



# **NCCI PY2015 Florida Rate Hearing**

## **Financial Analysis**

October 14, 2014

Harry Shuford  
Chief Economist

# NCCI PY2015 Florida WC Rate Hearing Financial Analysis

- Methodology
  - Models Unchanged
    - DCF
    - CAPM
    - IRR
  - Inputs Updated
    - Value Line Projected Dividend Growth Up 0.01%
    - Provision for Share Buy-backs Lower
    - Current Effective Dividend Yield Lower
    - Beta Lower
    - Cost of Capital Lower
- Financial Markets Improved
  - Interest Rates Are Now Just Above Recent Historic Lows
  - Stock Market Gained



# Cost of Capital – Overall Result

Cost of Capital (DCF) 10.42%

Cost of Capital (CAPM) 10.67%

**Estimated Cost of Capital (DCF & CAPM) 10.53%**



# What Contributed to the Change in the Indicated PY 2015 P&C for Florida

## FLORIDA - VOLUNTARY INTERNAL RATE OF RETURN MODEL

### RECONCILIATION EXHIBIT

1/1/15 vs 1/1/14

Change	From	To	P&C	Change in P&C	% Change in P&C
Last Year's Starting Value			8.334	-	



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Loss Payout Pattern			6.630	-0.105	6.2%

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TRUE

100.0%



# **NCCI PY2015 Florida WC Rate Hearing Financial Analysis**

Interest Rates, Investment Income, and the  
Underwriting Cycle



# NCCI PY2015 Florida WC Rate Hearing Financial Analysis

Over the Past Quarter Century

Every Hard Market Has Followed a Recession

Every Recession Has Been Followed by a Hard  
Market



# NCCI PY2015 Florida WC Rate Hearing Financial Analysis

Why?

Interest Rates Fall During and Following Recessions

# **NCCI PY2015 Florida WC Rate Hearing Financial Analysis**

This Reflects the Fundamental Challenge in  
Managing the Financial Performance in Property and  
Casualty Insurance

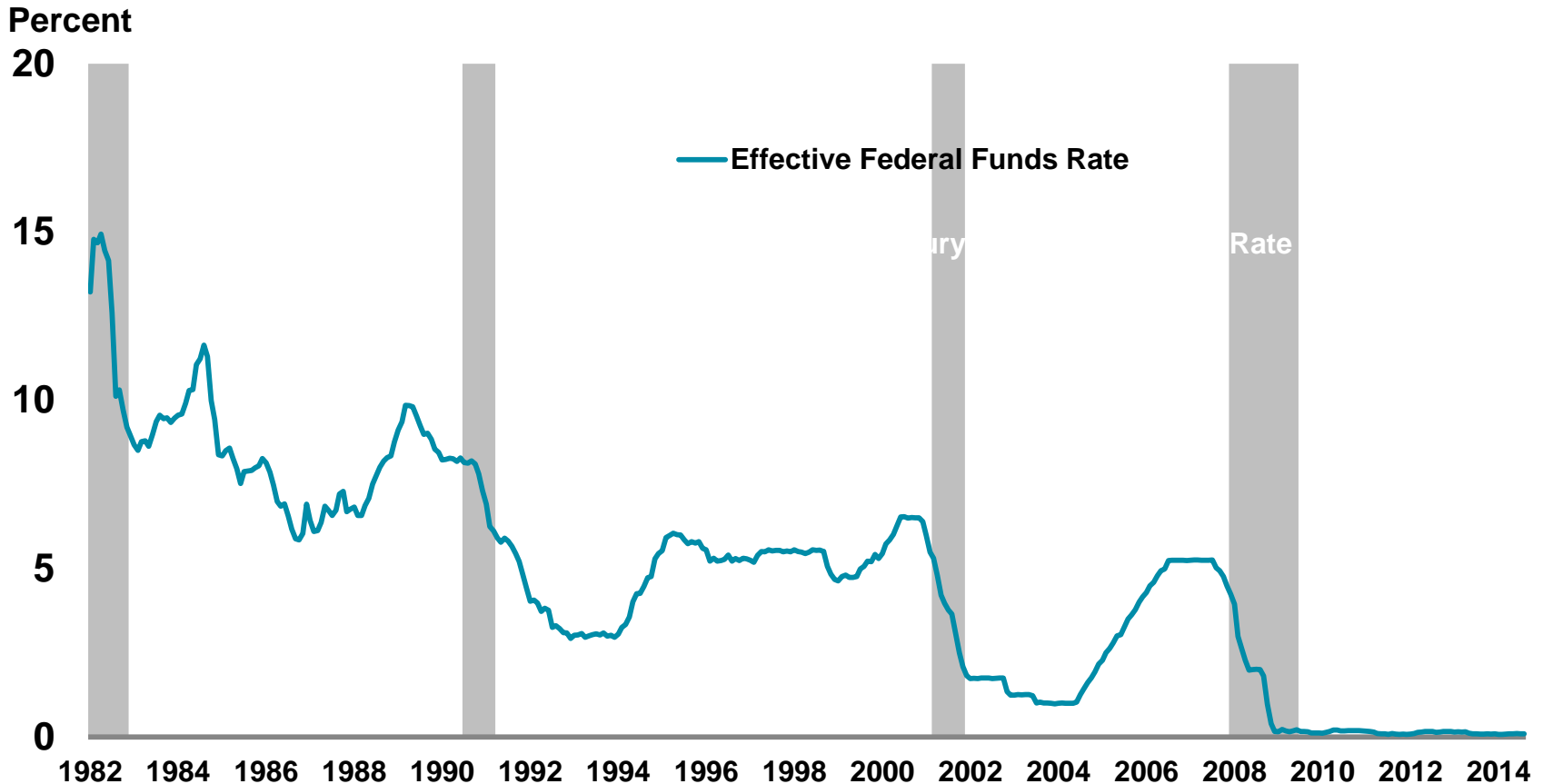
Trying to Maintain an Appropriate Balance between  
Underwriting and Investment Returns

# NCCI PY2015 Florida WC Rate Hearing Financial Analysis

Interest Rates Are at or Near Their Historic Lows



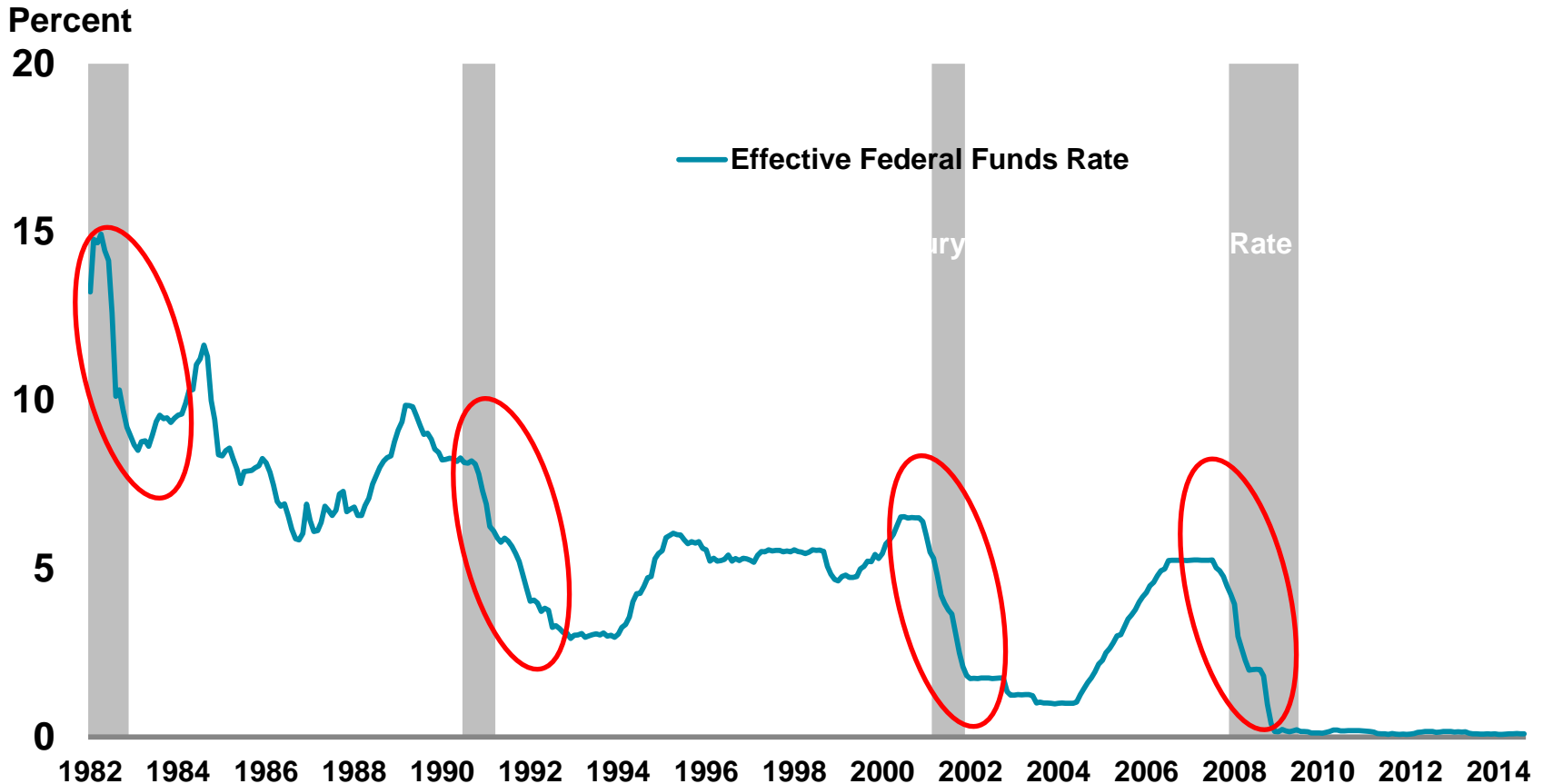
# The Federal Reserve Typically Reduces Short-Term Interest Rates Before the Start of a Recession, With Declines Continuing After the Economy Begins to Expand -



