FINANCIAL SERVICES COMMISSION

CHARLIE CRIST
GOVERNOR

ALEX SINK
CHIEF FINANCIAL OFFICER

BILL McCOLLUM
ATTORNEY GENERAL

CHARLES BRONSON
COMMISSIONER OF AGRICULTURE

OFFICE OF INSURANCE REGULATION

KEVIN M. MCCARTY
COMMISSIONER

January 30, 2008

The Honorable Charlie Crist
Governor of the State of Florida
PL 05, The Capitol
404 South Monroe Street
Tallahassee, FL 32399

Dear Governor Crist:

Section 627.285, Florida Statutes, provides that the Financial Services Commission (FSC) shall contract for an independent, actuarial peer review and analysis of the ratemaking processes of any licensed rating organization that produces rate filings for workers' compensation insurers, at least once every other year. This change to the workers' compensation law was included in Senate Bill 50A which was enacted July 15, 2003. The National Council on Compensation Insurance (NCCI) is the rating organization that submits rates to the Office of Insurance Regulation (OIR) on behalf of all workers' compensation insurers and was the subject of peer review.

OIR issued a request for proposal and completed its evaluations in November. Subsequently, OIR contracted with Oliver Wyman Actuarial Consulting, Inc. to perform the analysis. The timeline determined by the request for proposal required that a final report be delivered to the OIR on Friday, January 18, 2008 and the final report be submitted by February 1, 2008 to the members of the FSC, the President of the Senate and the Speaker of the House of Representatives.

Enclosed is the final report for your review. Oliver Wyman Actuarial Consulting, Inc. will provide any additional information that is needed by the FSC or the Florida Legislature. Also, enclosed for your review is the NCCI response to the final report. As always, my staff and I stand ready to provide any information you need as well.

Sincerely,

Kevin M. McCarty

Kevin M. McCarty

Enclosure

Cc: Mr. Stephen J. Klingel, President & CEO, NCCI Holdings, Inc.

KEVIN M. MCCARTY • COMMISSIONER
200 EAST GAINES STREET • TALLAHASSEE, FLORIDA 32399-0305 • (850) 413-5914 • FAX (850) 488-3334
WEBSITE: WWW.FLOIR.COM • EMAIL: KEVIN.MCCARTY@FLDFS.COM

Independent Actuarial Review

Ratemaking Processes of the National Council on Compensation Insurance, Inc.

State of Florida Financial Services Commission

January 2008

Scott J. Lefkowitz, FCAS, MAAA, FCA

CONTENTS

INTRODUCTION

Scope of Assignment

Oliver Wyman Actuarial Consulting, Inc.[1] (Oliver Wyman) has been engaged by the Financial Services Commission, State of Florida (the Commission) to conduct an independent actuarial peer review of the ratemaking processes of the National Council on Compensation Insurance, Inc. (NCCI), in Florida, for revised workers compensation rates and rating values, as required by Section 627.285, Florida Statutes.[2] Specifically, Oliver Wyman has been engaged to complete an actuarial review of the following:

1. Methodologies, thought processes, judgments and assumptions used to determine statewide rate level changes, including, but not limited to, database (paid loss versus paid loss plus case reserve or other), loss development methodology and selections, experience periods, trend calculations, premium development calculations, premium adjustments, benefit on-level adjustments, expense provisions, profit and contingencies provisions, impact of experience rating off-balance, impact of single large claims, amongst others.

2. Methodologies, thought processes, judgments and assumptions used to distribute statewide rate level changes to the major industry groups.

3. Methodologies, thought processes, judgments and assumptions used to determine individual workers compensation classification rates, including, but not limited to, loss development, benefit on-level adjustments, trend adjustments, experience adjustments, off-balance adjustments, industry group differential adjustments, determination of maximum limit on individual claims and associated adjustments, test correction factors, amongst others. Of note is the impact of large increases in payroll to specific classes associated with reconstruction in the wake of catastrophic storm activity in Florida during 2004.

4. Methodologies, thought processes, judgments and assumptions used to determine the impact of legislative changes, benefit-level adjustments, and legislative proposals.[3]

[1] *Formerly known as Mercer Oliver Wyman Actuarial Consulting, Inc. This is a change in name only.*

[2] *The statute requires that the Commission contract for an independent actuarial peer review and analysis of the ratemaking processes of any licensed rating organization that makes rate filings for workers' compensation insurance in Florida. The NCCI is responsible for collecting statistical information and making workers' compensation rate filings, on behalf of Florida's insurers.*

[3] *Since implementation of SB 50A on October 1, 2003, there have been no material law changes affecting workers' compensation costs. However, there have been a series of benefit level changes consisting of changes to medical provider reimbursement rates in Florida's Workers' Compensation Health Care Provider Reimbursement Manual (Medical Fee Schedule). As such, aside from examining the general methodology of NCCI's calculation of the impact of these changes, Oliver Wyman has focused its effort on examining the appropriateness of methodologies and processes employed by NCCI in calculating post-SB 50A workers' compensation rates.*

NCCI Ratemaking Methodology

The final result of the ratemaking process is a revised premium rate for each of over 500 individual workers' compensation employer classifications. Classifications are grouped into five industry groups.[4] Each classification is assigned a premium rate based on the combined impact of statewide average experience, the experience of the industry group to which it belongs, and the experience of the individual classification itself. The NCCI ratemaking methodology employed in Florida is composed of four general steps:

Step 1: Calculation of Statewide Rate Change
Statewide data for all workers' compensation classifications combined is used to determine the statewide rate change. This step relies primarily on what is known as Aggregate Financial Call data.[5] Contributing elements to the statewide rate change include:

Loss Experience: Is the actuarial forecast of the final cost of benefits for a group of claims greater than or less than what is expected in current premium rates?

Trend:[6] Are workers' compensation benefits increasing at a rate greater than or less than wages?

Benefit Changes: Have there been any changes in workers' compensation benefits not provided for in current premium rates?

Claim Adjustment Expense (LAE)[7]: Is the expected cost of LAE greater than or less than what is expected in current premium rates?

Other Insurance Company Expenses: Is the expected cost of insurance company overhead and commission greater than or less than provisions in current premium rates?

4 *The five industry groups are:*
Manufacturing, Contracting, Office and Clerical, Goods and Services, Miscellaneous

5 *NCCI collects, tabulates, checks, and edits combined statewide workers' compensation experience. Data is collected in a manner such that an actuarial analysis can be conducted to determine, on an average, statewide basis, whether rates need to be increased or decreased. The* ***Reporting Guidebook for the Annual Calls for Experience****, published by NCCI, includes a detailed description of the various data requests as well as instructions for completing these requests. Oliver Wyman relied on the 2008 edition of this guide (effective November 17, 2007) for the purpose of this report.*

6 *Premium rates are almost exclusively measured relative to payroll (in units of $100). There is an a priori assumption in premium rates that benefit costs will increase at the rate of wage inflation. Therefore, premium rates will decrease if actuarial analysis shows that benefit costs are increasing at a rate less than wage inflation, all else being equal. Similarly, premium rates will increase if actuarial analysis shows that benefit costs are increasing at a rate greater than wage inflation, all else being equal.*

7 *Claim adjustment expense is commonly referred to as loss adjustment expense (LAE). LAE is the total cost of adjusting claims, including (in general) overhead costs of maintaining a claims adjustment staff and claim defense costs. Claim defense costs generally include, but are not limited to, legal fees, court fees, and the cost of investigations.*

Taxes and Assessments: Is the expected cost of taxes and assessments greater than or less than the provisions in current premium rates?

