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April 5, 2016

The Honorable Ken Peterson
Commissioner
Minnesota Department of Labor and Industry
443 Lafayette Road
St. Paul MN 55155

RE: Report on Report on Workers' Compensation Rates in Minnesota

Dear Commissioner Peterson:

I am pleased to submit the Report on Workers' Compensation Rates in Minnesota to the Minnesota Workers' Compensation Advisory Council (Rate Oversight Commission). Pursuant to Minnesota Statutes section 79.55, subdivision 10, the Minnesota Commissioner of Commerce shall annually issue a report comparing the average rates charged by workers' compensation insurers in Minnesota to the pure premium base rates filed by the Minnesota Workers' Compensation Insurers Association (MWCIA). I am sending this report to you as chair of the Minnesota Rate Oversight Commission, to enable the Rate Oversight Commission to conduct its review in accordance with Minnesota Statutes section 79.55, subdivision 10.

I hope you will find this report helpful.

Sincerely,

Mike Rothman

Mike Rothman
Commerce Commissioner

Enclosure

MINNESOTA DEPARTMENT OF COMMERCE

2016 Report to the Workers' Compensation Advisory Council (Rates Oversight Commission)

Workers' Compensation Rates in Minnesota

As required by Minnesota Statutes § 79.55, subdivision 10

Executive Summary

Pursuant to Minnesota Statutes section79.55, subdivision 10, the Minnesota Commissioner of Commerce (Commissioner) shall issue a report by March 1 of each year, comparing the average rates charged by workers' compensation insurers in Minnesota to the pure premium base rates filed by the Minnesota Workers' Compensation Insurance Association (MWCIA).

During the past ten years, MWCIA pure premium base rates have been fairly stable, drifting downward slightly. At the same time, the loss cost multipliers (LCMs) used by the insurers to develop rates (which are applied to the MWCIA pure premiums) have also been fairly stable, with the exception of some increases in the 2012-2013 period. These increases may have been driven by an expectation of lower investment income. Combining the LCMs and the MWCIA loss costs, the rates charged by insurers have been fairly stable and have not moved significantly over the ten-year period, similar to the MWCIA pure premium base rates.

Purpose

As noted above, Minnesota Statutes section79.55, subdivision 10 requires the Commissioner to issue a Report by March 1 of each year. The statute also provides that the Minnesota Workers' Compensation Advisory Council (Rate Oversight Commission) shall review the Commissioner's report and if the experience indicates that rates have not reasonably reflected changes in pure premiums, the Rate Oversight Commission shall recommend to the legislature appropriate legislative changes to this chapter.

Background

In 1984, the Minnesota workers' compensation insurance rates were deregulated. At the same time, the Minnesota Legislature established the requirement for this annual report to track rates being charged by workers' compensation insurers in the new competition-based system. Minnesota Statutes section 79.55, subdivision 10 requires a comparison of the rate changes made by insurance carriers with the changes in the pure premium base rates published by the MWCIA. Because a simple comparison does not include many other factors, it may not be the best indicator of whether the competitive rating law is indeed making the Minnesota workers' compensation insurance market competitive. Although rate changes and pure premium changes can be expected to frequently move in the same direction, there are several reasons why they may not. A more detailed discussion of these factors is contained in the Appendix to this Report.

This Report may or may not be so important to an insurer in setting overall rate levels. Although it may have some merit for very small carriers, most insurers will set rate levels by looking at their own data as well as data gathered from competitors. The data needed to prepare this Report is generally too old for companies to use to make current decisions. The most likely value of the Report for insurance carriers is to establish the relationships between the occupational classifications (job class codes – JCC). At that level of detail, insurance carriers, for the most part, lack sufficient data for individual job class code analysis. However, this Report is useful as a general indicator of what is happening to workers' compensation rates in Minnesota.

Another approach is to examine whether carriers are actually using the MWCIA pure premiums, based upon whether a carrier's rates are moving in the same direction as the MWCIA's pure premiums. Based on information collected by the Commerce Department as of January 16, 2016, 156 of the 269 carriers had adopted the January 1, 2016, loss costs, representing 72% of the market share. However, it is important to note that the Commerce Department tracking tool may not be able to adequately track information in a timely way. If a carrier has filed for an effective date after the date of this extract, it would not appear on the tracking tool. Perhaps a better measure would be that as of November 2, 2015, 240 out of 269 carriers had adopted and had in effect the January 1, 2015, MWCIA pure premiums representing 94% of the voluntary market.

