STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

In the Matter of the Adoption of the Proposed Amendments to Rules Relating to Workers' Compensation Insurance Rates

STATEMENT OF NEED AND REASONABLENESS

STATEMENT OF AUTHORITY

Minnesota Statute § 79.51 requires the commissioner to issue rules implementing the provisions of Chapter 79. Rules 4 MCAR § 1.9140 - § 1.9143 were adopted in June, 1983, in fulfillment of this requirement. The current rules were originally written to facilitate the introduction of open competition during the transition period from July 1, 1983, to December 31, 1985. They were adopted following a hearing before Hearing Examiner Jon Lunde in January, 1982. The 1983 legislature accelerated the date of full competitive rating to January 1, 1984, eliminating the transition period. Prior to adoption, those sections of the rules governing the transition period were removed and various minor changes necessary to comply with the new law were made.

The proposed revisions and additions to the current rules are necessary to complete the requirements of Minnesota law. Included is a section on monitoring competition which responds to a mandate of the 1983 legislature. The proposed rules also cover recommendations made by Hearing Examiner Lunde in his report dated February 11, 1983.

Amendments to the Current Rules

4 MCAR § 1.9140 Definitions.

A. Applicability.

Subdivision A is amended to reflect the addition of rules 4 MCAR §§ 1.9144 - 1.9147.

C. Commissioner.

Subdivision C is amended to change the meaning of the word "commissioner" from the commissioner of insurance to the commissioner of commerce as required by Laws of Minnesota for 1983, ch. 289, Section 114.

L. Rating plan.

Subdivision L, which defines the term "Rating Plan" needs to be added since the term is referenced elsewhere in the rules and must be defined the same as in the statute.

4 MCAR § 1.9141 Licensing of data service organizations.

A. Application information.

Subdivision A.2.e is amended to correct a typographical error in the rules as adopted in June, 1983.

C. Amendments to application.

Subdivision C has been added to provide a procedure for amending original data service organization (DSO) applications and for amending manual rules. Minn. Stat. section 79.62 requires DSO's to be licensed by the commissioner. The license application is required to include manual rules related to the statistical plan and the classification system. The license remains in effect until the licensee withdraws from business or until the license is suspended or revoked. Prior to the effective date of Minn. Stat. section 79.62, the Rating Association was required to annually renew its license. This process provided a yearly opportunity for updating or amending the application and related manuals. Since the new law does not require annual application, some procedure is needed to amend the original application or associated manuals. Subdivision C requires the DSO to file any amendments to the application with the commissioner. Amendments are deemed effective in 30 days unless disapproved by the commissioner. DSO's must also file any proposed change in the statistical plan, classification system or manual rules with the commissioner. These changes must also be approved by the commissioner, who also establishes the effective date of the change. To ensure uniformity, all workers' compensation insurers must use the statistical changes in reporting data to the DSO of which they are a member.

D. Granting of license.

Subdivision C has been amended to become Subdivision D to allow for the addition of the new Subdivision C, above.

4 MCAR § 1.9143 Ratemaking report.

B. Contents of ratemaking report.

Subdivision B.2 is amended to include a requirement that both the commissioner and the DSO shall make a copy of the ratemaking report available for inspection during normal working hours. This amendment is needed to ensure that the public has reasonable access to the contents of the ratemaking report.

C. Use of ratemaking report.

Subdivision C.1 is amended to clarify that insurers may develop their own workers' compensation rates as long as they are consistent with the cited statutes.

D. Review by commissioner.

Subdivision D is needed to delineate a process to resolve disputes between the commissioner and the DSO with respect to the ratemaking report. Minn. Stat. section 79.61 requires the DSO to prepare and distribute a report on ratemaking in a form prescribed by the commissioner. But there is no process defined for

resolving any disagreements that may arise between the commissioner and the DSO as to the form of that report. Therefore, subdivision D authorizes the commissioner to issue an order specifying in what respects the report is deficient or fails to comply with Minnesota law. The DSO may ask for a hearing within 30 days after receiving the order.

New Rules

4 MCAR § 1.9144 Uniform data base.

A rule is needed to ensure adherence to a uniform classification and statistical plan. It is especially important in workers' compensation rate regulation to maintain sound statistical collection and reporting procedures. A sound workers' compensation data base is generally viewed as a necessary component in helping to achieve the objectives of the workers' compensation system, ie. the proper and equitable allocation of the cost of work-related injuries to the industry giving rise to them. This section is designed to maintain the appropriate data collection and reporting procedures required by the system. The rule contains three subdivisions designed to address the issue of maintaining a useful workers' compensation data base.

The perceived adequacy of the data base is also very important to both small employers and insurers. Uncertainty about the credibility of the data could lead to increased prices and more conservative underwriting, especially for the smaller or more risky employers. Lack of confidence in the data base could also result in the concentration of the market among those insurers with a large enough book of business to have confidence in their own data.