Profit and Contingencies: Is the economic/actuarial forecast of reasonable insurance company profit greater than or less than the provision in current premium rates?

Step 2: Distribution of Statewide Rate Change to Industry Groups

The statewide rate change is distributed to each of the five industry groups based on the relative loss experience of each individual industry group.[8] The weighted average of the rate changes for each of the five industry groups must equal the statewide rate change calculated in Step 1. The allocation to industry groups relies primarily on what is known as Workers' Compensation Statistical Plan (WCSP) Data.[9]

Step 3: Distribution of Industry Group Rate Changes to Individual Classifications

The industry group change is distributed to each individual classification within each industry group. The distribution is based on the actual loss experience of each individual classification, and relies on WCSP data. The weighted average of the rate changes for all classifications in an individual industry group must equal the industry group rate change calculated in Step 2.

Step 4: Calculation of Rating Values

Each employer is subject to an experience rating program, where, depending on employer size, the employer's premium rate is adjusted for the employer's actual experience. The employer's premium rate is adjusted upward or downward depending on whether the employer's actual experience is greater than or less than the average experience of its classification.[10] While the experience rating program is mandatory, there are other voluntary rating programs, each of which relies on specific rating values. The final step of the ratemaking process is the calculation of the required rating values for these programs.

[8] *For example, if the average statewide rate change is a 5.0% increase, and the manufacturing industry group has much greater loss experience than expected, while the other four industry groups have lower loss experience than expected, the manufacturing industry group might be allocated a 10% rate increase, while the other four industry groups might be allocated a 2% rate increase. The weighted average for all five industry groups must equal the statewide 5.0% increase.*

[9] *WCSP data is a database of individual claim experience and policy specific information collected, tabulated, checked, and edited by NCCI. Information is collected in sufficient detail such that workers' compensation experience can be allocated to individual classifications, and therefore, to the five industry groups. WCSP data is the basis for allocating the statewide rate level change to the five industry groups and to all individual classifications.*

[10] *Employers must meet a minimum size threshold to be experience rated. Employers below that threshold are not experience rated due to their small size. For employers that meet the minimum size criteria, the weight, or credibility, assigned to actual experience depends on their size. For smaller employers, actual experience plays a smaller role because of the low credibility assigned to actual experience. For the largest employers, credibility is so high that these large employers pay premium rates based essentially on their own experience.*

General Approach of this Review

The general approach to this review was as follows:

1. Identification of data and methodology used.

2. Appropriateness of data and methodology used.
   - Is the methodology a commonly applied actuarial technique?
   - Is it appropriate in the circumstances of its use by NCCI?
   - Does it meet Actuarial Standards of Practice?
   - Is data appropriate for methodologies employed?

3. What additional methodologies were available?
   - Comparison to NCCI applications in other states
   - Comparison to approaches in non-NCCI jurisdictions

4. Identification of consistency of methodology used.
   - What changes to methodology were made in the past, and why?
   - What was the impact of the change in the methodology?

5. Is there evidence of bias in the ratemaking process?

6. Did NCCI respond to recommendations in Oliver Wyman's report issued in January, 2006 (hereafter referred to as "Oliver Wyman's prior review" or "Oliver Wyman's prior report")

The review process was as follows:

1. Review initial documentation provided by NCCI.

2. Issue requests for additional information from NCCI.

3. Discuss questions/concerns of NCCI regarding additional requests.

4. Discuss progress, questions, and concerns with the Florida Office of Insurance Regulation.[11]

5. Discuss general results with NCCI, and give consideration to NCCI concerns.

6. Issue Draft Report to Florida Office of Insurance Regulation.

7. Consider comments from Florida Office of Insurance Regulation and NCCI.

8. Issue Final Report

[11] *Oliver Wyman's contact during the course of this review was Mr. James Watford, ACAS Actuary, Florida Office of Insurance Regulation*

The draft report was presented to the Florida Office of Insurance Regulation on January 11, 2008. The final date for presentation of the final report was January 18, 2008.

This assignment was not used as a vehicle to substitute Oliver Wyman's professional opinions for those of NCCI. Oliver Wyman conducted an objective review and identified those areas where, in Oliver Wyman's opinion, NCCI's documentation was incomplete or where inappropriate actuarial judgments were made, or where additional investigation by NCCI into specific issues was warranted. Oliver Wyman's findings that specific processes, judgments, or assumptions were reasonable, or Oliver Wyman's lack of issue with the same, do not necessarily mean that Oliver Wyman endorses them or would take the same approach if Oliver Wyman were to conduct its own independent analysis of rate needs in the state of Florida.

During the course of this report, references are made to applications for revised workers compensation rates and rating values effective 1/1/05, 1/1/06, 1/1/07, and 1/1/08. These applications are referred to as applications effective 1/1/05, etc.

Applications effective 1/1/05 and 1/1/06 were reviewed during the course of Oliver Wyman's prior review. Applications effective 1/1/07 and 1/1/08 were issued since publication of Oliver Wyman's prior report, and were reviewed during the course of this review.

Oliver Wyman's report to the Commission consists of the text and charts in this document.

A complete list of documents and data provided is attached at the end of this report. Applicable Caveats and Limitations are attached as well.

EXECUTIVE SUMMARY

Principal Conclusions

1. **The NCCI ratemaking process (in Florida[12]) is based on commonly applied actuarial methodologies that are supported in actuarial literature as well as frequency of usage by credentialed actuaries.**

   a. The NCCI ratemaking process draws from a group of actuarial methodologies employed by NCCI and other ratemaking organizations in other states.

   b. Descriptions of certain methodologies that are part of the NCCI ratemaking process are required reading within the syllabus of examinations for membership published by the Casualty Actuarial Society.[13] In particular, Oliver Wyman notes that the NCCI Experience Rating Plan Manual for Workers' Compensation and Employers Liability Insurance and the Retrospective Rating Plan Manual for Workers' Compensation and Employers Liability Insurance are part of that group of readings, as are other NCCI publications:

      - Experience Rating Plan Manual for Workers' Compensation and Employers Liability Insurance (as of June 30, 2007)

      - Retrospective Rating Plan Manual for Workers' Compensation and Employers Liability Insurance (as of June 30, 2007)

      - The 1998 Adjustment to the Experience Rating Plan:
        Guide to Understanding the Changes

      - Fundamentals of Individual Risk Rating: Parts I, II, and III
        Gilliam and Snader

   c. Actuarial methodologies used by NCCI are appropriate within the context of their use in the NCCI ratemaking process in Florida.

   d. Actuarial methodologies used by NCCI meet the applicable Actuarial Standards of Practice (ASOP), as published by the American Academy of Actuaries.[14]

[12] *This report addresses NCCI ratemaking processes and methodologies in the state of Florida, only. Unless otherwise specified, any references to the NCCI ratemaking process or ratemaking methodologies are meant to be specific to the state of Florida.*

[13] *2008 Syllabus of Basic Education, Casualty Actuarial Society*
4350 N. Fairfax Drive, Suite 250, Arlington, VA 22203

[14] *An umbrella organization of major actuarial organizations in the United States*
1100 Seventeenth Street NW, Seventh Floor, Washington, DC 20036

In Oliver Wyman's opinion, the following standards apply:

- ASOP 9 Documentation and Disclosure in Property and Casualty Ratemaking, Loss Reserving, and Valuations (Effective January, 1991 – Repeal is Pending)
- ASOP 12 Concerning Risk Classification (Effective December, 2005)
- ASOP 13 Trending Procedures in Property Casualty Insurance Ratemaking (Effective July, 1990)
- ASOP 23 Data Quality (Effective December, 2004)
- ASOP 25 Credibility Procedures Applicable to Accident and Health, Group Term Life, and Property/Casualty Coverages (Effective October, 1996)
- ASOP 29 Expense Provisions in Property/Casualty Ratemaking (Effective July, 1997)
- ASOP 30 Treatment of Profit and Contingency Provisions and the Cost of Capital in Property/Casualty Insurance Ratemaking (Effective July, 1997)

e. Actuarial methodologies used by NCCI are consistent with the Statement of Principles Regarding Property and Casualty Insurance Ratemaking, as published by the Casualty Actuarial Society, and referenced in ASOP 9.