It should be noted that the Commerce Department tracks the changes in the loss cost multipliers (LCMs), not the rate changes. The LCM may be a better indicator of what is happening in the market. (As a reminder, the LCM is the factor that the insurance carrier uses to adjust the pure premium to the desired rate level, with an average factor in Minnesota of 1.97.) Tracking actual rate changes is possible, but challenging.

In addition, employers are most concerned about the premiums that are paid, not the rates. Please see the section of the Appendix on "Pricing Flexibility" for additional comments about adjustments from rates to premiums.

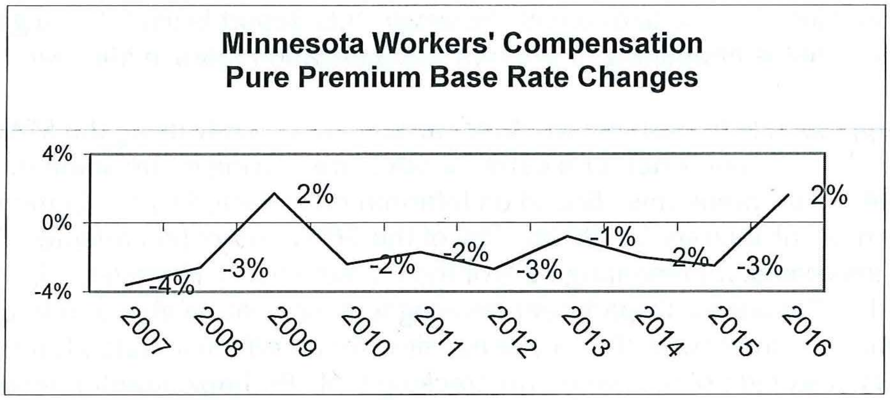
Report on Rates Charged by Insurers versus MWCIA Pure Premium Base Rates

The Commerce Department has conducted a review of the base rates charged by insurance carriers selling workers' compensation coverage in Minnesota and compared these rates with the pure premium base rates[1] charged by the MWCIA for the time period 2007-2016. The results of this comparison are contained in this Report. An underlying assumption of the statute is that changes in workers' compensation carrier base rates should reflect changes in the MWCIA pure

[1] The pure premium is the amount that an insurance carrier would need to charge in order to cover only the workers' compensation benefits (losses) paid to injured workers. These pure premiums, for each employer job classification, are calculated by the MWCIA based on industry experience.

premiums.[2] In general, carrier base rate changes and MWCIA pure premium changes do move in the same direction. However, there are various reasons why this may not occur and these are discussed in the Appendix.

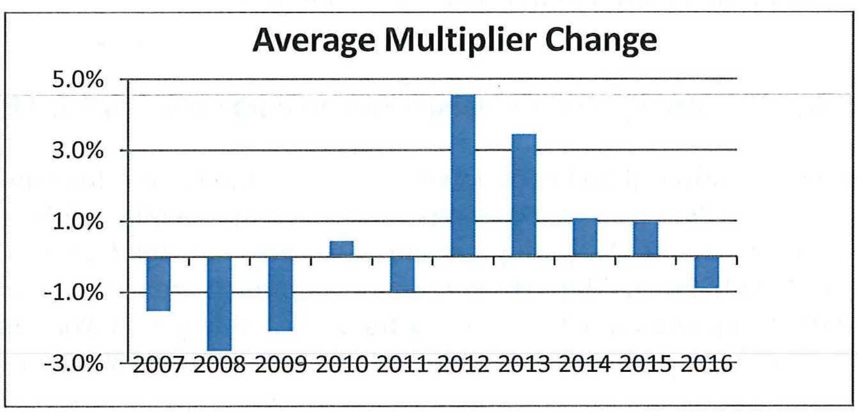
The chart below shows the changes in MWCIA pure premiums during the past ten years.



During this period, the annual changes have been modest and mostly decreases. The cumulative effect is more significant. Since 2007, pure premium base rates have declined 11.0%.

In order to go from pure premiums to rates, an insurer determines a loss cost multiplier (LCM) which adjusts for additional losses and for insurance company expenses, taxes, and expected profit (after considering investment income). These rates must be filed and approved by the Commerce Department before they can be used.

