COMMERCE
DEPARTMENT

2018 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 section § 79.55, 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).

Until two years ago, MWCIA pure premium base rates have been fairly stable, drifting downward slightly, until experiencing a double digit decrease two years ago. Another large decrease (although not in the double digits) was experienced last year. 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. We do note that the MWCIA pure premium base rates had larger than usual decreases effective January 1, 2017 and January 1, 2018. At the time this report was issued, it does not appear that the carriers have adjusted their LCMs significantly in reaction to these latest MWCIA pure premium decreases.

Purpose

As noted above, Minnesota Statutes section § 79.55, 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 § 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.

The MWCIA Ratemaking 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 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 February 6, 2018, 185 of the 271 carriers had adopted the January 1, 2018, loss costs, representing 69% of the market share. However, it is important to note that if a carrier has filed for an effective date after the date of this extract, it would not appear on the tracking tool. As of November 1, 2017, however, 249 out of 271 carriers had adopted and had in effect the January 1, 2017, MWCIA pure premiums representing 97% 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 themselves. The LCM may be a better indicator of what is happening in the market. (This is because 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 1.96.)

Finally, 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 2009 – 2018. 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 [2]premiums. 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.

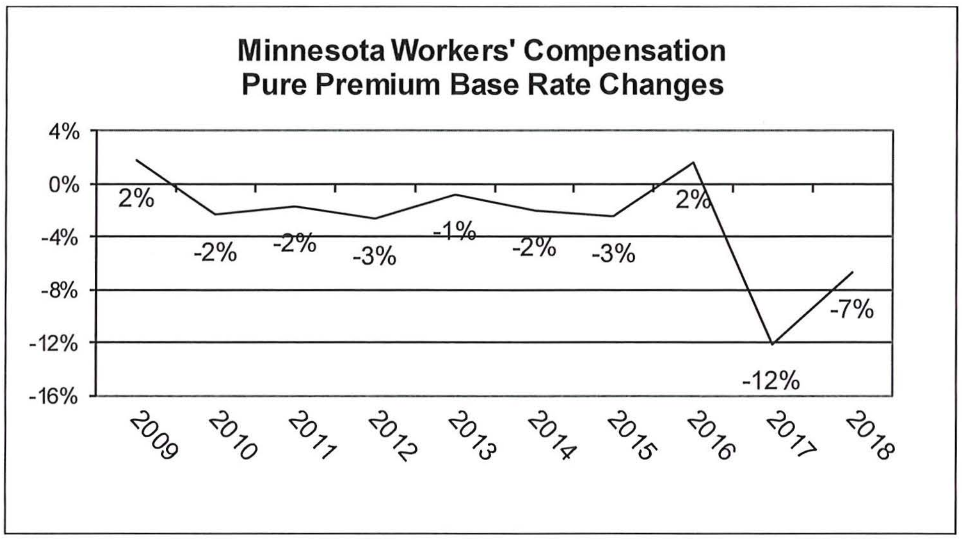

Figure 1

During this period, the annual changes have most often been modest decreases with the exceptions of 2017 and 2018 when larger decreases occurred. The cumulative effect is more significant. Since 2009, pure premium base rates have declined by more than 25%, although more than two thirds of this is due to the January 1, 2017 and January 1, 2018 changes.

In order to go from pure premiums to rates, an insurer determines a loss cost multiplier (LCM) which adjusts for additional loss elements excluded from the MWCIA pure premiums and for insurance company expenses, taxes,

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[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.

[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.

and expected profit (after considering investment income). These rates must be filed and approved by the Commerce Department before they can be used.

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

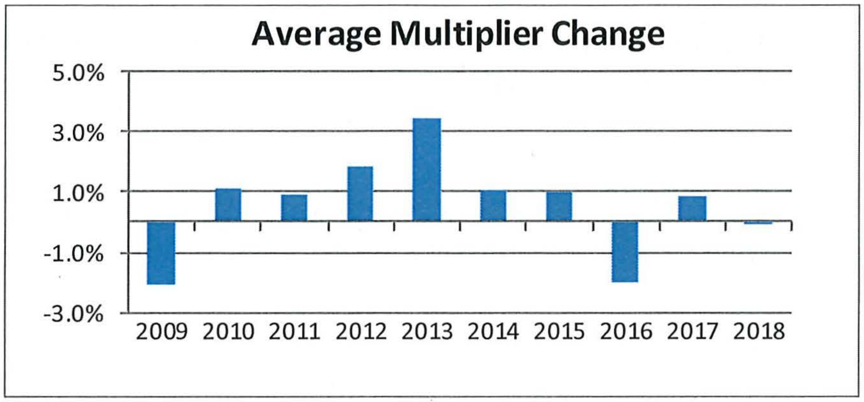

Figure 2

The rate change is the combined effect of the pure premium change and the multiplier change. For example, the MWCIA pure premium change in 2017 was -12.1%. The average LCM in the filings made during 2017 increased 0.9%. As a result, the overall rate effect for business written in 2017 is approximately -11.3%.