Shaded areas indicate U.S. economic recessions  
Source: Board of Governors of the Federal Reserve System

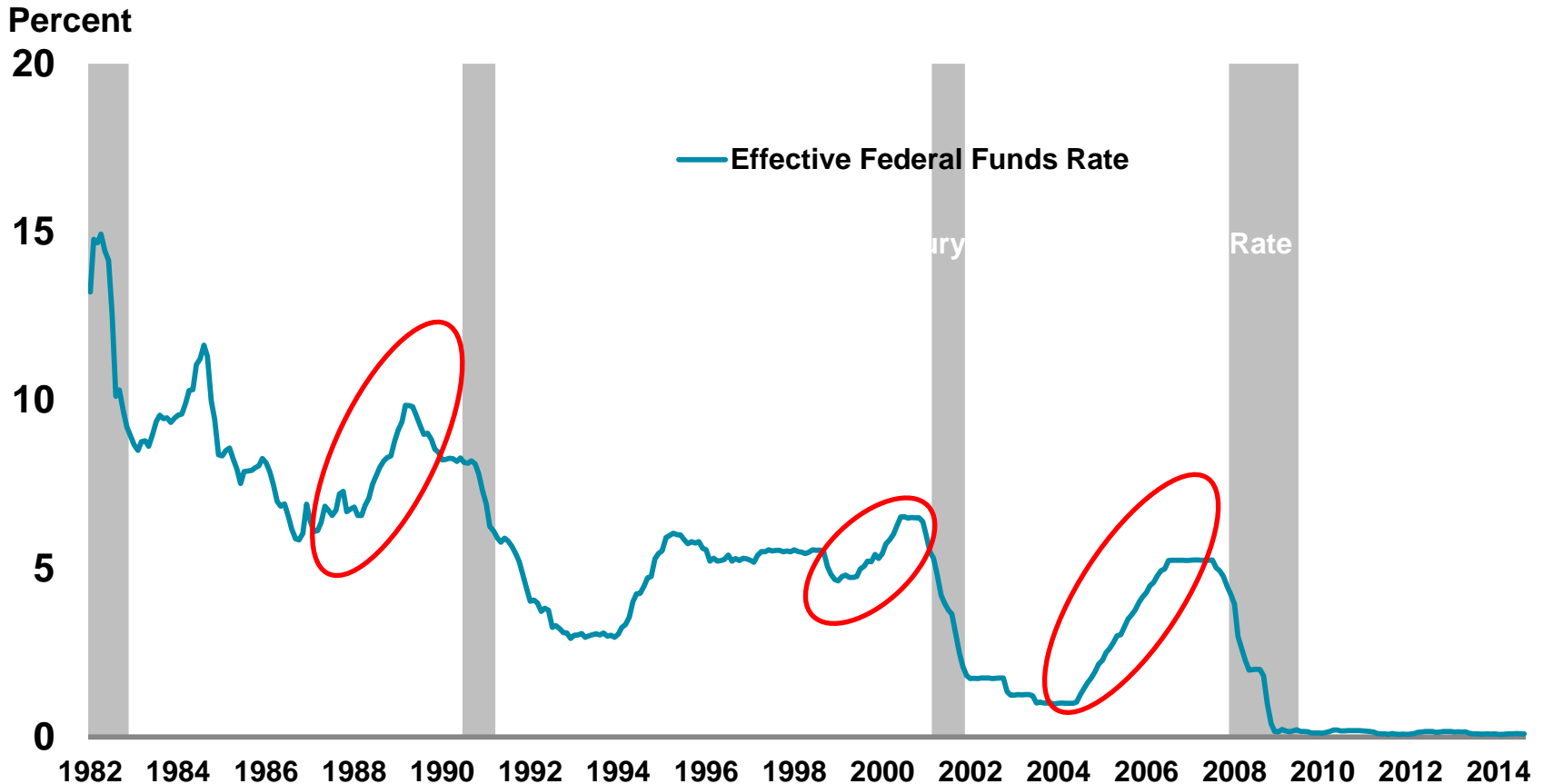


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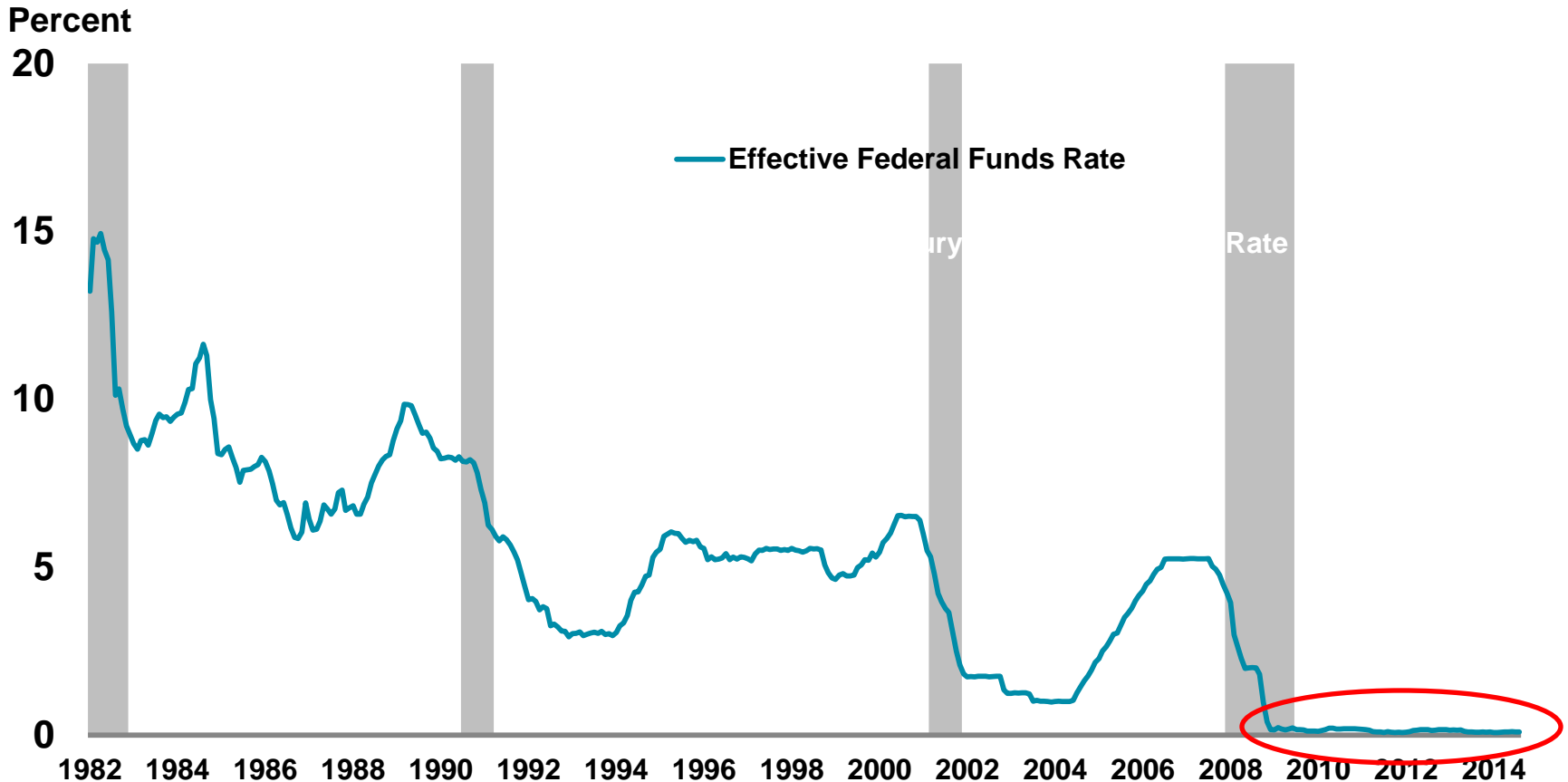
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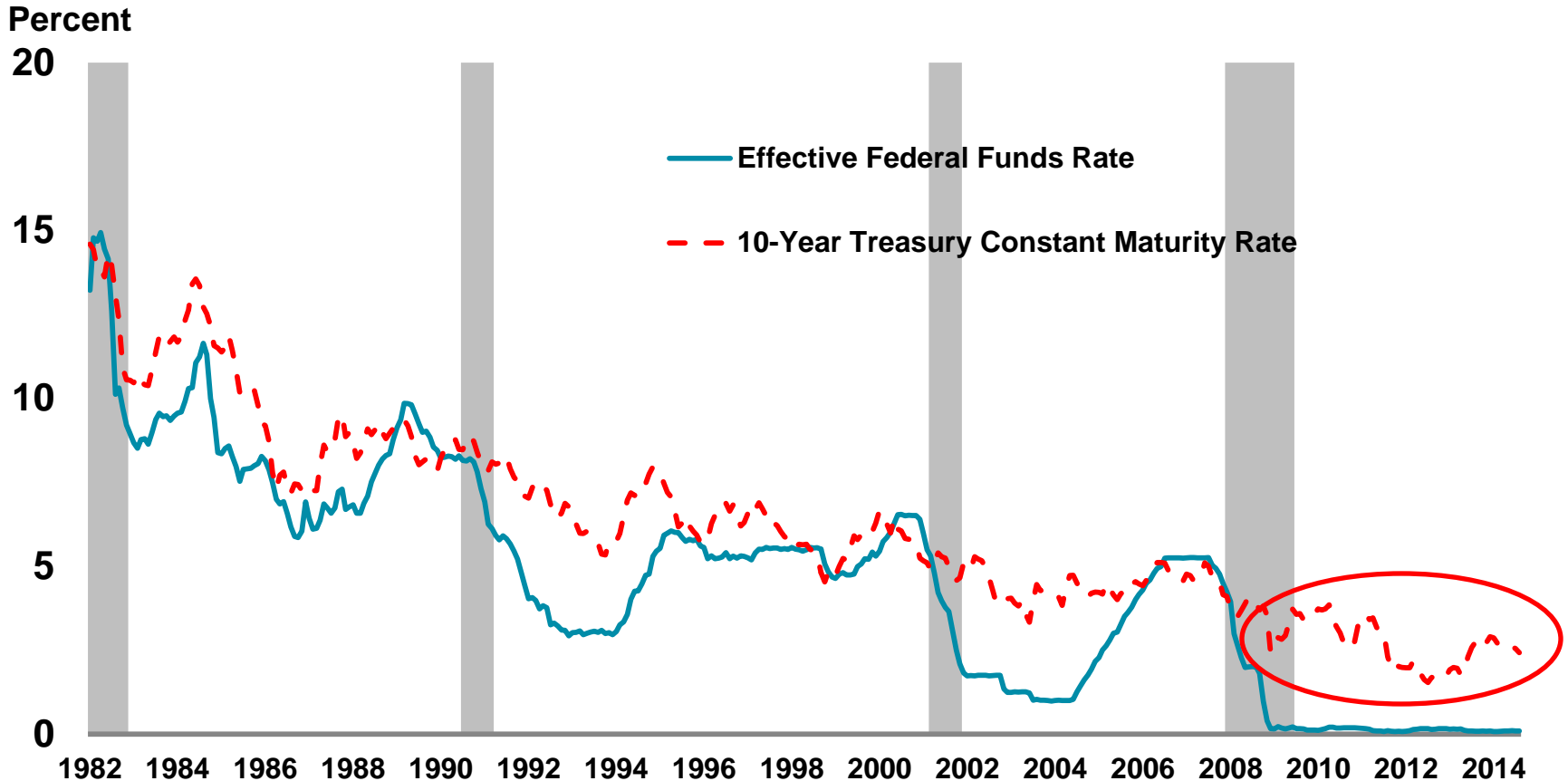