Oliver Wyman reviewed the key elements of the NCCI ratemaking process, as well as selected specific details of the calculation of the statewide rate change and of the calculation of individual classification rates. Oliver Wyman's conclusion is based on this review. There are minor elements of the NCCI ratemaking process that were not examined in this review. Some of these elements of the process might potentially benefit from review or updating. Additionally, while Oliver Wyman tested the behavior of certain rating values over time for reasonableness, Oliver Wyman did not examine the detailed calculations of all of these elements during this review. These issues are not material as respects the conclusion above.

2. The NCCI ratemaking process is based on data that is appropriate as respects the actuarial methodologies used in the ratemaking process.

a. The financial call data collected by NCCI is appropriate for the actuarial methodologies used by NCCI to calculate the statewide rate change. In particular, the data is appropriate for the determination of the contributions of experience and trend to the statewide rate change.

b. The WCSP data collected by NCCI is appropriate for the actuarial methodologies used by NCCI to distribute the statewide change to the five industry groups and the individual classifications in each industry group.

The financial call data and WCSP data are the primary data sets used by NCCI in the ratemaking process. Each set of data has advantages and limitations. The ratemaking processes employed by the NCCI tend to maximize the advantages of each set of data, and tend to minimize the impact of limitations of each set of data.

3. **The general NCCI ratemaking process is consistent over time. However, judgments and assumptions as respects specific decisions on methodology and the selection of actuarial parameters may vary between rate applications.**

   a. The general ratemaking process employed by NCCI and the specific algorithms used in the NCCI rate application have been consistent over time.

   b. Certain specific judgments and assumptions vary between rate applications. In general, specific judgments and assumptions are a matter of professional actuarial opinion. There is a concern that relying on varying judgments and assumptions rather than a consistent selection methodology over time introduces bias (or at least the perception of bias) into the ratemaking process. Conversely, there are arguments that fixing all aspects of the ratemaking methodology may lead to illogical results when changes occur to the workers' compensation system. This author, as respects statewide ratemaking, has generally recommended that methodologies and selection criteria be fixed over time unless there is a compelling reason to change. However, this is a professional opinion. Oliver Wyman finds nothing inherently improper with NCCI's general approach to ratemaking as respects this issue. Additionally, given the material system changes that have occurred in Florida as a result of SB 50A, variation of specific methodologies, judgments and assumptions could be appropriate. However, in these circumstances adequate support demonstrating the need for suggested changes is required, or conversely, adequate support demonstrating the need for continuing with past practice is required in situations where change might be indicated.

4. **NCCI's judgmental selection of annual loss ratio trends creates a perception of bias in the ratemaking process.**

   NCCI judgmentally selects loss ratio trends based on an examination of multiyear trends in various metrics. In the last four applications (rates and rating values effective 1/1/05, 1/1/06, 1/1/07, and 1/1/08) NCCI proposed indemnity loss ratio trends that were greater, in some cases significantly, than every indicated loss ratio trend based on empirical data[15] except for one. In the case of medical loss ratio trends, NCCI's proposals were greater than all the indicated medical loss ratio trends except for two.

[15] *NCCI typically examined exponential trends based on the most recent five years on a calendar/accident year basis and on the most recent eight years on a policy year basis. NCCI examines loss ratio trends directly as well as the individual component frequency trend and severity trend. Empirical trends referred to in this statement are calculated directly based on observed loss ratios.*

This is summarized in the following tables

Indemnity Trend						
			Application			
Data	Exponential Model	Type	01/01/2008	01/01/2007	01/01/2006	01/01/2005
Paid + Case	PY 8 Point	Direct Loss Ratio	-8.3%	-5.8%	-3.8%	-2.2%
Paid + Case	AY 5 Point	Direct Loss Ratio	-11.0%	-6.1%	-2.1%	-3.0%
Paid	PY 8 Point	Direct Loss Ratio	-7.0%	-5.2%	-3.1%	-1.3%
Paid	AY 5 Point	Direct Loss Ratio	-9.2%	-5.5%	*-0.3%*	*-0.3%*
	NCCI Selected		**-6.0%**	**-3.0%**	**-1.0%**	**0.0%**

Medical Trend			Application			
Data	Exponential Model	Type	01/01/2008	01/01/2007	01/01/2006	01/01/2005
Paid + Case	PY 8 Point	Direct Loss Ratio	-3.4%	-1.1%	-0.2%	0.3%
Paid + Case	AY 5 Point	Direct Loss Ratio	-6.0%	-2.2%	0.5%	0.1%
Paid	PY 8 Point	Direct Loss Ratio	-2.6%	-0.8%	0.6%	1.0%
Paid	AY 5 Point	Direct Loss Ratio	-4.7%	-0.9%	3.2%	2.7%
	NCCI Selected		**-1.0%**	**0.5%**	**1.5%**	**1.5%**

Highlighted cells indicate empirical trends that were greater than NCCI's selections. In response to this observation, NCCI asserted that in applications prior to 1/1/05, trend selections were materially lower than the majority of indicated empirical trends. A portion of that data is summarized below, and clearly supports NCCI's assertion:

Indemnity Trend						
			Application			
Data	Exponential Model	Type	01/01/2003	01/01/2002	01/01/2001	01/01/2000
	8 Point	Direct Loss Ratio	1.1%	2.5%	1.4%	0.7%
	5 Point	Direct Loss Ratio	-4.4%	-1.5%	3.1%	0.3%
	NCCI Selected		**1.0%**	**1.0%**	**1.0%**	**0.0%**

Medical Trend			Application			
Data	Exponential Model	Type	01/01/2003	01/01/2002	01/01/2001	01/01/2000
	8 Point	Direct Loss Ratio	2.4%	2.8%	1.8%	2.1%
	5 Point	Direct Loss Ratio	-3.6%	-0.8%	2.2%	0.3%
	NCCI Selected		**1.0%**	**1.0%**	**1.0%**	**0.0%**

(In the table above, labels as to experience period – PY or AY – as well as database – paid or paid plus case – are excluded because in most instances this information was not determinable from the information provided by NCCI)

Nevertheless, as respects the most recent four applications, NCCI's judgmental selection of trend factors creates at least the perception of bias in the ratemaking process.