The chart below shows the average changes in insurance carrier LCMs during the past ten years.



[2] Throughout this report, the terms pure premiums and loss costs are used interchangeably. Due to statutory restrictions, the pure premiums calculated by MWCIA are not quite the full amount for the loss cost, but it is most of the full amount. No expenses of any type are included. In addition, considerations for profits and contingencies, investment income and taxes are also excluded. See the Appendix for additional detail.

The rate change is the combined effect of the pure premium change and the multiplier change. For example, the pure premium change in 2016 was +1.6%. The average LCM in the filings made during 2015 increased 1.0%. As a result, the overall rate effect for business written in 2015 is approximately 2.6%.

For the ten-year period, the average change in LCMs was 0.2% each year. Prior to 2010, there were generally declines in the average LCM. In both 2012 and 2013, the increases were above 3%. More recent annual changes have been close to 1%, (Please note that 2016 is evaluated in January, while the other years are evaluated in November).

For most of the past ten-year period, pure premiums and multipliers and, therefore, rates drifted lower. However, from 2011 through 2013, the average rate increased because the increases in the LCMs were of a greater magnitude than the decreases in the MWCIA pure premiums. In 2014 and 2015, the rate changes returned to drifting lower.

There are multiple factors influencing these dynamics. Given the steady increase in medical costs, it would be expected that workers' compensation loss costs would increase. In fact, medical costs per claim have gone up, although recently at a slower rate. However, there has been a dramatic drop in the number of claims. As noted in the *2013 Workers' Compensation System Report* produced by the Minnesota Department of Labor and Industry: "In 2013, there were: ...4.6 paid claims per 100 full-time-equivalent workers in 2013, down 42% from 2000." Low interest rates, with the perception by carriers that they would earn less investment income, may be putting upward pressure on LCMs.

Current Workers' Compensation Environment in Minnesota

The workers' compensation insurance market in Minnesota appears to be competitive. There are over 200 insurance carriers and the largest market share of any one insurer is 12%.

The Commerce Department has reviewed the LCMs that were in effect and available as of January 16, 2016. As demonstrated by the table below, there is significant variation in the LCMs filed by insurance carriers in Minnesota.

2016 Loss Cost Multipliers for the Ten Largest Workers' Compensation Writers in Minnesota (Based on 2014 Written Premium)

		LCM
1	SFM Mutual Insurance Company	2.006
2	Western National Mutual Insurance Company	2.500
3	Owners Insurance Company	1.880
4	ACUITY, A Mutual Insurance Company	1.755
5	Travelers Indemnity Company of America (The)	1.340
6	Federated Mutual Insurance Company	2.270
7	Zurich American Insurance Company	1.884
8	West Bend Mutual Insurance Company	1.770
9	SECURA Insurance, A Mutual Company	1.820
10	Grinnell Mutual Reinsurance Company	1.900

Please note that a higher filed rate does not necessarily mean that a higher premium will be charged to the employer. There are various discounts available. Schedule rating is typically thought of as the most significant discount. Most insurers have filed schedule rating plans with credits up to 40%.

The Minnesota Assigned Risk Plan writes 6% of the market. The table on the next page shows market share information (as a percent of voluntary market) for the Assigned Risk Plan, the voluntary market as a whole, and the top ten carriers for both 2013 and 2014.

Market Shares for the Ten Largest Workers' Compensation Writers in Minnesota (Based on 2014 Written Premium)

	2014 Written Premium	Market Share *	2013 Written Premium
Total Voluntary Market	$924,781		$880,091
Total Vol. Market Plus Assigned Risk	$988,604		$945,017
Change in Premium *	5%		
Number of Insurers *	274		274
Assigned Risk Plan	$63,823		$64,926
SFM Mutual	106,797	12%	101,517
Western Natl Mutual	30,114	3%	29,755
Owners Ins Co	24,321	3%	22,082
Acuity A Mutual Ins Co	22,953	2%	20,763
Travelers Ind of Amer	22,782	2%	18,680
Federated Mutual	21,680	2%	20,718
Zurich American	19,150	2%	21,039
West Bend Mutual	17,672	2%	15,818
Secura Ins A Mutual Co	17,058	2%	13,171
Grinnell Mutual Reins	15,647	2%	15,366

* of Voluntary Market

Self-insurance is also a viable option in Minnesota. The 2013 *Workers' Compensation System Report*, issued by the Minnesota Department of Labor and Industry, states that, based on paid indemnity claims, 26% of the total workers' compensation market is self-insured.