A. Uniform classification and statistical plan.

Subdivision A requires the commissioner to approve a uniform classification system, unit statistical plan and manual rules. Every workers' compensation insurer is required to report its workers' compensation experience consistent with the uniform statistical plan approved by the commissioner.

B. Amendments to the uniform classification or statistical plans.

Subdivision B allows any data service organization to file a petition with the commissioner to change the uniform classification system or statistical plan. Changes must be approved by the commissioner who will also set an effective date. This subdivision further requires that any change ordered by the commissioner must be used by all workers' compensation insurers when reporting data to the DSO.

C. Insurer variations.

Subdivision C permits insurers to develop variations of the uniform classification plan. Such variations are, however, subject to the commissioner's prior review in that they must be filed 30 days prior to its use. The subdivision specifically requires that variations shall be disapproved if the insurer fails to demonstrate that the data produced under such a plan cannot be reported consistent with the requirements of the uniform statistical plan and classification system. The burden is upon the individual insurer to show that, if it intends to use variations of the uniform classification plan, that such variations will not compromise the established data reporting procedures.

4 MCAR § 1.9145 Monitoring competition.

1983 amendments to Minn. Stat. § 79.51 require the commissioner to adopt rules governing the monitoring of competition. This rule is needed to provide a framework for monitoring the marketplace under competitive rating. Rather than approve a single schedule of rates, the responsibility of the insurance regulator under open competition is to monitor the efficiency of competition as a regulator of rates. Although it is difficult to specify a specific monitoring system, certain indicators can be used to make a judgement about the competitive market. The rule also responds to the recommendations of Jon Lunde, Hearing Examiner, in his report dated February 11, 1983.

Monitoring of competition is necessary to satisfy the public and the legislative concern that price competition is an effective method of rate regulation. The information gathered should help the regulator detect market weaknesses, initiate corrective action, identify noncompetitive markets, and remedy abuses. Competition should also be monitored to determine if there is an appropriate degree of competition. The commissioner may, as a result, recommend the expansion or contraction of the scope of competitive rating.

A. Information and anlysis.

Subdivision A directs the commissioner to monitor competition in the state in order to determine whether a competitive market exists. The rule authorizes the commissioner to utilize existing information or to participate in the development of new data systems if necessary. Insurers are required to provide the additional data needed to develop such information systems.

B. Criteria.

Subdivision B lists criteria which the commissioner shall consider when determining whether a reasonable amount of competition exists. The criteria listed are not meant to be exhaustive and the commissioner may use any reasonable criteria as long as they are clearly included in the commissioner's findings.

Subdivision B.1 requires the commissioner to compare changes in premium and loss costs. Improved experience (lower loss costs) without some rate reduction lessens the likelihood of finding that competition exits. If, on the other hand, underlying experience is worsening, then rate increases are expected and such increases would not be attributed to a lack of competition. If loss ratios were very poor over an extended period of time, then the commissioner must consider the effects of competition on the solvency of carriers.

Subdivision B.2 requires consideration of ease of entry into the market. Legal and economic barriers to entry and capitol and surplus requirements for licensing need to be reviewed. One would expect increased entries into the market following a period of high profitability and increased exits following low profitability.

Subdivision B.3 requires consideration of market share including the number, size, and dispersion of firms. If conditions of the insurance market are to conform to the assumptions underlying the competitive model, then there must be enough firms so that no one firm can independently influence the price. The

more concentration, the greater the implication that a few firms have the power to fix prices. A significant change in the relative market positions without undue concentration is one of the most unambiguous indicators of competition.

Subdivision B.4 requires the commissioner to consider changes in class rates, variation in rates and frequency of rate changes. Considerable rate variation suggests absence of price fixing. Frequent price changes would be anticipated in a competitive market when underlying costs are in a state of flux. Rate changes reflect the insurer's willingness and/or ability to change prices in response to competitive pressures or changes in underlying conditions.

Subdivision B.5 requires the commissioner to consider changes in the residual market. Change in the size of the residual market as a percent of the total market is an important measure of the effectiveness of competition. An increase in the size of the residual market is an indicator of availability or affordability problems. An increased concentration of small employers in the residual market may indicate that competition exists for the large risks only.

Subdivision B.6 authorizes the commissioner to use any other reasonable criteria as long as they are enumerated in his final determination. This authority is needed because it is difficult to specify a precise monitoring system and the listed criteria may not produce results which are "conclusive". The commissioner needs to be free to employ additional relevant tests of market structure and performance and to develop additional or alternative criteria.

4 MCAR § 1.9146 Commissioner Review of Rate Filings.

When the rules were originally written, a transition period between prior approval rates and open competition was part of the law. Since ratemaking under open competition was not expected until January 1, 1986, the original rules dealt with rates during the transitional period. At that time, the Commerce Department expected to draft rules for ratemaking under open competition based on the experience during the transition period. With the changes in the law, it is necessary to draft such rules now.