5. **An analysis of the experience of individual classifications demonstrates a material decrease in loss experience and frequency for contracting classifications that experienced significant payroll growth in 2004 and 2005. Classifications that could be associated with reconstruction activity subsequent to 2004 hurricane activity are overrepresented in this group.**

The chart on the following page shows that for contracting classifications with payroll growth from 2003 to 2004 in the top 25% of all contracting classifications[16]:

- Experience declined from 2003 to 2004, whereas for all other contracting classifications, experience increased[17].
- Claim frequency declined from 2003 to 2004 at a significantly greater rate than the decline for all other contracting classifications.

Policy Year Indicated Pure Premiums

	2004	2003	2002	2001	2000
Top 25%	9.54	12.00	10.77	10.40	11.29
Remainder	5.52	5.19	4.81	4.81	4.88
Combined	5.93	5.75	5.36	5.32	5.43

Policy Year Indicated Frequency

	2004	2003	2002	2001	2000
Top 25%	1.31	1.67	1.67	1.82	2.09
Remainder	0.77	0.83	0.90	0.94	1.00
Combined	0.83	0.90	0.97	1.02	1.10

Contacting classifications included in the top 25% tier of payroll increases include the following:

Contracting Classification	2003 - 2004 Payroll Increase	Description
9534	27%	MOBILE CRANE AND HOISTING SERVICE CONTRACTORS-NOC-ALL OPERATIONS
5102	28%	DOOR, DOOR FRAME OR SASH ERECTION-METAL OR METAL COVERED
6400	37%	FENCE ERECTION-METAL
5610	38%	CLEANER - DEBRIS REMOVAL - CONSTRUCTION OR ERECTION CONTRACTOR
5551	38%	ROOFING-ALL KINDS & DRIVERS
6204	39%	DRILLING NOC & DRIVERS
5651	41%	CARPENTRY-DWELLINGS-THREE STORIES OR LESS
6325	47%	CONDUIT CONSTRUCTION-FOR CABLES OR WIRES-& DRIVERS
5645	48%	CARPENTRY-DETACHED ONE OR TWO FAMILY DWELLINGS

[16] *Only classifications with a minimum five year average payroll of $10 million were included.*

[17] *Policy year 2003 shows a surge in experience due to losses in class 5645. This exaggerates the observed decline. Nevertheless, policy year 2004 shows a significant decline even when compared to policy years 2002 and prior. Remaining classifications show an increase to experience in all cases.*

(Continued from prior page)

Contracting Classification	2003 - 2004 Payroll Increase	Description
5613	49%	CLEANER-DEBRIS REMOVAL-TEMPORARY LABOR SERVICE
5057	78%	IRON OR STEEL: ERECTION NOC
3365	78%	WELDING OR CUTTING NOC & DRIVERS
5473	112%	ASBESTOS CONTRACTOR-NOC & DRIVERS
7601	368%	TELEPHONE, TELEGRAPH OR FIRE ALARM LINE CONSTRUCTION & DRIVERS
6233	390%	OIL OR GAS PIPELINE CONSTRUCTION & DRIVERS

NCCI did do a measurement of claim activity in Florida counties impacted by hurricane activity. Additionally, NCCI did examine experience by industry group, by time period. However, a definitive change in behavior for a specific group of classifications did occur that was not brought to the regulator's attention in the 1/1/08 application.

6. Response to Recommendations in Oliver Wyman's prior review:

Recommendation 1:
NCCI should conduct a detailed investigation into the behavior of case reserve levels in Florida. The purpose of the study would be to provide an understanding of the fundamental reasons for the decrease in case reserve levels, including, but not limited to, the impact of SB 50A and the impact of changes in case reserve adequacy levels. The information would be used to better assess the reliability of paid loss plus case reserve data as well as the reliability of different techniques used to calculate key actuarial parameters associated with this technique.

For the proceedings for Revised Workers' Compensation Rates and Rating Values effective January 1, 2007, in Oliver Wyman's opinion, NCCI did not adequately investigate behavioral changes in key data elements. In Oliver Wyman's prior review, Oliver Wyman reported that a key element of the application effective January 1, 2006 was the material difference between results generated by paid loss data and by paid losses plus case reserve data. NCCI, with support from a consulting actuary, attributed lower results based on paid loss plus case reserve data to decreases in case reserve[18] levels and concluded that paid loss plus case reserve data will understate results. Oliver Wyman's prior review noted that while decreases to case reserve levels did occur, results would be understated only if changes to case reserve levels were the result of decreases to case reserve adequacy. NCCI presumed that the changes were due to decreases to case reserve adequacy, and engaged a consulting actuary who made the same presumption. This presumption was not based on an investigation as to the *reasons* for the changes. Oliver Wyman, based on data provided by NCCI during the course of Oliver Wyman's prior review, found that the changes to case reserve levels were almost coincident

[18] *Case reserves are established by claims management professionals at insurance companies and represent the expected future cost of individual claims, based on information available at the time the reserve is set. Actuarial projections rely on a consistent level of case reserves over time. All else being equal, sudden decreases to case reserve levels will cause unadjusted actuarial projections to underestimate costs.*

with implementation of SB 50A, and were limited to Florida[19]. As a result, Oliver recommended that NCCI conduct a detailed investigation into the behavior of case reserve levels in Florida. In response to this recommendation, NCCI conducted a qualitative survey that, in Oliver Wyman's opinion, was not sufficiently detailed so as to answer to the basic question of whether the decrease to case reserve levels was due to decreasing case reserve adequacy or due to an improvement to experience. Additionally, NCCI engaged the same consulting actuary who issued an opinion similar to the opinion issued in prior proceedings. The consulting actuary attributed the decrease to case reserve levels entirely to changes in case reserve adequacy, without investigation.

A review that would have provided more useful information would have been an examination of claims for similar injuries closed prior to implementation of SB50A and closed after implementation of SB50A. The examination would have included, but not been limited to, a comparison of payments, case reserves, and other relevant metrics from claim incidence to claim closure before and after implementation of SB50A. This would have provided significant quantitative information from which a determination could have been made as to the reasons for changes to the behavior of data in Florida.

It is important to note that NCCI did implement a change in methodology that decreased the difference between results based on the paid loss data and paid loss plus case reserve data. As such, NCCI addressed the underlying causative concern. Nevertheless, a detailed review would have been, and could still be, useful in understanding the significant system changes that have occurred in Florida.

Recommendation 2:
NCCI should investigate and quantify the impact of rate limiting procedures on classification rates and the classification ratemaking system in general, as respects the impact of SB 50A on individual classification rates and report back to the Florida Office of Insurance Regulation. The purpose of the study would be to determine if a temporary adjustment to the classification ratemaking procedure to accelerate classification rate realignment due to SB 50A is warranted. Mercer notes that this type of realignment is more readily accomplished in an environment where statewide rate level is declining, rather increasing.

The NCCI ratemaking methodology incorporates a procedure that limits changes to individual classification rates to a range around the statewide change.[20] The purpose of this procedure is to prevent large swings to rates for individual classifications. Notwithstanding SB 50A, the procedure is acceptable. However, at the time of Oliver Wyman's prior review, examination of data indicated that the limiting procedure at that time was delaying recognition of savings for

[19] *This issue is discussed in detail in Oliver Wyman's prior report published in 2006. Oliver Wyman examined case reserve levels for the top ten largest carriers in Florida, and examined changes to case reserve levels for these carriers in Florida and in AL, GA, MS, SC, TN and VA. The examination indicated that the changes to case reserve levels were unique to Florida.*

[20] *In actuality, it is a range around the industry group change to which the classification belongs.*

classifications with the highest proportion of indemnity loss experience. As such, Oliver Wyman's prior review recommended that NCCI should investigate and quantify the impact of rate limiting procedures on classification rates and the classification ratemaking system in general. The purpose of the study would be to determine if a temporary adjustment to the classification ratemaking procedure to accelerate classification rate realignment due to SB 50A is warranted. Oliver Wyman noted that this type of realignment is more readily accomplished in an environment where statewide rate level is declining, rather increasing.

