopped writing PEOs, coverage was nearly impossible to find.

Insurers have historically been reluctant to write workers' compensation coverage due to the risks inherent with PEO coverage (see *Workers' Compensation Large Deductible Study*, NAIC/IAIABC Joint Working Group, March 2006). Some PEOs have adapted to this changing market and some have formed their own insurance company. PEOs have been a source of workers' compensation coverage for many employers in Florida that could not obtain coverage in the voluntary market, particularly small employers. When the premiums for the FWCJUA have been deemed too high by employers, the PEO market has been the only available option for many employers who want to remain in business and comply with the law.

## Market Structure, Conduct, and Performance to Promote Competition

The previous sections of this report do not suggest any obvious impediments to a workers' compensation market that has been found to be reasonably competitive. This section concentrates on the ability of the market to promote competition.

## Mandatory Rating Plans

Before discussing the methods that workers' compensation insurers compete in the marketplace, it is useful to summarize the rating and premium pricing variations that result from the mandatory rating plans currently in effect. The following rating plans are required of all insurers in the state of Florida:

- Experience Rating Plan – This plan recognizes differences between individual employers by comparing the actual experience of an individual employer with the average expected experience of employers in the same classification. The plan produces an experience modification factor that may increase or decrease premiums. An employer is eligible for this program if the average annual premium is at least $5,000.

- Premium Discounts by Size of Policy – The premium discount plan adjusts the employer's premium to reflect the relative expense of servicing large premium policies as a percent of premium is less than that for small premium policies. For example, the policy issuance costs for a $200,000 policy may be higher than those for a $20,000 policy, but the cost are not ten times as high.
- Drug-Free Workplace Premium Credit – A 5% premium credit provided to employers that certify the establishment of a drug-free workplace program.
- Employer Safety Premium Credit – A 2% premium credit provided to employers that certify the establishment of a safety program.
- Florida Contracting Classification Premium Adjustment Program - A premium credit is provided for policies with one or more contracting classifications that pay above average hourly wages. The credit amount increases as the average wage paid increases. The credit is calculated based on payroll and hours worked information submitted by the employer to NCCI.
- Small Deductibles - For a reduced premium, the employer agrees to reimburse the insurer for each claim up to the deductible amount and the carrier covers benefits for each claim above the deductible amount. Small deductibles range from $500 to $2,500 and are required by section 440.38(5), F.S. An insurer may refuse to issue a policy with a deductible based on financial stability of employer.
- Coinsurance - For a reduced premium, the employer agrees to reimburse the insurer 20% of each claim up to $21,000. This option is required by Section 440.38(5), F.S. An insurer may refuse to issue a policy with a coinsurance amount based on the financial stability of the employer.
- Coinsurance and Deductible - For a reduced premium, the employer agrees to reimburse the insurer a deductible amount in the range of $500-$2,500 per claim and 20% of each claim up to a maximum of $21,000. This option is required by Section 440.38(5), F.S. An insurer may refuse to issue a policy with a coinsurance and deductible amount based on the financial stability of employer.

## Optional Plans Used by Insurers to Compete on Price

Insurers use the following plans to compete on price:

- Policyholder Dividends - Insurers reward their policyholders by returning some of their profit at the expiration of the policy by issuing policyholder dividends, which may be based on the policyholder's experience, the carrier's experience, and other factors.
- Deviations –Section 627.211, F.S. allows insurers to file a uniform percentage increase or decrease that is to be applied to all rates an insurer charges or to rates for a particular class or group of classes of insurance.
- Intermediate Deductibles - For a reduced premium, the employer agrees to reimburse the insurer for each claim up to the deductible amount and the carrier covers the amount of the claim above the deductible amount. Intermediate deductibles range from $5,000 to $75,000.
- Large Deductibles – Large deductible policies operate similarly to the small and intermediate deductible, but have a deductible amount of $100,000 and above. In order to qualify for the large deductible program, an employer must have standard premium of at least $500,000.
- Consent to rate – The insurer and employer agree to a rate in excess of the approved rate. The insurer must limit this option to no more than 10% of policies written or renewed in each calendar year.
- Retrospective Rating Plans – The final premium paid by the employer is based on the actual loss experience of the employer during the policy, plus insurer expenses and an insurance charge. If the employer controls the amount of claims, they pay lower premiums. Before there were large deductible programs, retrospective rating plans were the dominant rating plan for large employers.
- Waiver of subrogation - For an additional premium, the insurer may waive its right of recovery against specifically named parties liable for injury covered by the policy.

## Non-Price Competition

In addition, insurers compete in ways unrelated to the determination of premium such as:

- Offering premium payment plans that vary the amount of money paid initially and through installments;
- Demonstrating the availability and effectiveness of specialized loss control;
- Demonstrating the effectiveness of their claims handling including fraud detection;
- Paying higher agent commissions or providing other incentive programs, and/or;
- Emphasizing policyholder service in auditing, policy issuance or certificates of insurance.