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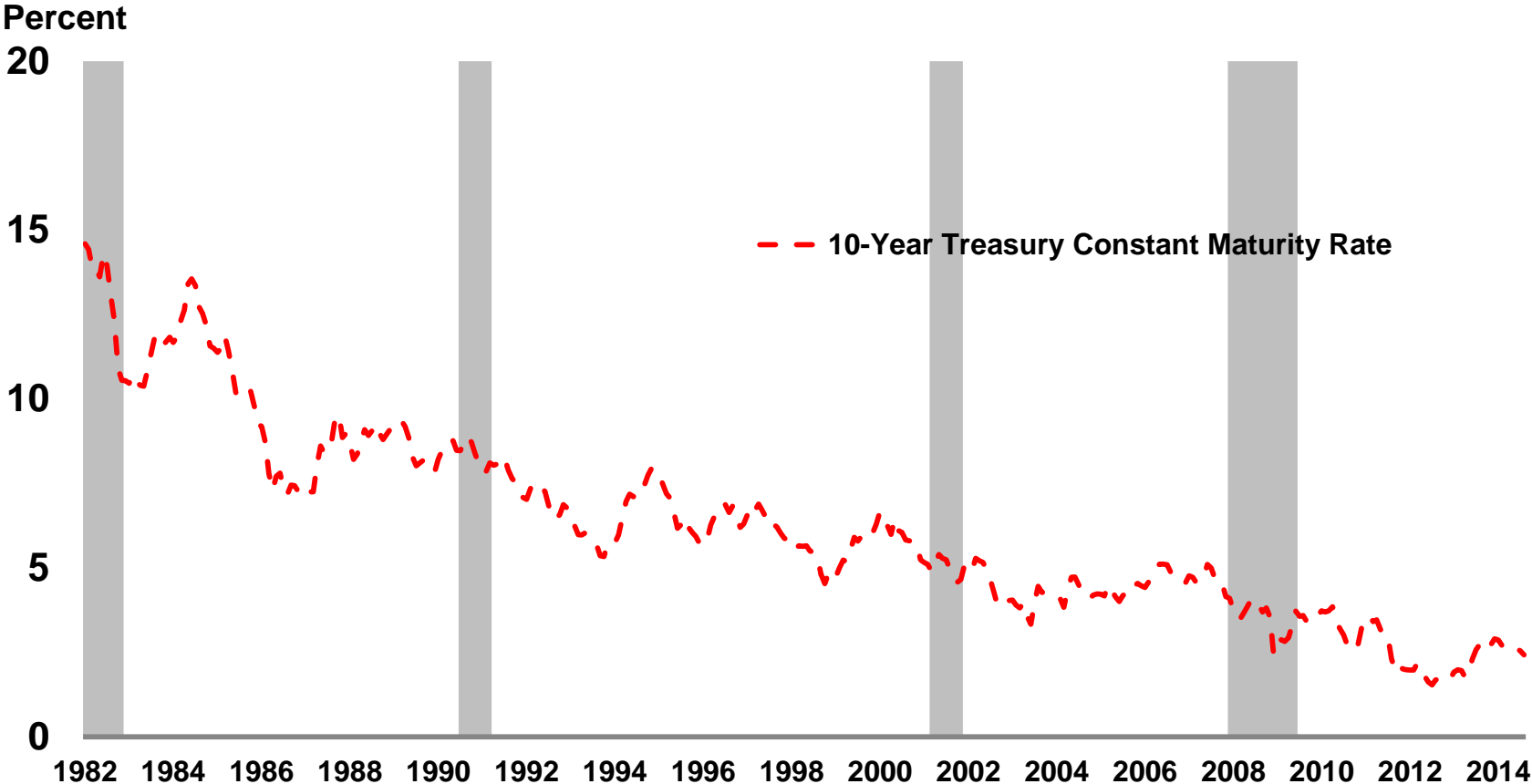
# The Federal Reserve Typically Reduces Short-Term Interest Rates Before the Start of a Recession, With Declines Continuing After the Economy Begins to Expand - Other Interest Rates Follow