A. Rating Criteria.

Although the commissioner will not be determining rates under open competition, he/she still has the responsibility of ensuring that the premiums are neither inadequate nor unfairly discriminatory. If a competitive market fails to exist, then the commissioner must also ensure that premiums are not excessive. In reviewing rate filings, the commissioner should consider losses, expenses, and profits. Loss experience must be evaluated with respect to any factors which could make the experience atypical or which could have an effect on future losses. Expenses should reflect the actual expenses of the individual insurer. Profits must include a consideration of investment income.

B. Experience Rating Plans.

Under open competition, an insurer may use its own experience rating plan or one developed by the data service organization of which it is a member. However, any experience rating plan must meet certain criteria. First, the experience modification factor (the mod) must reflect any major changes in the evaluation of a claim which is settled before the policy becomes effective. In order to calculate a new mod, losses are evaluated and reported to the data service

organization approximately 6 months before a new policy becomes effective. Some losses may settle during the ensuing 6 months. In the past, a few insurers have refused to adjust the premium when a loss was settled during this time and the final cost was much smaller than the carried reserve. Under open competition, with the increasing freedom for insurers and insureds, it is unlikely that this situation would occur. Nevertheless, the rules require that the mod be changed when the value of the loss changes dramatically. The conditions in the rules define situations where the mod would change by more than 5 percentage points (eg., from .95 to .90). These technical statements in the rules reflect the loss limitation features which are part of the experience rating plan.

A second requirement for experience rating plans involves notification of the insured. The Commerce Department believes that this information will encourage employers to be aware of and concerned about their loss experience.

C. Schedule Rating Plans.

A schedule rating plan is a method for adjusting premium on an individual risk basis. This type of plan considers changes in the working environment which are not reflected in the loss experience. Credits and debits are determined based on such criteria as the condition of the premises, medical facilities and safety devices. Most insurance companies writing in Minnesota have filed schedule rating plans. Carriers feel they need the abiliity to price below average rate level. This is one indication that the market is competitive.

Although schedule rating plans are a competitive tool, there are potential problems with them. Such plans could be used in a discriminatory manner. Insureds might not be treated the same. Since there is an aspect of judgement in these plans, the size of the discount or the surcharge could be determined only by the competitive need. The Commerce Department has been particularly concerned with the possible effect on smaller employers. In theory, it would be possible for an insurer to set its rates at a level only intended for smaller employers, while larger employers would be given the benefit of schedule credits. When schedule credits and debits could be 50% or more of the premium, the filed rate level has little meaning. Because of these concerns, the rules limit the maximum effect of schedule rating plans to 25% of the premium determined by the manual rate and the experience modification factor. The commissioner retains the authority to set the maximum effect even lower, if necessary.

It is possible that smaller insurance companies could be at somewhat of a disadvantage with this rule. Large insurers frequently license two or more companies in one state and have different rate levels in each company. Thus, they can retain all the flexibility they desire, even with a schedule credit limitation. A small insurer, with only one company, would not have the same options. However, limiting the schedule credits and debits does not really change the flexibility difference between larger and smaller insurers. This already exists. Even if the effect of this rule were more significant for smaller insurance companies, the Commerce Department believes the limitation is important enough for smaller employers to merit its implementation.

D. Failure to Comply.

Hearing Examiner Lunde critized the original rules for their failure to "establish procedures for assessing penalties under Minn. Stat. § 79.56, subd. 3". This section addresses that problem. With the "use and file" law, rates and rating plans will be used before they are actually filed with the Department of Commerce. With this legal system, it is reasonable to allow insurers to continue to use rates for a brief period during which time defects can be corrected. It is the intent of the Department of Commerce to encourage competition. However, filings with erroneous information or rates which could be inadequate or discriminatory must be corrected.

4 MCAR § 1.9147 Policy forms.

This rule is needed to clarify responsibility for writing policy forms to be utilized by workers' compensation insurers. Insurers are required to use policy forms written by a data service organization unless the insurer's rating plan requires a policy provision or endorsement for which the data service organization has no useable form. In this case, the insurer may file its own policy form.

Effects on Small Businesses.

The potential impact of 4 MCAR §§ 1.9140 - 1.9143 on small employers and insurers was addressed at the time those rules were adopted (see the Statement of Need and Reasonableness and testimony of Nancy R. Myers). The amendments to those rules and the addition of 4 MCAR §§ 1.9144 - 1.9147 are not expected to have any additional impact on those small businesses. In fact, many of the provisions of the new rules are designed to further protect small insurers or employers from any negative impacts of competitive rating. (See especially 4 MCAR § 1.9144 Uniform data base, 4 MCAR § 1.9145 Monitoring competition, and 4 MCAR § 1.9146 Commissioner review of rate filings.)