Over the past ten-year period, the average change in LCMs was 0.6% each year. In 2013, the increase was above 3%. 2009 and 2016 had decreases of close to 2% each. The remaining most recent annual changes have been close to 1%. (Please note that 2017 is evaluated in February, while the other years are evaluated in November).

During the past ten-year period, pure premiums and multipliers and, therefore, rates drifted lower generally. 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. In 2017 and 2018, due to the large decrease in the MWCIA pure premiums, the rates decreased by a more significant amount.

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 2015 Workers' Compensation System Report produced by the Minnesota Department of Labor and Industry: "In 2015, there were: ...4.1 paid claims per 100 full-time-equivalent workers in 2015, down 48% from 2000." Low interest rates, with the perception by carriers that they would earn less investment income, may be putting upward pressure on LCMs. For the latest year, the large decrease in the MWCIA pure premiums are likely also placing pressure for insurers to increase their 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 10%.

The Commerce Department has reviewed the LCMs that were in effect and available as of February 6, 2018. As demonstrated by the table below, there is significant variation in the LCMs filed by insurance carriers in Minnesota.

2018 Loss Cost Multipliers for the Ten Largest Workers' Compensation Writers in Minnesota (based on 2016 written premiums)		
		LCM
1	SFM Mututal Insurance Company	2.114
2	Zurich American Insurance Company	1.876
3	Western National Mutual Insurance Company	2.600
4	New Hampshire Mutual Insurance Company	1.759
5	Owners Insurance Company	1.880
6	Federated Mututal Insurance Company	2.211
7	Acuity, A Mutual Insurance Company	1.755
8	Secura Insurance, A Mutual Insurance Company	1.790
9	Travelers Indemnity Company of America (The)	1.340
10	West Bend Mututal Insurance Company	1.770

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 5% 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 2015 and 2016.

Market Shares for the Ten Largest Worker's Compensation Writers in Minnesota (based on 2016 written premium)			
	2016 Written Premium	**Market Share***	**2015 Written Premium**
Total Voluntary Market	$1,036,064		$998,859
Total Voluntary Market Plus Assigned Risk	$1,088,058		$1,058,578
Change in Premium*	4%		
Number of Insurers*	276		273
Assigned Risk Plan	$151,994		$59,719
SFM Mutual	101,341	10%	102,093
Zurich American	36,570	4%	34,543
Western National Mutual	30,929	3%	30,463
Owners Insurance Compnay	28,680	3%	19,091
Acuity A Mutual Insurance Compnay	26,342	3%	26,008
Travelers Ind of America	23,648	2%	23,390
Federated Mututal	21,879	2%	23,438
Secura Ins A Mutual Company	21,330	2%	19,930
New Hampshire Insurance Company	19,889	2%	23,422
West Bend Mututal	18,228	2%	18,818

** Of involuntary market*

Self-insurance is also a viable option in Minnesota. The 2015 *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 60%. This is lower than the 63% figure given in last year's version of this report due to the relatively low 2016 loss ratio (It should be noted that these lower loss ratios in recent years are the primary driver for the MWCIA filed decreases for 2017 and 2018). These results vary significantly by carrier. Within the top ten voluntary writers, five-year loss ratios vary from 27% to 74%. For future results, the Commerce Department would expect to see close to the same amount of rate increases and decreases in the immediate future. It is possible that the large decreases in the MWCIA pure premiums observed in 2017 and 2018 could place some short-term upward pressure on loss ratios in future years.

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. Other than the 2017 and 2018 MWCIA pure premium changes, 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. However, in 2017 and 2018, there was a significant decrease in the pure premiums, which could make rates less stable in the short run.
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 10%. 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, appeared to stabilized for a while and now appears to be decreasing rapidly. 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, 2017, the 12-month rolling calendar year earned premium was $47.1 million.
4. The Workers' Compensation Reinsurance Association's surplus continues to grow. At year-end 2015, the surplus was $453 million versus the $432 million surplus the year before. At year-end 2016, it increased to $674 million. 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 fourteen years ago.** Injured workers who are still receiving medical and wage loss benefits eighteen 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 department rule, 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 eighteen 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 fewer 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 recently that the self-insured market has stabilized and the assigned risk plan market share has been decreasing.

- **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.

- **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.