SPECIAL STUDY COMMISSION ON WORKERS' COMPENSATION

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June 30, 1984

The Honorable Joseph E. Brennan
Governor of Maine
State House
Augusta, Maine 04333

Dear Governor Brennan:

We are pleased to submit to you the findings and recommendations of our study of workers' compensation insurance issues set forth in Chapter 479, Public Laws of 1983. We are also submitting to you a copy of the report of our consulting actuary whose work informed much of our study.

We believe we have conducted a most thorough study of the issues included in our mandate. Furthermore, we believe our recommendations will lead to a more rational and efficient system of establishing prices and delivering workers' compensation insurance to Maine employers for the protection of their workers. Finally, we have suggested an area for further study which may lead to other improvements in the overall workers' compensation system in Maine.

Please be assured that we stand ready to assist you and the Legislature in any way we can to see that this study leads to meaningful changes for the people of Maine.

Sincerely yours,

John E. Menario

Floyd Harding

H. Alan Timm

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June 30, 1984

The Honorable Gerard P. Conley
President of the Maine Senate
State House
Augusta, Maine 04333

The Honorable John L. Martin
Speaker of the Maine House
State House
Augusta, Maine 04333

Dear President Conley and Speaker Martin:

We are pleased to submit to you the findings and recommendations of our study of workers' compensation insurance issues set forth in Chapter 479, Public Laws of 1983. We are also submitting to you a copy of the report of our consulting actuary whose work informed much of our study.

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FINDINGS
AND
RECOMMENDATIONS
OF THE

SPECIAL STUDY COMMISSION
ON
WORKERS' COMPENSATION
INSURANCE

JUNE 30, 1984

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Introduction

This Special Study Commission on Workers' Compensation was created by Chapter 479 of the Public Laws of 1983. That law proceeded from several recommendations of the Speakers' Select Committee on workers' compensation and included substantive changes in the workers' compensation laws of Maine. The recommendation of the Speaker's Select Committee for the establishment of a special commission was made to ensure that certain issues which the Select Committee felt it had neither the time nor resources to investigate would be studied. According to Ch. 479, P.L. 1983, the role of the study commission was to "evaluate the impact of reserving practices, return on investments and profitability on workers' compensation ratemaking and structural alternatives, such as state funds." The law charged the study commission with reporting back to the Legislature and to the Governor on these matters no later than April 30, 1984 (later extended to June 30, 1984) and included a $100,000 appropriation, the bulk of which was intended and used for the hiring of a consulting actuary (see Appendix A for relevant portion of Ch. 479, P.L. 1984).

At our second meeting, the three voting members of the commission recommended to the Governor that he appoint a representative of the Department of Business Regulation, but make no appointment providing representation for the workers' compensation insurance industry because it had become clear that each of two major insurance trade organizations were vying to have one of its own members appointed to fill the advisory slot, and they appeared to differ on some key issues within the scope of the study. However, the commission invited all segments of the workers' compensation insurance industry to attend all meetings of the commission and to submit their positions on any issue discussed.

In response to the commission's recommendations, Governor Brennan appointed Commissioner Harvey DeVane of the Department of Business Regulation to serve as an advisory, non-voting member of the study commission.

The study commission met for the first time on September 23, 1983, and met for a total of 16 times, concluding our deliberations with a public hearing on our draft recommendations held at the State House on Wednesday, June 20, 1984. All meetings were open to the public and prior notice was provided. Most meetings were tape recorded and transcripts of those meetings are available. Appendix B includes a list of meeting dates and the names and associations of all persons who testified before the study commission.

After interviewing five consulting actuarial firms, the study commission chose the firm of Tillinghast, Nelson & Warren to conduct research to assist with the study. Tillinghast, Nelson & Warren assigned John P. Tierney of its Newton, Massachusetts office to be primary consultant to the study.

It is fair to say that the issues within the scope of this study are of concern to legislators, employers and others because of the high cost of workers' compensation insurance in Maine relative to most other states. There is controversy today, not only over how much workers' compensation insurance costs, but over how much it <u>should</u> cost. Rates have not been increased since March 2, 1981, although premiums have continued to increase as the size of payroll has grown. Much of the controversy over what rates should be stems from the fact that the last three rate requests have been disapproved or dismissed without a finding on their merits. More will be said about this issue in subsequent sections of this report.

At the outset, the study commission wishes to emphasize that none of its findings and recommendations is likely to result in dramatic or immediate reductions in the cost of insurance. On the other hand, we believe there is much which can be done to make the pricing and delivery of compensation insurance more rational and, in the long run, less costly than would be the case if the present ratemaking and delivery systems are not changed.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

I. Role of Investment Income and Profitability in Workers' Compensation Insurance Ratemaking.

Each of the last four NCCI rate request filings presented two percentage increases. The first figure purported to indicate the rate increase needed according to the traditional ratemaking formula. That formula says rates should be sufficient to ensure that premiums collected equal all insurance industry costs and expenses plus an underwriting profit margin of 2.5%. In the last three filings the "indicated" rate formula showed an approximate 100% increase in rates was needed. The second figure was the rate increase actually requested. In each case, the requested increase was substantially less than the "indicated" increase. In the last three filings the requested increase ranged from 25-30%. The NCCI did not disclose the method used to arrive at the increased rates actually requested. This failure was at least partly responsible for all three filings being denied or dismissed without a finding on their merits.