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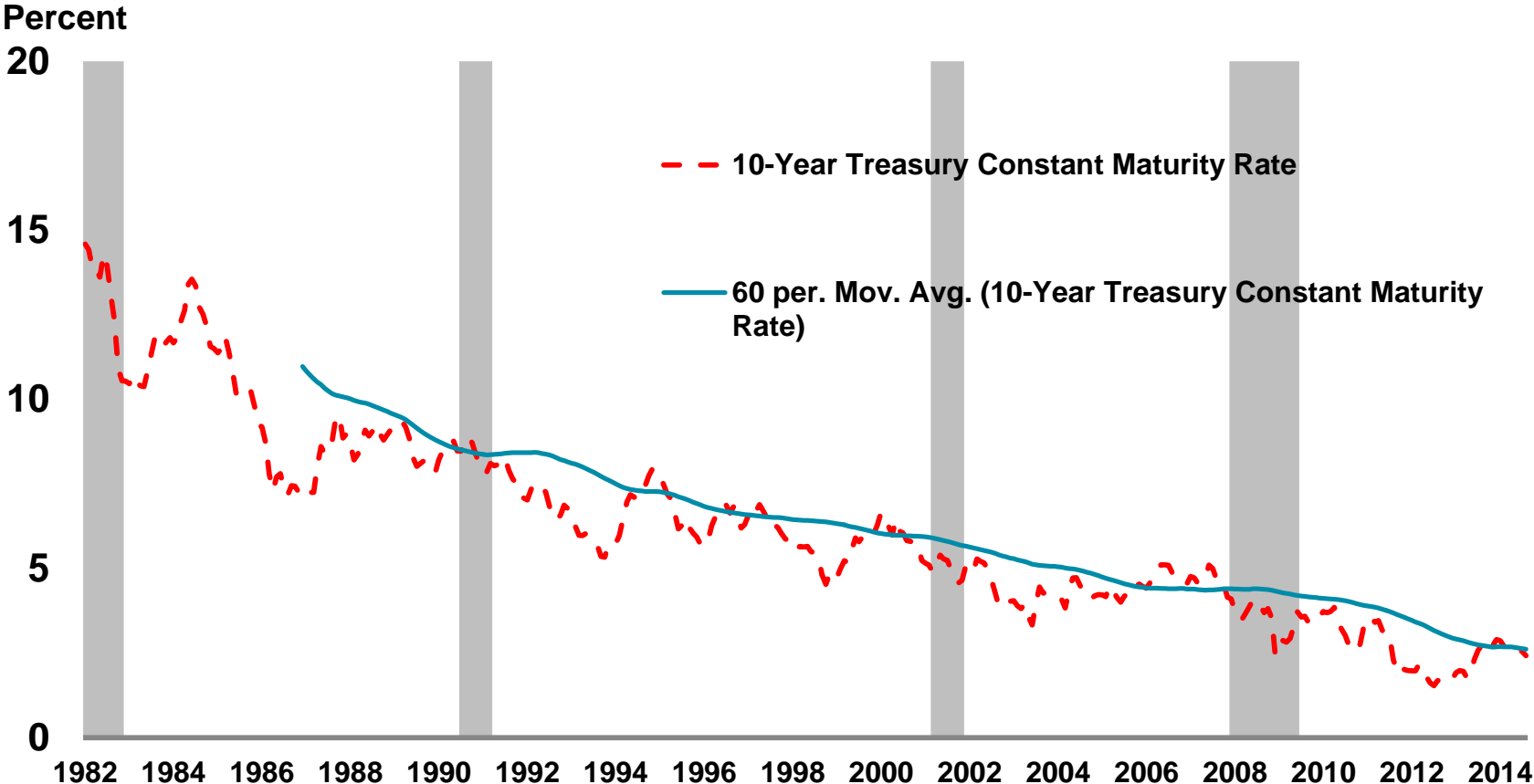
# Long-term Interest Rates Have Been Trending Downward for More than a Quarter Century and Are Currently Near Historic Lows



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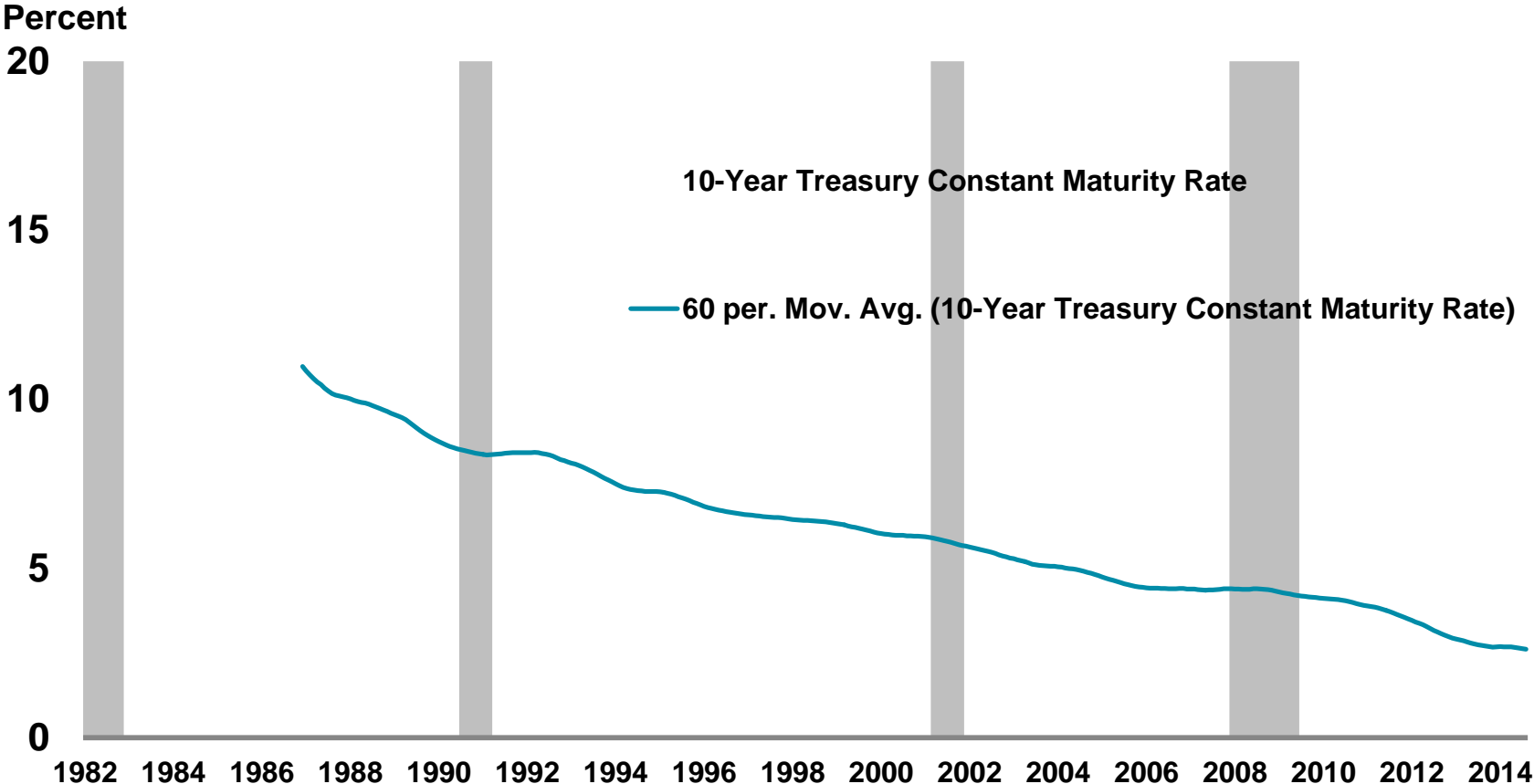
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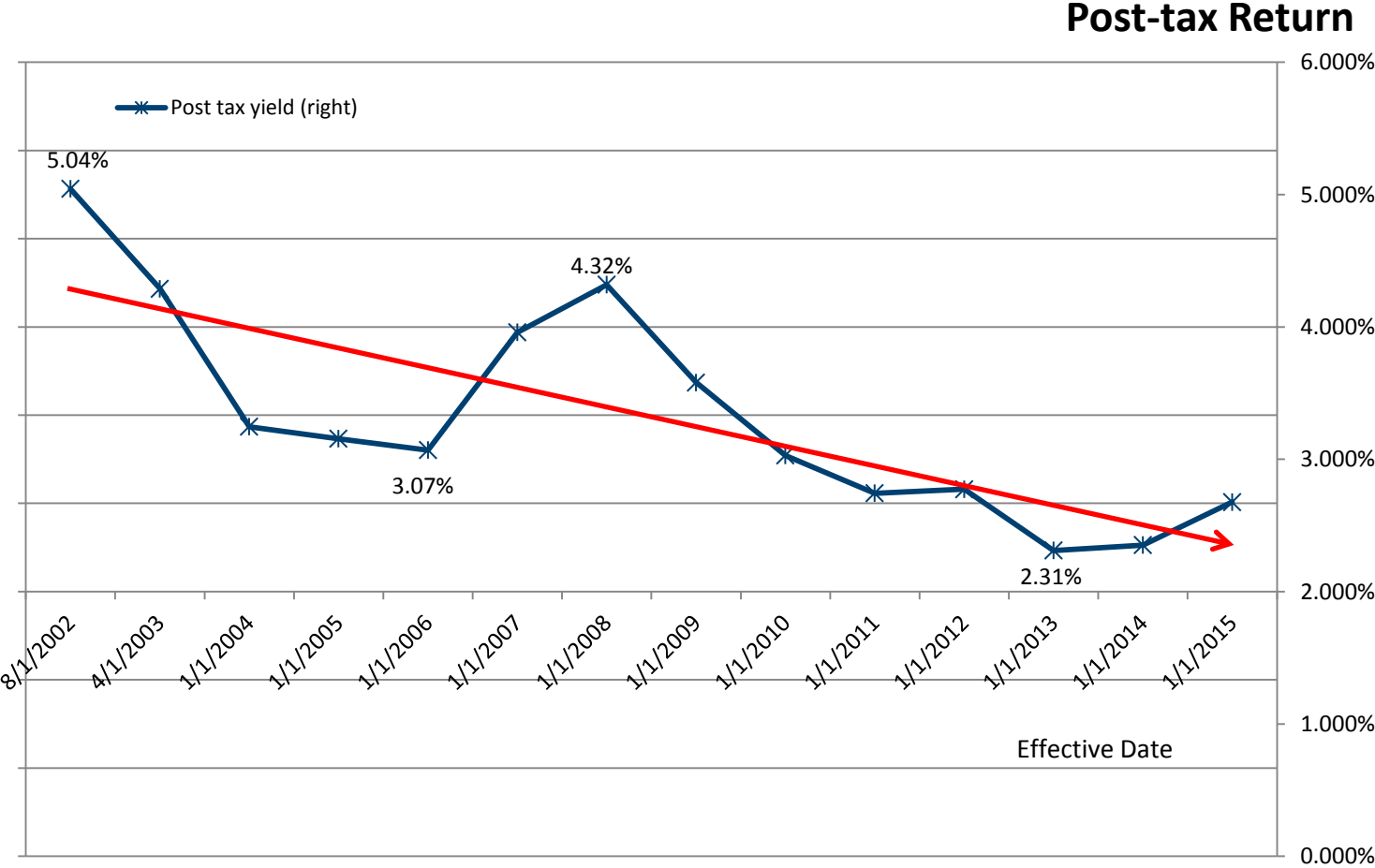
# NCCI PY2015 Florida WC Rate Hearing Financial Analysis

Interest Rates Are at or Near Their Historic Lows

Why Does This Matter?