Voluntary market losses have been close to break-even the past five years. Based on industry average expenses, an insurance carrier typically pays 65% of its premium in losses and has enough left to cover loss settlement costs and expenses. The loss ratio average for the industry for the past five years is 66%. These results vary significantly by carrier. Within the top ten voluntary writers, five-year loss ratios vary from 31% to 79%. For future results, the Commerce Department would expect to see close to the same amount of rate increases and decreases in the immediate future. Carriers may also have been concerned about whether federal lawmakers would be reauthorizing the Terrorism Risk Insurance Act of 2007 (TRIA) which expired December 31, 2014, and thus, there may have been an upward pressure on rates. With the enactment of the Terrorism Risk Insurance Program Reauthorization Act of 2015, these concerns should be alleviated.

Lastly, a relevant question may be simply: "Is the Minnesota workers' compensation market competitive?" Several observations can be made to answer this question:

1. The market appears to be largely stable. There have not been large changes in the pure premiums or in the LCMs. For the most part the pure premiums have been trending slowly downward, with some minor increases in company LCMs in the past few years.

2. The market appears to be competitive. There are more than 200 insurance carriers writing workers' compensation coverage in Minnesota and the largest market share of any one company is 12%. There is a wide range in the LCMs. Among the top 20 carriers, the LCMs range from 1.30 to 2.60. This range may reflect different pricing policies. For example, a carrier with a high LCM may rely on discounts to be competitive.

3. One of the significant concerns related to the workers' compensation insurance system in Minnesota is the impact of the residual market, known as the Workers' Compensation Assigned Risk Plan (ARP). It had been growing rapidly, but now appears to be leveling off. In September 2011, the premium written in the ARP was $32.1 million. By January 2014, that number had grown to $60.0 million. As of September 30, 2015, the 12-month rolling calendar year earned premium was $62.8 million.

4. The Workers' Compensation Reinsurance Association's surplus continues to grow. At year-end 2014, the surplus was $432 million versus the $280 million surplus the year before. This should strengthen the workers' compensation insurance system in Minnesota.

5. The National Association of Insurance Commissioners (NAIC) annually publishes a competition database report. This report indicates that Minnesota workers' compensation is not concentrated based on the market shares of the largest four groups and the Herfindahl-Hirschman index. In addition, this Report considers the number of sellers, the number of entries and exits, the premium growth (for both the latest year and the past 10 years), and the return on net worth for the past 10 years, all of which did not indicate that the market was uncompetitive.

Appendix

Why the pure premiums and the rates may move in different directions.

Both the pure premiums and the rates charged by insurance carriers are measures of the workers' compensation loss experience. Although these measures will frequently move in the same direction, there are various factors that could cause one to move up and the other to move down.

- **Data Differences.** The MWCIA pure premium analysis compares actual losses with *hypothetical* premiums, calculated by the MWCIA using the most recent set of pure premiums and payrolls reported by the insurers. However, when a carrier determines its rate level, it compares its actual losses with the premiums it actually collected (usually brought up to the current benefit and rate level). If an insurer has had more losses than expected, then the insurer will need to increase rates, no matter what the pure premium analysis indicates. The pure premium analysis is a "what if" estimate of the number. The insurance carrier analysis is grounded more firmly in actual results.

  The analysis in the MWCIA pure premium report provides the individual insurance company with a perspective on industry-wide experience. However, the MWCIA pure premium report for insurance carriers has more value in providing information about the relationship between the approximately 500 classes of employers. Insurers do not have enough data to set these relationships based on their own data and need an industry base to have a credible analysis of the differences between the job class codes.

- **Age of Data.** The pure premiums are based on industry data. Because the data is collected from all insurers, it is on average more than two years old when compiled and analyzed by the MWCIA. In contrast, an insurance carrier determining a rate level change is using data that often is less than six months old. If anything, company rate changes, instead of *following* the MWCIA pure premium changes, are a *forecast* of what each individual company believes will happen.