In response to Oliver Wyman's recommendation, NCCI adjusted the classification ratemaking procedure to accelerate rate realignment. Specifically, NCCI has increased what are called swing limits from +/-10% to +/-15% in the 1/1/07 application to +/-20% in the 1/1/08 application. Oliver Wyman agrees with NCCI's action on this item.

Recommendation 3

a. Consideration should be given to decreasing the limit on claims used to determine individual classification rates.

The current ratemaking procedure caps the amount an individual claim can contribute to data used to determine rates for individual classifications. The basis for this recommendation was that the cap used in the application effective 1/1/06 was $888,000. Only a small portion of total lost time claims in Florida reach this level, and that there were several classifications in that application whose rates have been impacted by the occurrence of an exceptionally large claim. NCCI acknowledged that NCCI was conducting research into this matter in response to Oliver Wyman's recommendation. Nevertheless, the limit was increased in the 1/1/07 application to $986,000. The limit, however, was held at this value in the 1/1/08 application.

In Oliver Wyman's view, NCCI's actions were inadequate. Fixing the claim limit at $986,000 has had essentially no impact on the process, and apparently NCCI's research into this matter is ongoing.

b. The 24 year loss payout pattern used in the internal rate of return calculation that determines the profit and contingencies provision is unrealistically short. Consideration should be given to increasing the payout pattern to 35 or more years.

NCCI examined the impact of increasing the payment pattern used in the internal rate of return calculation, and reported that there was a negligible impact on the indicated profit and contingencies provision. The internal rate of return calculation discounts cash flows in the future to real money values today. Therefore, the real value of dollars paid in excess of the 24 year limit in the current model is so low that extending cash flows beyond 24 years has minimal impact on the results of the calculation.

c. The calculation of individual classification rates relies on paid loss plus case reserve loss development factors calculated from WCSP data. NCCI should monitor WCSP data for the same case reserve behavior observed in the statewide financial data.

Oliver Wyman's prior review observed a decrease in paid loss plus case reserve loss development factors in statewide financial data. The calculation of individual classification rates relies on paid loss plus case reserve loss development factors calculated from WCSP data. Given that WCSP data is generally older than statewide financial data, the same phenomenon had not yet been observed in WCSP data at the time of Oliver Wyman's prior review. As such, Oliver Wyman's prior review recommended that NCCI monitor WCSP data for the same case reserve behavior observed in the statewide financial data. Oliver Wyman noted that it would be likely that the same behavior observed in statewide financial data (reduction of loss development factors) will be observed in WCSP data, when that data becomes available for ratemaking.

WCSP data that has emerged since the time of Oliver Wyman's prior review does show the same phenomenon as had been observed in statewide financial data. However, due to the age of WCSP data available for the 1/1/08 application, only the most recent data point for the most recent policy year exhibits this behavior. NCCI did not note this nor were there any adjustments made to anticipate future decreases to loss development factors generated by data from the WCSP data base. In this respect, NCCI did not respond to Oliver Wyman's recommendation.

Recommendations

1. **NCCI should conduct a detailed investigation into claim behavior in Florida. This study would ideally provide information on case reserve levels as well as payment patterns and overall claim behavior. The purpose of the study would be to provide an in depth understanding of the impact of impact of SB 50A on loss experience in Florida and to identify other possible influences not necessarily recognized at this point in time. Since October 1, 2003, rate level in Florida has decreased by almost 50%. While a significant portion of this decrease is likely due to implementation of SB 50A, a portion of it may also be due to underlying trends that may be completely independent of SB 50A, or may have been amplified by SB 50A, or some combination of both[21]. Given the material and dramatic changes in rate level since the time of implementation of SB50A, it would be extraordinarily beneficial for future rate forecasts to understand, quantitatively, what has changed in Florida. As mentioned earlier, a review that could provide useful information would be an examination of claims for similar injuries closed prior to implementation of SB50A and closed after implementation of SB 50A. This is just one suggestion, as other investigations may be as or more useful. SB 50A was implemented over four years ago. A significant body of claims experience will therefore be available for examination by NCCI at this point in time.**

2. **NCCI should include an actuarial methodology that quantitatively provides a trend selection based on observed empirical trends. Numerous approaches exist that provide reasonable and unbiased results over time. Such approaches have been used by NCCI in the past[22], and are currently used in at least one NCCI state[23]. If such an approach were included in future rate applications, judgmental departures from that approach could be justified by NCCI if there were compelling reasons to do so.**

3. **NCCI should continue to investigate and quantify the impact of rate limiting procedures on classification rates and the classification ratemaking system in general. The following items should be addressed:**

[21] *NCCI pointed out that unrelated trends may be supplementing or amplifying the impact of SB 50A. Oliver Wyman agrees that this is a reasonable possibility.*

[22] *An example would include trend indicated by an exponential regression, weighted against an a priori expected trend value. The weight given the indicated exponential trend would be based on the quality of the statistical fit of the data to the exponential model. Various incarnations of this basic approach have been used by NCCI in the past.*

[23] *In Virginia, trend is calculated as the weighted average results of five year, six year, seven year, and eight year exponential regressions on loss ratio trends. Weights are based on the relative quality of statistical fit for each group of data. The method has functioned well in Virginia for at least the past five applications.*

a. **Consideration should be given to decreasing the limit on claims used to determine individual classification rates.**

The current ratemaking procedure caps the amount an individual claim can contribute to data used to determine rates for individual classifications at approximately $986,000. With this maximum limit, individual classes are still bearing the risk of large, infrequent, and unpredictable claims that would be more appropriately shared across all classifications. It is not reasonable to expect that the occurrence or non-occurrence of a claim with costs of $986,000 would be predictive of future costs for an individual classification, given the infrequent occurrences of such claims. Additionally, the current classification ratemaking methodology leverages the effect of a large claim into a much larger impact on classification rates due to loss development and trend adjustments.

Until NCCI implements the result of research that apparently has been on going since Oliver Wyman's prior review, Oliver Wyman recommends that the cap on individual claim be reduced to $400,000. This corresponds to the value that will generate an excess loss factor of approximately 10% for Hazard Group 2. That is, as a percentage of premium, losses excess $400,000 can be expected to be 10% of premium. The current limit corresponds to an excess loss factor of approximately 5% for Hazard Group 2.

b. **The calculation of individual classification rates relies on paid loss plus case reserve loss development factors calculated from WCSP data. NCCI should adjust WCSP loss development to reflect expected changes to development factors based on information available from statewide financial call data.**

This issue is discussed in detail in the prior section.

c. **NCCI should continue to monitor the behavior of individual classifications over time as respects the appropriateness of the value of specific swing limits. NCCI has appropriately increased swing limits from 10% to 20% since the time of Oliver Wyman's prior review. During that same period average rate level in Florida has decreased by approximately 30%. It would be appropriate to maintain swing limits at the 20% level until rate level stabilizes in Florida. At that point, it would be prudent to reduce swing limits back to the 15% or 10% levels. Additionally, there is an interrelationship between the limit on claims in class ratemaking data and the impact of swing limits. To the extent that the limit on claim size is reduced, the impact of swing limits, that is the number of classifications impacted by the application of swing limits, will be reduced. NCCI should consider this issue as well during the course of the preparation of future rate applications. Ultimately, however, the selected value of swing limits is a regulatory decision, based on how much variation in individual classification rates from one year to the next is acceptable.**

This issue was discussed at length under item 5 in the prior section.