It Means that Expected Investment Income Is Low

# Changes in the Post-tax Yield Are a Key Driver of Changes in the P&C

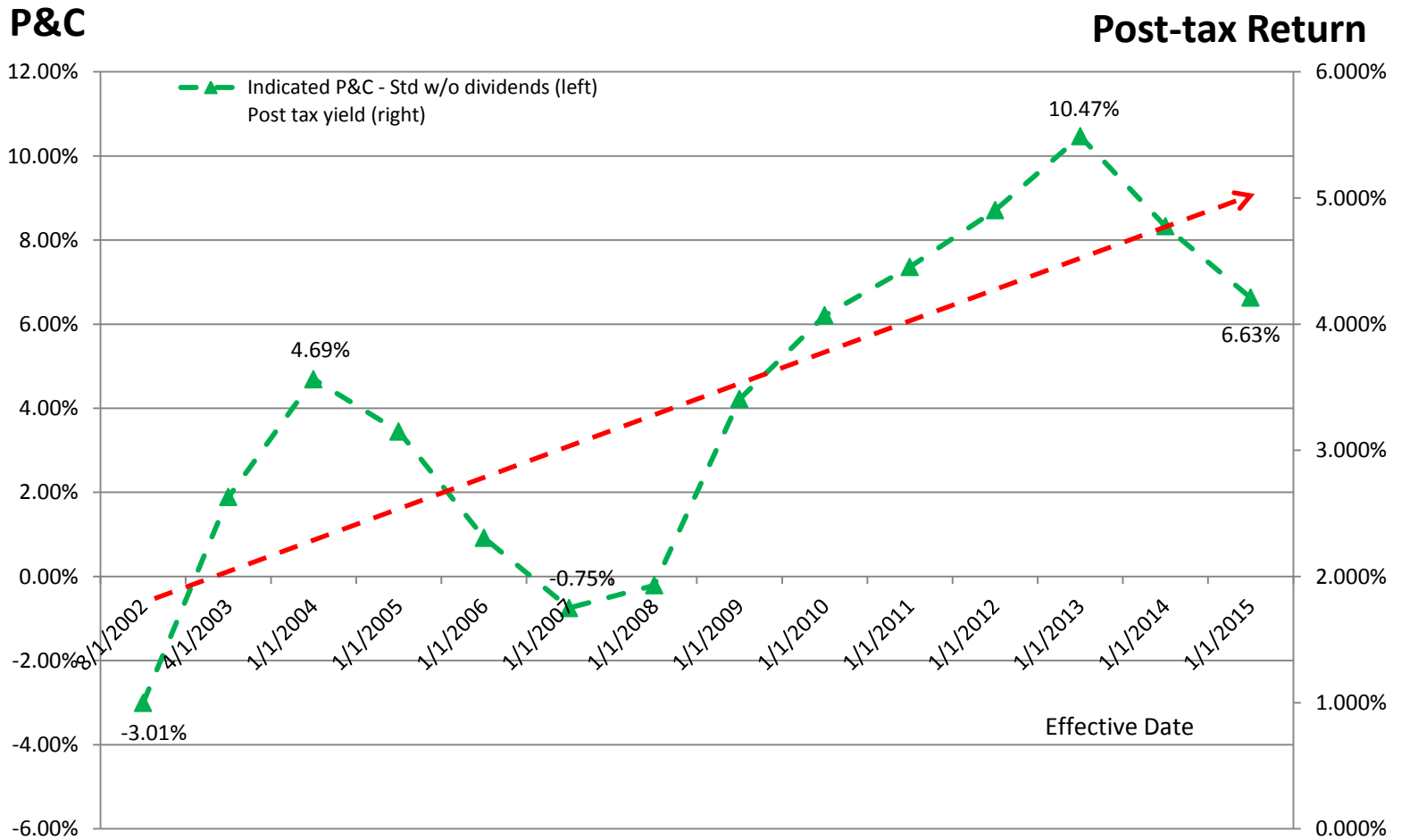


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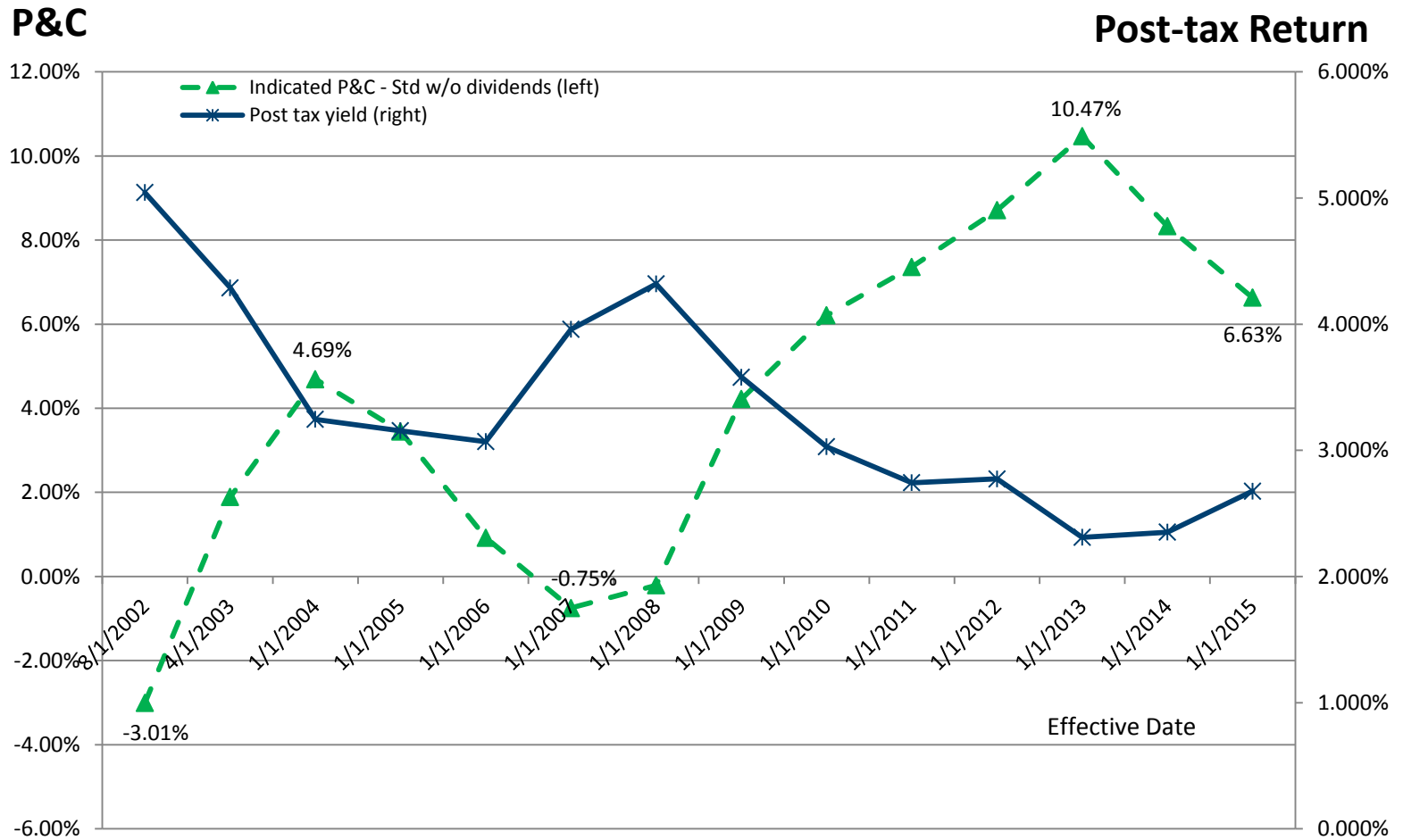
When Expected Investment Income Is Low