- **Additional development for injuries that occurred at least ten years ago.** Injured workers who are still receiving medical and wage loss benefits ten years after an injury are usually seriously hurt. Changes in medical technology and care can add to the costs (or in some instances reduce them) of these injuries in unexpected ways. By statute, the MWCIA pure premiums cannot reflect any changes in the expected loss costs to ultimate value so the MWCIA cuts off the changes at a selected report (currently ten years). However, insurance carriers can and must reflect these changes in their rates. If insurers believe that these costs are increasing, then the rate changes will be greater than the pure premium changes.

- **Reinsurance.** By law, all workers' compensation insurance carriers in Minnesota must purchase reinsurance from the Workers' Compensation Reinsurance Association (WCRA). The MWCIA pure premiums do not include any reinsurance charges. The insurance carrier rates must, of course, consider the costs of reinsurance, making adjustments if they believe that they will incur higher or lower than average costs in the Minnesota workers' compensation market when compared to what WCRA compiles. In Minnesota, the WCRA makes most of the investment income as opposed to the individual insurance carriers. An additional complication is that the WCRA reinsures the entire workers' compensation market, including the Assigned Risk Plan (ARP) as well as government and private self-insured employers. The ARP, in particular, has had poor reinsurance experience. The voluntary market subsidizes a portion of the ARP's reinsurance costs.

- **Insurance carrier expenses and investment income.** The MWCIA pure premiums cannot, by statute, include any expenses or adjustments for investment income. Insurers must consider both of these items. An insurance carrier must collect enough to pay its expenses and must also consider the amount of investment income that will be earned on the reserve funds held to pay losses. (In Minnesota, a great deal of the investment income is earned by the WCRA, not the individual insurance carriers.) Changes in the insurer's company expenses and potential investment income affect the filed rates but not the MWCIA pure premiums.

- **Market share.** The average multiplier is calculated by weighting each carrier's multiplier against the carrier's premium for the most recent year. Consequently, the average multiplier will be affected by premium movement between the voluntary market and the ARP and the self-insured market as well as movement between the carriers (from those who heavily use schedule credits to compete versus having a lower LCM and less credits available). In theory, if the ARP is being depopulated, then the average multiplier will rise as employers that are somewhat costlier than average are written in the voluntary market at rates that are higher than average. This may cause the average multiplier to increase even when no employer actually gets an increase. On the other hand, self-insured employers generally have better than average experience. If the voluntary market writes more of these employers, the average multiplier will probably decline. Recently the ARP was growing and the self-insured market share was slightly decreasing, so these impacts may be offsetting each other for the voluntary market LCMs. However, it appears that the self-insured market has stabilized and may even be growing slightly for the latest available year.

- **National Perceptions.** Insurance carriers do not look at Minnesota workers' compensation experience in a vacuum; instead, they consider what is happening to the line of insurance in total. Other than SFM Mutual Insurance Company, none of the other carriers of significance have most of their premium exposure in Minnesota. Forecasts for the entire market more likely have a larger impact on carrier behavior than Minnesota results, particularly for the industry. It was also thought that the uncertainty surrounding the reauthorization of the federal Terrorism Risk Insurance Act (TRIA) was putting upward pressure on rates. However, with the passage of the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA 2015), this dynamic has been removed.

- **Pricing flexibility.** It is possible in many instances for an insurance carrier to change an employer's premium without changing the manual rate. An employer's premium calculation begins with the manual rate filed by the insurance carrier. This amount is then adjusted for the employer's loss experience, via the experience modification factor. If the employer chooses to have a deductible, they receive a premium credit for assuming that portion of the loss. After these basic adjustments, the insurer may also offer a schedule credit or debit, reflecting the condition of the premises, the training and selection of employees, safety programs and return-to-work options and/or other characteristics as determined by the insurance carrier. Schedule credits and debits are loosely defined and depend, to some extent, on the underwriter's judgment and perception of risk. Consequently, it is possible for employers to have premium adjustments even if the manual rates do not change. Schedule credits can be as high as 40% of premium, so the possible magnitude of these adjustments is quite significant. By statute, the Commerce Department cannot regulate the size of discounts and the Department does not track either the size or use of schedule credits. Employers will be more concerned about the actual premiums that they pay (such as per employee or amount of payroll after considering the job classification mix) rather than whether their rate went up.