DISCUSSION AND ANALYSIS

Statewide Rate Indication

Introduction

Contributing elements to the statewide rate change include

Loss Experience
Benefit Changes
Trend
Loss Adjustment Expense
Other Insurance Company Expenses
Taxes and Assessments
Profit and Contingencies

Each is discussed individually.

Loss Experience

The purpose of the analysis of loss experience is to forecast the final expected cost of claims with dates of loss during the specified time periods, or experience periods. Key considerations in this process are the selection of experience periods, database, and methods used to calculate loss development factors. Loss development factors (LDFs) are actuarial parameters used to adjust loss data to a final cost basis.

<u>Experience Period</u>

There are generally two types of experience periods available for analysis, policy year and calendar/accident year. Policy year experience is defined as losses associated with claims incurred on policies written during a specific calendar year. For example, policy year 2005 (PY2005) experience includes claims associated with policies written during 2005. Policy year experience extends over a 24 month period because only policies written on January 1 will have claims with dates of loss exclusively in the year of writing. Using the PY2005 example, a policy written on December 31, 2005 will provide coverage for claims with dates of loss from December 31, 2005 through December 30, 2006. Roughly half the claims associated with PY2005 will have dates of loss in 2005. The other half will have dates of loss in 2006. The average date of loss is approximately December 31, 2005.[24] Additionally, premium associated

[24] *This would be the case if policies are written and incepted evenly over the year, and if claims occur evenly over the policy periods. As these are usually not the case, the average date of loss is generally close to, but not exactly equal to, December 31.*

with PY2005 experience would be premium charged for policies written in 2005, regardless as to when that premium is actually billed or paid.

Calendar/Accident year experience is defined as losses associated with claims with dates of loss in a specific calendar year. For example, calendar/accident year 2005 (C/AY005) experience includes claims with dates of loss in 2005. The average date of loss is approximately June 30, 2005[25], which is six months earlier than PY2005 experience. Premium associated with C/AY2005 would be premium earned during calendar year 2005.[26]

There are advantages and disadvantages to the use of either experience period. Calendar/Accident year experience represents the most recent experience period available for analysis and is therefore a better indicator of current conditions and reduces reliance on trend. However, loss experience must be matched to the premium paid to insure the claims generating the losses. Accident year experience generally is not an exact match of premium to losses. Additionally, being the most recent experience available also increases the potential for statistical variability of accident year experience.

Policy year experience is somewhat more mature than accident year experience, and therefore has less potential for statistical fluctuation. Additionally, policy year experience provides for a more precise match of premium to losses. Policy year experience is not as recent as accident year experience, and increases reliance on trend.

NCCI examines both policy year and accident year experience during the course of its analysis. However, NCCI uses the two most recently available accident years to determine the statewide rate change. The process and selections are reasonable.

Database

NCCI has several types of loss data that may be used to forecast the final cost of claims. The choices are based on the loss data available from NCCI's financial calls. While different data elements are available, there are two combinations that NCCI has historically relied on in ratemaking:

Paid Loss data
Paid Loss plus Case Reserve data

[25] *This would be the case if claims occur evenly over the year. As this is usually not the case, the average date of loss is generally close to, but not exactly equal to, June 30.*

[26] *The portion of total premiums written based on the ratio of the time passed on the policies to their effective term. This pro-rated amount of written premium has been "earned" and is properly categorized as income that will fund claims associated with that portion of the policy that has passed. For example, if a $1,000 policy has a one-year term and six months has passed since the effective date, $500 of premium has been earned.*

Paid loss data relies exclusively on benefit payments. Paid loss plus case reserve data relies on benefit payments and case reserves. Case reserves are the most recent estimates by claims professionals of the outstanding costs on open reported cases. Therefore, the use of paid loss data, as opposed to paid loss plus case reserve data, excludes the most recently available information on expected future costs embedded in case reserves. Paid loss data relies much more heavily on loss development factors for forecasting purposes, whereas paid loss plus case reserve data essentially substitutes case reserves, the most recently available information on the expected future costs of individual claims, for a substantial portion of paid loss development. Paid loss data is distorted by changes in claim payment (settlement) patterns while paid loss plus case reserve data is also distorted by changes to case reserve levels.

Documentation provided to Oliver Wyman indicates that NCCI has considered the impact of the changes in Florida's workers' compensation environment on data used to determine statewide rate level indication, and the process, judgments, and assumptions are reasonable from an actuarial perspective.

Currently, NCCI bases the rate level indication on paid loss plus case reserve experience and a modified paid loss approach where paid loss data is used through a specific reporting period, at which point paid loss plus case reserve data, is incorporated into the analysis. NCCI terms this latter approach the "adjusted" paid loss method. The result of the adjusted paid loss method reconciles the bulk of the difference between the results of a pure paid loss approach and the results of the paid loss plus case reserve method.

Loss Development

Loss development factors (LDFs) measure the growth in losses associated with a group of claims over time. Claims are generally grouped by experience period, either policy year or calendar accident year. LDFs are selected using some type of average of the most recent observations available. Such averages could include the most recent five observations, or the most recent five observations excluding the highest and lowest values, or the most recent three or two observations, etc. All of these averaging techniques are appropriate and reasonable. However, using an average of the most recent two observations could be more responsive to current conditions, but could also subject estimates to volatility over time. NCCI used an average of the latest two available LDFs. This is a change from applications examined during Oliver Wyman's prior review. This change is appropriate, given the material changes to experience observed in Florida since 2003.

Oliver Wyman also examined the method and calculation of what are termed the 19th to ultimate report LDFs. These factors estimate growth beyond a 19th report, the last report for which NCCI collects loss development data. The calculation and results are similar to NCCI practice in other states and are reasonable.

Premium Adjustment

For accident year analysis, calendar year earned premium is matched with loss experience. A number of adjustments to earned premium data are required to bring premium to current cost levels. These include an adjustment to remove premium generated by the expense constant, an adjustment to factor in historical rate changes, and an adjustment to remove the impact on premium of variations in the effect of the experience rating program. The adjustment procedure is a standard NCCI calculation in Florida and other states, and is reasonable.

Large Deductible and Standard Experience

NCCI analyzes loss experience generated by large deductible policies and loss experience generated by standard polices separately. The results from each analysis are combined in a weighted average technique using net premium as a weight for large deductible experience and standard premium for standard policies. This approach is reasonable.

Benefit Changes

Adjustment of Losses to Current and Expected Future Benefit Levels

Historical losses, for the purpose of the experience indication and the calculation of trend, must be adjusted to reflect changes in benefit levels at the time the losses were incurred to the period during which the prospective rates will be in effect. The NCCI calculation is a standard actuarial procedure.