The Indicated P&C Is High

# Changes in the Post-tax Yield Are a Key Driver of Changes in the P&C



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# **NCCI PY2015 Florida WC Rate Hearing Financial Analysis**

Underwriting Results Must Improve to  
Offset the Projected Decline in Investment Income

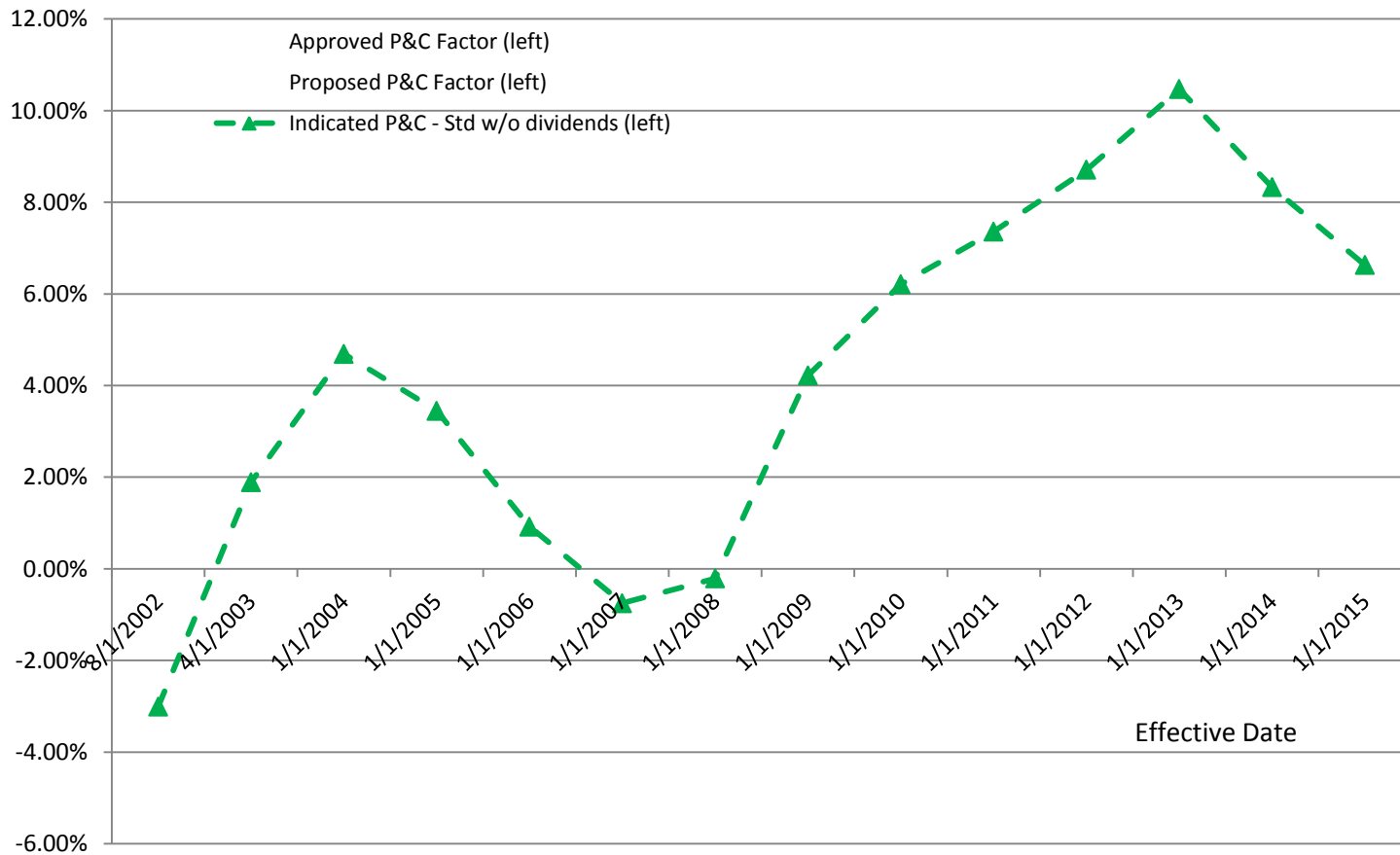
# NCCI PY2015 Florida WC Rate Hearing Financial Analysis

Over the Past Five Years the Filed and Approved P&Cs Have Been Significantly Lower than the P&Cs Indicated by NCCI's Financial Analysis



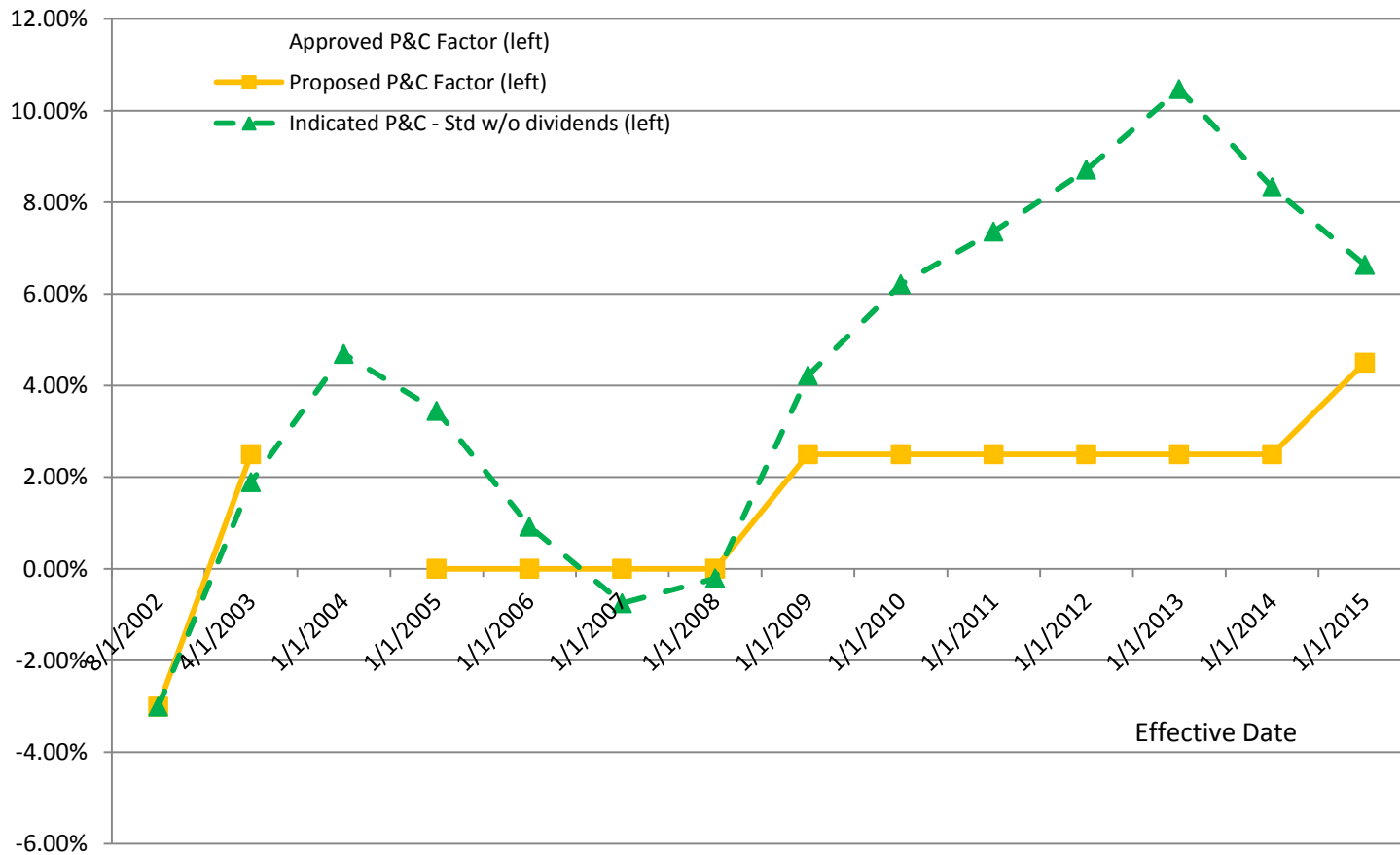
# The Approved P&C Has Been Significantly Lower than the Indicated for the Past Five Years