**Deviations**

In the mid 1980's, the use of deviations as a means of competing was commonplace. From 1983 to 1985 over 40% of the market was written at deviated rates. However, by 1989 only 9% of the market was written at deviated rates. After the two year legislatively required moratorium (1990 and 1991) on deviations, the use of deviations has ceased to be a meaningful factor in the workers' compensation marketplace in Florida.

Despite the changes in Section 627.211, F.S., made by chapter law 2004-82 (SB 1926) to allow for easier approval of deviations, only one insurer has filed for a new deviation since the law became effective on July 1, 2004 and that was approved during 2006. Two insurers have renewed their prior deviation, which means there are currently only three insurance companies with a deviation in Florida.

| Workers' Compensation Rate Deviations (all downward) from 1981 to 2005 | | | | | | | |
|---|---|---|---|---|---|---|---|
| **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 | unavailable | 11.6% |
| **1984** | 122 | 54.0% | 16.5% | **1996** | 4 | unavailable | 11.2% |
| **1985** | 121 | 40.8% | 15.9% | **1997** | 3 | unavailable | 11.6% |
| **1986** | 79 | 18.3% | 12.7% | **1998** | 3 | unavailable | 11.6% |
| **1987** | 57 | 11.5% | 10.4% | **1999** | 3 | unavailable | 11.6% |
| **1988** | 55 | 11.3% | 10.0% | **2000** | 5 | unavailable | 12.0% |
| **1989** | 43 | 8.8% | 10.3% | **2001** | 4 | unavailable | 10.8% |
| **1990** | 0 (moratorium) | 0% | 0% | **2002** | 3 | unavailable | 10.8% |
| **1991** | 0 (moratorium) | 0% | 0% | **2003** | 3 | unavailable | 8.3% |
| **1992** | 0 | 0% | 0% | **2004** | 2 | unavailable | 10.0% |
| | | | | **2005** | 3 | unavailable | 10.0% |

*Note: For the period 1995 to 2005, the market share is not available because the deviations only apply to a portion of the company's total written premium.*

**Large Deductibles**

In the early 1990's, insurers approached the Department of Insurance about filing a rating plan for large employers (defined as having $500,000 in standard premium) that would be more flexible in how the premium would be determined. The justification for the flexibility would be based on the following general concepts:

- The rating plan would be used only for very large employers. These employers would generally be eligible to be individually self-insured.

- Rating is similar to rating for excess insurance that is purchased by individual self-insureds.
- The minimum deductible is $100,000 and could be in the millions. Thus, the employer will be responsible for the vast majority of claims.

The Department ultimately agreed to these type plans with restrictions that were incorporated in Administrative Rule 69O-189.006 (formerly 4-189.006).

As large deductible programs have been implemented, there has been a dramatic shift in premiums. The typical large deductible policy will have a deductible credit that can range from 30% to 90%. Thus, the premiums paid by employers and reported by insurers will be a fraction of premiums paid for other rating plans. This means that premiums in the annual statement and premiums reported for assessments and taxes are much lower than they were previously.

As the volume of large deductible policies written in Florida has increased, the effect has been to lower the base for assessment and taxes such that Section 440.51(1)(b), Florida Statutes have been revised to require premiums to be reported without the deductible credit.

An ancillary effect of large deductibles has been the movement for very large employers to cease being individually self-insured and to buy an insurance policy from an insurance company with a large deductible program.

## Conclusion

Based on the number of entities and market shares of actively writing companies in the market, the number of entities entering and exiting the market and the financial performance of the entities in the market, Florida’s worker’s compensation market can readily be characterized as a competitive market.

Availability does not appear to be a significant concern in the aggregate, although it does appear that small firms, new firms, and construction firms may face some market shortfalls in the voluntary market. The residual market is small, suggesting that the voluntary market is absorbing the vast majority of demand. While not without risk, the growth of the use of PEOs among smaller employers has, as well, helped availability by making coverage affordable.

For an employer, availability is not particularly important if the coverage is not affordable. In the voluntary market, rates have declined by nearly over 40% since reform legislation was passed in 2003. Within the residual market, it appears that conservative actuarial estimates have contributed to uncompetitively high rates in the recent past for the FWCJUA, although statutory changes appear to have helped to moderate rates most recently.

## OIR Certification of Compliance with Section 627.211(6) & 627.096, Florida Statutes

Section 627.096, Florida Statutes was created in 1979 as part of the "wage loss" reform of the workers' compensation law. This statute has three basic requirements as it pertains to this report:

1. An investigation and study of all insurers authorized to write workers' compensation in Florida. The Office has accomplished this objective by its thorough review of the quality and integrity of the data submitted in the most recent National Council on Compensation Insurance (NCCI) filing.

2. A study of the data, statistics or other information to assist and advise the Office in its review of filings made by or on behalf of workers' compensation insurers. In addition to the NCCI filing mentioned above, the Consumer Advocate's offices hired an independent actuary to review the filing and make recommendations. Also there are public hearings regarding the NCCI filing which further allow an opportunity for third parties to register their opinions and input.

3. The statute gives the Financial Services Commission the authority to require all insurers to submit data to Office. The NCCI has been collecting workers' compensation data in Florida for more than 50 years; therefore, the Office has contracted with NCCI to perform these statistical services for the State of Florida.