Estimating the Impact of Changes in Provider Reimbursement Rates

The general method used by NCCI to estimate the cost impact of changes in provider reimbursement levels is reasonable. The estimated impacts appear to be reasonable. Oliver Wyman did not examine the detailed calculation.

Trend

Trend forecasts the anticipated annual percentage change in loss ratios. Loss ratio trends represent the combined effect of changes in the incidence of claims over time, or frequency, as well as the change in the average cost per claim, or severity, over time.

Trend, as respects workers' compensation loss ratios, measures the change in loss experience relative to wage inflation. That is, a 0% loss ratio trend does not imply that workers' compensation costs are not increasing. Rather, a 0% loss ratio trend implies that workers' compensation costs are increasing at the same rate as wages. A loss ratio trend greater (less) than 0 implies workers' compensation costs are increasing at a rate greater (less) than wage inflation.

NCCI conducted a detailed analysis of trend factors separately for medical and indemnity loss experience. NCCI examined frequency trend, indemnity severity trend, medical severity trend, indemnity loss ratio trend, and medical loss ratio trend, separately for policy year data and accident year data, separately for paid loss data and paid loss plus case reserve data, separately for standard coverage and standard coverage combined with large deductible experience.[27]

Issues and recommendations regarding the judgmental selection of trend were discussed earlier in this report.

Loss Adjustment Expense

LAE is calculated as a ratio to loss, and is the sum of two components, unallocated loss adjustment expense (ULAE) and allocated loss adjustment expense (ALAE). The methodology employed by NCCI is used in other NCCI states. Countrywide ratios of ALAE and ULAE to loss are calculated. The countrywide ratio of ULAE is assumed to apply in Florida. The countrywide ratio of ALAE to loss is adjusted by a relativity of Florida experience to countrywide experience. The relativity is based on a comparison of the ratio of paid ALAE to paid loss in Florida to the same calculated using countrywide data.

The approach in Florida is reasonable, but Oliver Wyman has the following concerns:

1. The ratio of LAE to loss in Florida has been amongst the highest in NCCI states.

2. It is likely that SB 50A will impact LAE costs. The current NCCI methodology does not contemplate an impact of SB 50A on the ratio of LAE to losses in Florida. This is something that could be considered in future rate applications.

Other Insurance Company Expenses

Other insurance company expenses include the provisions for production expense and general expense. The provision for production expense includes commission and brokerage costs, and other acquisition costs. The methodology used by NCCI is reasonable and consistent with the methodology used in the prior application. The resulting provisions generally do not vary by significant amounts over time.

An important consideration in determining the production and general expense provisions is factoring back in the impact of the premium discount program. The data underlying the calculation of these provisions generates production and general expense provisions *after* the impact of premium discount. The premium discount program essentially gives a volume discount to large insureds. However, the starting point must be undiscounted premium and therefore the production and general expense provisions *before* application of premium discount are required. NCCI calculates the impact of the premium discount program and adds these components to the provisions calculated above. The calculation and approach is reasonable.

[27] *NCCI also calculated what are commonly referred to as econometric trends. These are trends based on a comparative analysis of loss ratio behavior with economic metrics. Oliver Wyman did not examine the process used to determine econometric trends because these did not appear to play a role in the rate application.*

Of note is that effective January 1, 2007 NCCI proposed revisions to the premium discount program to adjust for the impact of the change in the distribution of premium by size of employer over time. The rational underlying NCCI's proposal was reasonable.

Taxes and Assessments

Taxes and assessments are based on actual charges in Florida. The only exception is the miscellaneous tax provision of 0.30%. The miscellaneous tax provision is a catch all provision for taxes, licenses and fees not specifically provided for. It is common ratemaking practice to include this provision, and the value of 0.30% is not unreasonable.

Profit and Contingencies Provision

The profit and contingencies provision provides the insurance company the required return on equity, after taking into account the investment income earned on premium payments until losses and expenses are actually paid. The approach and model used by NCCI is a commonly applied approach used in other NCCI states. While Oliver Wyman may disagree with certain judgments and assumptions in the modeling procedure, these are issues of either policy or professional judgment, not of actuarial reasonableness.

Distribution to Industry Groups

The statewide rate change is distributed to each of the five industry groups based on the relative loss experience of each individual industry group. Classifications are grouped by industry association, not hazard. The industry groups are Manufacturing, Contracting, Office and Clerical, Goods and Services, and Miscellaneous. The procedure used to distribute the statewide change to each industry group essentially relies on a measurement, for each industry group, of actual losses to expected losses. Numerous adjustments are made to account for trend, development, experience rating, etc. Additionally, NCCI uses a credibility procedure to limit the impact of the procedure on an industry group with relatively low loss volume. In Florida, however, all industry groups are fully credible. The procedure is identical to procedures used in other NCCI states that Oliver Wyman has examined, and is reasonable.

Distribution to Individual Classifications

Introduction

Rates for individual classifications are calculated in a four step process:

Calculation of the pure premium
The pure premium is the expected cost of indemnity and medical benefits per $100 payroll during the period when rates will be in effect.

Conversion of the pure premium to a manual rate
The provisions for expense and profit (and contingencies) are added to the pure premiums to produce a manual premium rate.

Application of swing limits and correction factors

Disease Loadings

Each step is discussed individually.

Calculation of the Pure Premium

The pure premium is calculated as a weighted average of three factors:

Indicated Pure Premium
Pure Premium Present on Rate Level
Pure Premium Indicated by National Relativity

The weighted average pure premium is termed the Pure Premium Derived by Formula. The process is performed individually for three component pure premiums, serious[28] indemnity, non-serious indemnity, and medical combined. Loss data is partitioned into additional groups for the purpose of determining the indicated pure premium, as described below. However, once the indicated pure premium is determined, the process continues based on the three component pure premiums listed above.

Indicated Pure Premium
The indicated pure premium is calculated using actual loss experience in Florida. The most recent five available policy years of data from the WCSP are used. For the rates effective

[28] *Serious cases include fatal, permanent total, major permanent partial. Non-serious includes all other.*

January 1, 2006, the five most recent policy years were 1998 through 2002.[29] Losses are partitioned and analyzed by injury type, as follows:

Indemnity	Medical
Fatal	Serious
Permanent Total	Non-Serious
Major Permanent Partial	
Minor Permanent Partial	
Temporary Total	

Individual claims in the WCSP database are limited to a maximum limit to prevent distortion to individual classification rates. The limit on individual claims used for rates effective January 1, 2008 is $986,000. The limit on multi-claim occurrences is twice the limit on individual claims.

The following adjustments are made to each loss component:

Loss Development:	Losses are developed from a first report through a fifth report using paid loss plus case reserve loss development factors calculated from WCSP data. Loss development from a fifth report to ultimate is based on statewide LDFs calculated from financial call data and used in the calculation of the statewide rate change.
Experience Change:	Losses are adjusted for the statewide average experience change.
Trend:	Losses are trended based on the selected annual indemnity and medical trend factors used in the statewide rate change calculation.
Benefit Level:	Losses are adjusted to the expected benefit level.
LAE:	Losses are adjusted to include LAE.
Off-Balance:	Losses are adjusted to remove the impact of experience rating off-balance.
Industry Group:	Losses are adjusted to reflect the relative experience of their industry group.
Unlimited to Limited:	Losses are increased to offset the impact of limiting individual claims. This is the process by which the impact of large losses is shared between all classes in an industry group.