## P&C



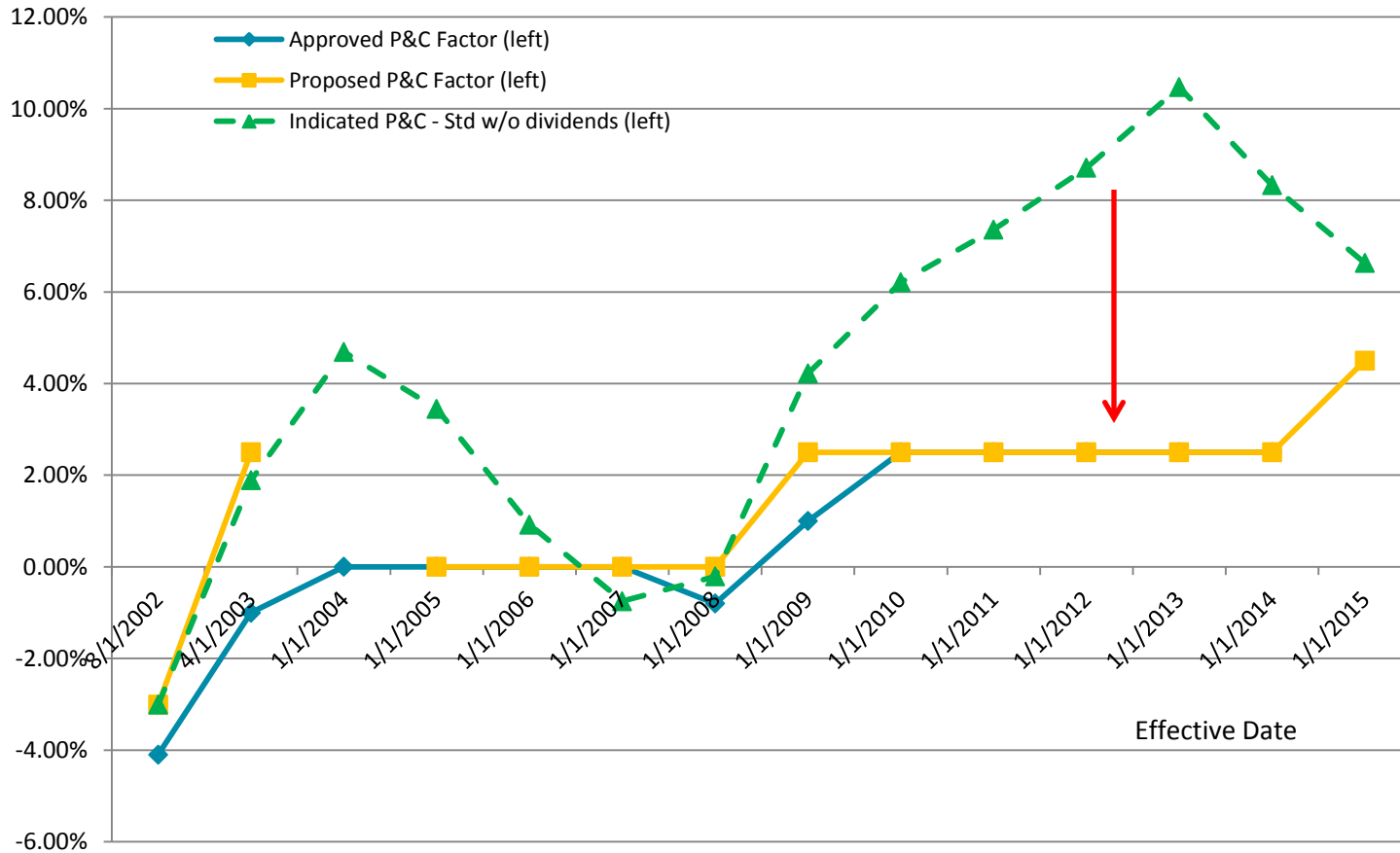
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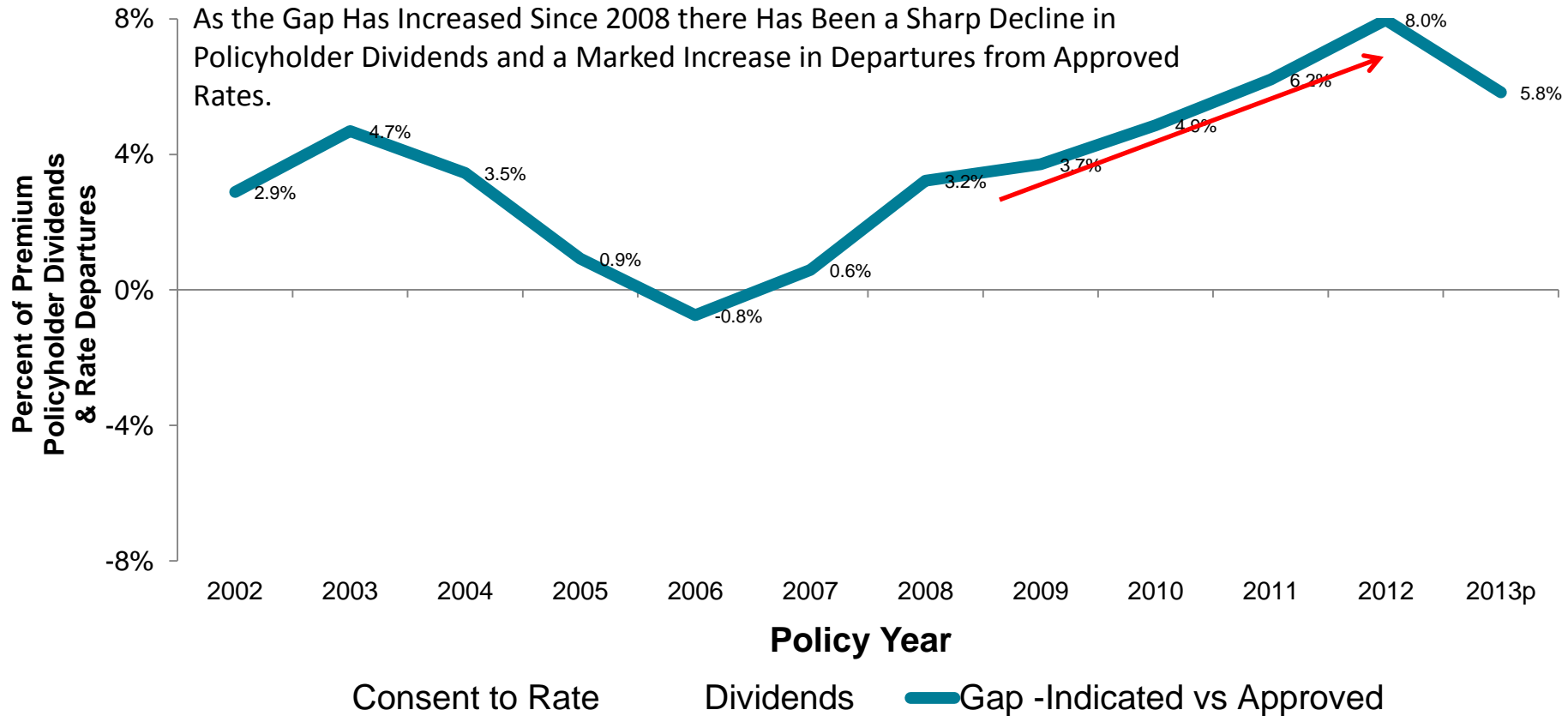


# NCCI PY2015 Florida WC Rate Hearing Financial Analysis

Why Should the Selected and Approved P&Cs Be Closer to the Value Indicated by this Financial Analysis.

The Impact on the Florida Workers Compensation Market of Capping the P&C at 2.5% Has Been Increasing Steadily for Several Years

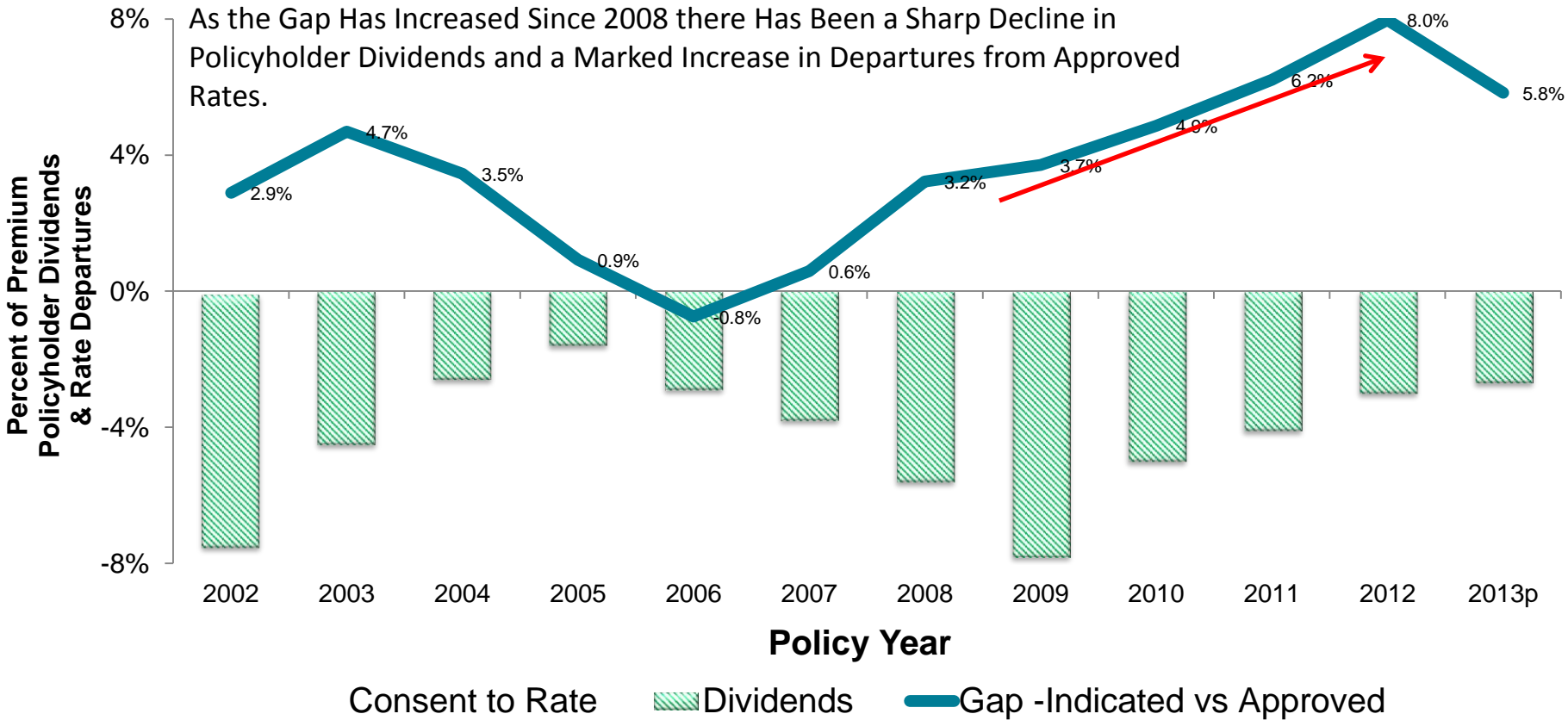
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p Preliminary  
 Based on data through 12/31/2013  
 Dividend ratios are based on calendar year statistics