[29] *Based on Oliver Wyman's review of the prior actuarial review, there had been a concern that the most recently available policy years were not being used, and that the data used to determine the indicated pure premium was older than necessary. This issue has been addressed.*

Pure Premium Present on Rate Level
The pure premium present on rate level is the pure premium underlying the current rate adjusted in a manner similar to the adjustments made to loss data used to calculate the indicated pure premium. Differences include no adjustment for loss development and no adjustment for loss limitation, as the pure premium underlying the current rate is already on an ultimate loss basis and already reflects unlimited losses.

Pure Premium Indicated by National Relativity
The pure premium indicated by national relativity is the pure premium for the specific classification adjusted to Florida cost and benefit levels.

Pure Premium Derived by Formula
The pure premium derived by formula is a weighted average of the indicated pure premium, the pure premium present on rate level, and the pure premium indicated by national relativity. The weights are calculated using a credibility procedure that gives weight to the indicated pure premium (actual loss experience) based on actual loss experience.

Conversion of the Pure Premium to a Manual Rate

In this step the pure premium derived by formula is loaded for expense and profit (and contingency) provisions determined in the statewide rate change calculation.

Application of Swing Limits and Test Correction Factors

Resulting manual rates are tested for rate swing. Currently in Florida, the rate change to an individual classification is limited to a range within 20% of the change to the industry group to which the classification belongs. For example, if a specific industry group has a 12% rate increase, the rate change for each classification in that industry group can be no greater than 32% (= 12% + 20%) or less than -8% (= 12% - 20%). As a result of the limiting procedure, as well as other processes within the ratemaking calculation, the resulting average rate change for all classifications in an industry group may not precisely equal the required industry group change. This is addressed by calculation of a test correction factor (TCF) that is applied to each individual classification rate to ensure that the required industry group change is achieved. The calculation of the TCF is an iterative procedure, because no individual classification rate is permitted to violate the swing limit test.

Disease Loadings

The last step is addition of specific disease loadings for individual classifications to which this applies. An example is the disease loading of 0.10 per $100 of payroll for classification 8833 "whenever this classification is applied to a hospital or sanitarium specializing in the treatment of tuberculosis."

Findings

General Findings

The NCCI calculation of individual classification rates is actuarially sound and commonly applied in other states.

Specific Issues

As discussed in the Executive Summary, there is a lag in the distribution of expected SB 50A savings to individual classes. As a result, while average statewide rate level has been appropriately adjusted for the impact of SB 50A, certain individual workers' compensation classifications have been charged premium rates that are too high, while others have been charged premium rates that are too low. The principal reason for this is that current ratemaking methodology tends to delay the redistribution of costs post SB 50A to individual classifications. These issues were discussed at length in the Executive Summary and are addressed in Oliver Wyman's recommendations.

Rating Values

Oliver Wyman's examination was limited to the variation of certain rating values over time. In particular, Oliver Wyman examined:

Expected Loss Rates

D Ratios

Excess Loss Factors

Oliver Wyman notes that while there were some outliers, changes from rating values effective January 1, 2007 to January 1, 2008 were not unusual. However, Oliver Wyman does note that expected loss rates, during the period from 1/1/05 to 1/1/08, decreased, on average, by a materially lower amount than rates. This was not expected, since expected loss rates are calculated directly from rates, by classification. This item was discussed with NCCI, who noted that there are a number of reasons that, given the dramatic changes in experience in Florida, could be the source of this observation. All parties agreed, however, that the behavior of the experience rating program, which depends critically on expected loss rates, appears to have been reasonable over time and that this observation is not a material concern at this time.

CAVEATS AND LIMITATIONS

1. The conclusions within this study are developed in the accompanying text and exhibits, which together comprise the report.

2. The report was prepared for the use of the Financial Services Commission, State of Florida. This report may be distributed only in its entirety.

3. The information and advice contained in this document is not intended by Oliver Wyman to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code that may be imposed on the taxpayer.

4. Oliver Wyman's findings that specific processes, judgments, or assumptions were reasonable, or its lack of issue with the same, do not necessarily mean that Oliver Wyman endorses them or would take the same approach if Oliver Wyman were to conduct its own independent analysis.

5. The exhibits and conclusions drawn thereof in this report rely on the accuracy and completeness of the data and information provided without independent audit. If the data or information is inaccurate or incomplete, the findings and conclusions of this report may have to be revised.

6. The conclusions are projections of the financial consequences of future contingent events and are subject to uncertainty. There may have been abnormal statistical fluctuations in the past, and there may be such fluctuations in the future. Due to the inherent uncertainties actual costs may vary significantly from published rates.

7. Unanticipated changes in factors such as judicial decisions, legislative actions, claim consciousness, claim management, claim settlement practices, and economic conditions may result in actual experience that is significantly different from estimates.

8. In addition to the assumptions stated in this report, numerous other assumptions underlie the calculations and results presented herein.

9. Numbers in tables and exhibits are generally displayed to more significant digits than their accuracy suggests.

10. The opinions set forth in this document are for purposes of discussion of Oliver Wyman's findings with the State of Florida and NCCI. Oliver Wyman reserves the right to revise its recommendations should additional analysis performed in the future, or additional data and information that emerge in the future, indicate the need to do so.

11. The information and advice contained in this document is not intended by Oliver Wyman to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code that may be imposed on the taxpayer.

12. These caveats and limitations notwithstanding, the conclusions represent Oliver Wyman's professional opinion as respects the analysis presented in this report.

DOCUMENTS AND INFORMATION

The following is list of documents utilized for the purpose of this report. In addition to documents listed below, Oliver Wyman may have relied on internal data sources, insurance industry data sources, or other information not specifically listed below.

All documentation provided during the course of Oliver Wyman's prior analysis.

2008 Reporting Guidebook for the Annual Calls for Experience
2007 Reporting Guidebook for the Annual Calls for Experience

2007 NCCI Annual Statistical Bulletin
2006 NCCI Annual Statistical Bulletin

Florida Workers Compensation Rate Hearing on October 9, 2006 for application effective 1/1/07

- NCCI Application including Exhibits and Technical Supplement
- Response to Interrogatories from Mr. James Watford, ACAS
- Data underlying Florida A-Sheets effective January 1, 2007
- Robert F. Conger's Testimony
- Tony DiDonato's Testimony
- Tony DiDonato's Supplemental Testimony
- Direct Testimony of Martin H. Wolf, Ph.D.
- Compliance Filing

Florida Workers Compensation Rate Hearing on October 8, 2007 for application effective 1/1/08

- NCCI Application including Exhibits and Technical Supplement
- Data underlying Florida A-Sheets effective January 1, 2008
- Response to Interrogatories from Mr. James Watford, ACAS
- Dr. Mark Crawshaw's Explanatory Memo
- Dr. Mark Crawshaw's Direct Testimony
- Dr. Mark Crawshaw's Rebuttal Testimony
- Tony DiDonato's Testimony
- Tony DiDonato's Supplemental Testimony
- Direct Testimony of Martin H. Wolf, Ph.D.
- Compliance Filing
- NCCI Response to Oliver Wyman's prior report, April 20, 2006
- Lori Lovgren Pre-filed Testimony
- WCSP Loss Development Exhibits
- Florida Off-Balance Exhibits

Case Reserve Study - Summary of Responses: April 2006
Case Reserve Study – Questionnaire

NCCI Power Point Presentation on the impact of 2004 storm activity in Florida