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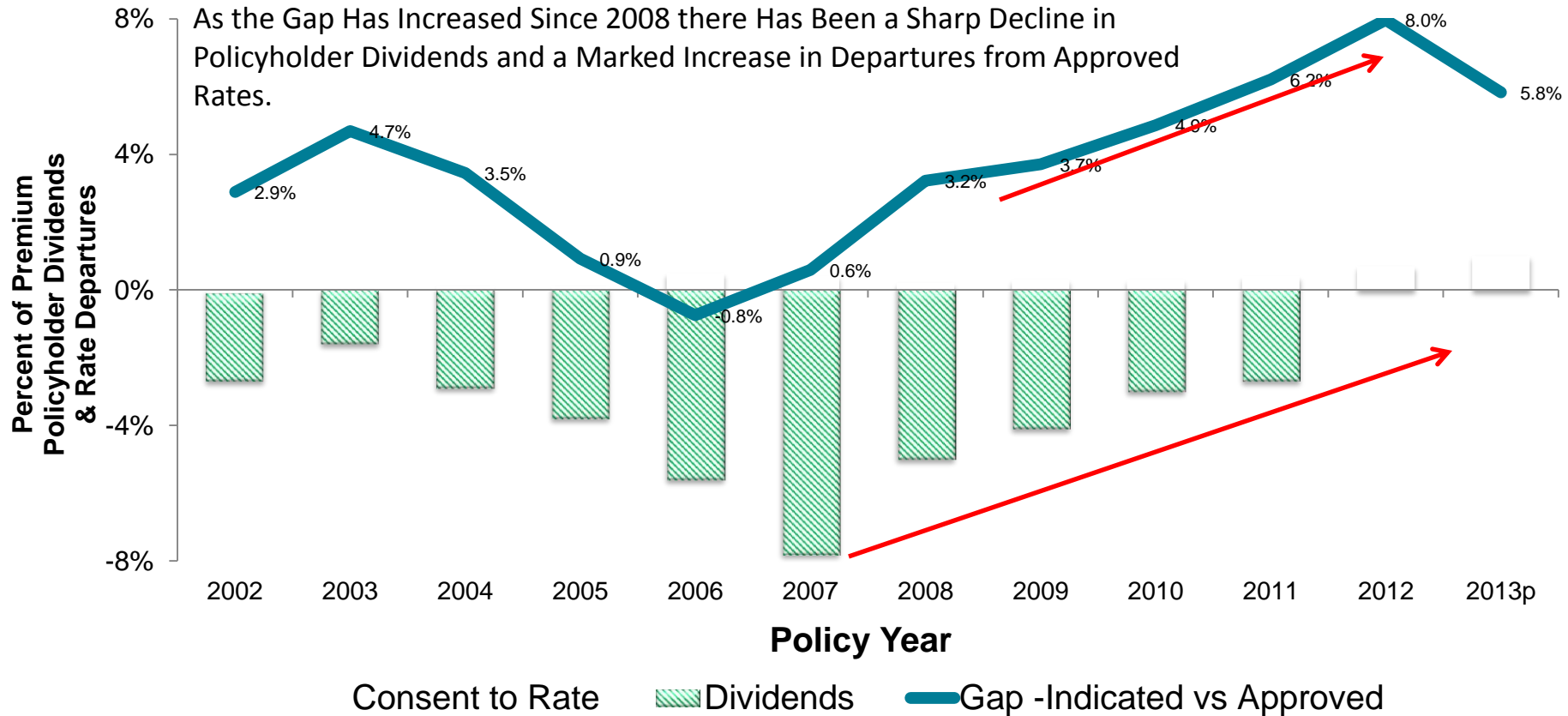


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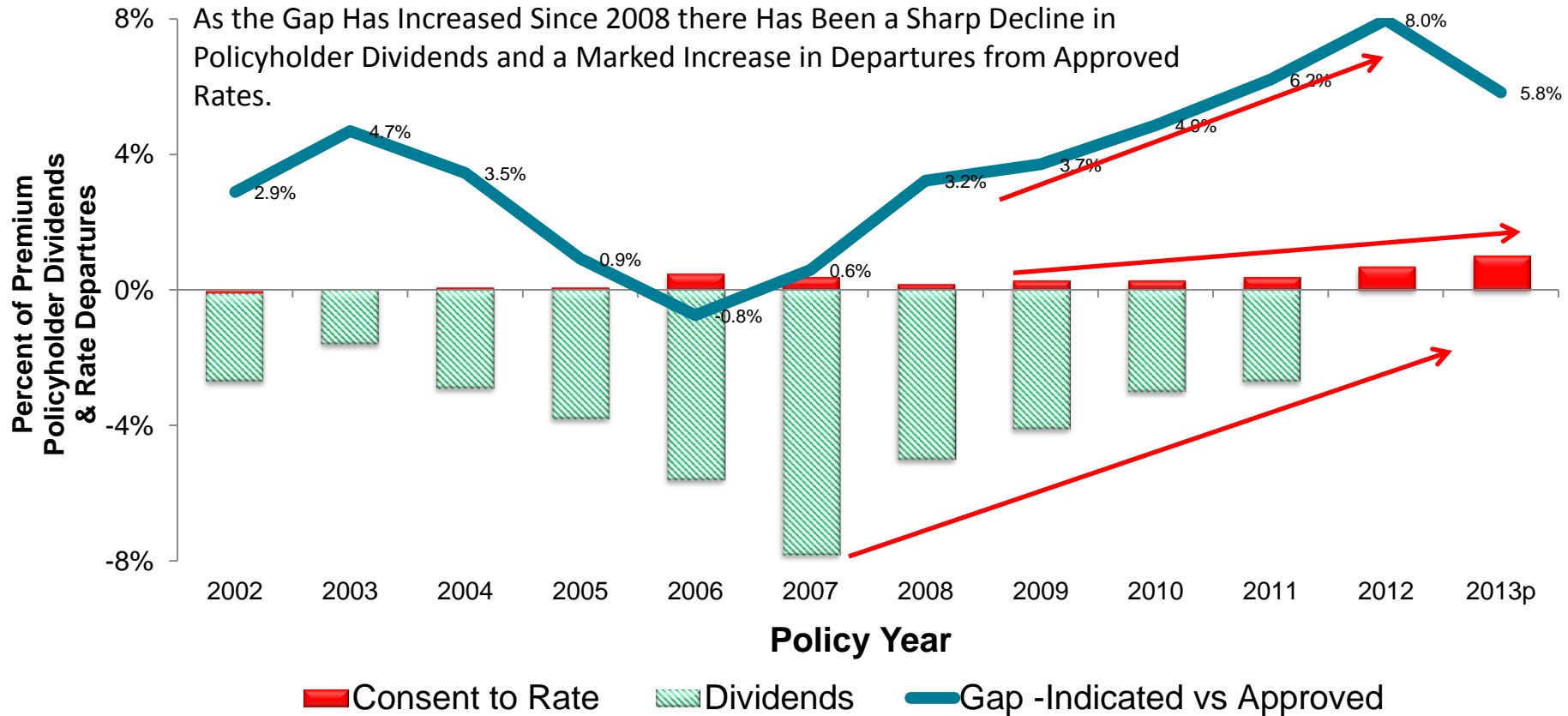
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Why Should the Selected and Approved P&Cs Be  
Closer to the Value Indicated by this Financial  
Analysis?

To Ease the Financial Pressures that Have Been  
Growing in the Workers Compensation Market in  
Florida

# NCCI PY2015 Florida WC Rate Hearing Financial Analysis

Questions and Comments