Use of the traditional ratesetting formula, which results in an indicated need for a doubling of rates, excludes profits realized from the investment of funds collected as premiums. These premium dollars are invested between the time when they are collected and the time when they are paid out for claims, which is often as long as 15 or more years. Investment income provides insurance companies with as much as 30% or more of their revenues.

Our consulting actuary, using a rather conservative economic model, determined that a 30% rate increase would yield an industry-wide return on equity (ROE) of 9.5-16.5%, depending upon an individual company's premium-to-surplus ratio. The model assumed a 6% after-tax investment yield from U.S. Treasury bills. A 7% yield would result in the same ROE with only a 23% rate increase.

FINDING:

Income from invested funds has a major impact on insurance industry profits. The traditional ratesetting formula excludes investment income and substitutes instead an arbitrary underwriting profit margin, and thus highly inflates the industry's rate needs.

RECOMMENDATION:

Any ratesetting procedure, whether conducted industry-wide or on a company-by-company basis, should include income from all sources. The traditional NCCI ratesetting formula is totally inappropriate and the determination of indicated rate need based upon it should be discontinued.

II. Impact of Insurance Industry Reserving Practices

As claims are filed, insurance companies identify funds in anticipation of payment of those claims. These estimated funds are called reserves. Their amount is based on an estimate of the ultimate future cost of all claims. The amount reserved is adjusted annually based upon new knowledge about each claim as it progresses.

FINDING:

Our consulting actuary found that insurance companies have historically set aside an insufficient reserve for claims, and that as claims progressed those reserves had to be increased. This tendency to underreserve, however, has decreased and is not now as significant as reported by NCCI.

Nothing about industry reserving practices appears to have a significant impact on Maine's workers' compensation insurance rates.

RECOMMENDATION:

Our consulting actuary recommends that NCCI improve its reserve reporting analytical methods by using more years of loss development data and more than one statistical method of analyzing data.

III. Current System of Workers' Compensation Insurance Ratemaking

The current regulatory process for determining workers' compensation insurance rates establishes uniform manual rates to be used by all insurance companies operating in Maine. There are currently 179 of them. The companies file jointly for rate increases through a pricing cartel, or rating bureau, known as the National Council of Compensation Insurers (NCCI). These uniform manual rates go into effect after quasi-judicial public hearings are conducted by the Maine Bureau of Insurance. This regulatory process is similar to that conducted by the Public Utilities Commission.

The system has become increasingly complex in recent years and it is argued by some that this increased complexity is at least partly responsible for the last three rate increase requests having been turned down without a finding on their merits.

FINDING:

The increasingly complex data requests are designed to elicit insurance industry income and expense data relevant to industry experience <u>in Maine</u>. Thus, the increased complexity appears necessary and justifiable in the context of the current ratesetting process. However, uniform rate regulation by the state in any area (e.g., public utilities, transportation, insurance) is justifiable only if a natural monopoly exists in the marketplace. No natural monopoly exists in the workers' compensation marketplace because there are 179 individual companies selling in the Maine market. The current system of uniform manual rates denies consumers of workers' compensation insurance the benefits of a fully competitive marketplace.

RECOMMENDATION:

The State of Maine should abandon its current ratemaking system and adopt a system which permits competitive forces to determine in the marketplace the prices of workers' compensation insurance.

FINDING:

Despite the setting of uniform manual rates, there is a significant amount of "back door" competition in the marketplace. Because various pricing policies are not commonly understood by purchasers of workers' compensation insurance and because they sometimes must be negotiated, comparison shopping is difficult.

RECOMMENDATION:

The State of Maine should require insurance companies to compete "up front" on their premium prices.

FINDING:

Most of the "back door" price competition in present use is not available to small employers.

RECOMMENDATION:

Insurance companies should be required to offer discounting and dividends to employers of all sizes. Experience rating, if not made available to all employers, should be offered to employers with annual premiums below the current minimum of $2,500.

IV. Competitive Rating System for Workers' Compensation Insurance

The rating or pricing of most lines of insurance in Maine, as in other states, is governed through open competition among private insurance carriers with oversight by state regulators. However, in workers' compensation insurance rates are set only after lengthy hearings and 'prior approval' by regulators. The following explanations have been offered for this system: Workers' compensation is "social insurance" requiring substantial state involvement; there is a need for a uniform system to collect data; deregulation would be disruptive by emphasizing competition over loss prevention, and workers' compensation insurance historically has been rigidly regulated.

FINDINGS:

Other lines of insurance, including automobile insurance, can also be considered "social insurance." Both workers' compensation and auto insurance involve a no-fault concept and often require mandatory minimum levels of protection. Assigned risk pools are also common to both lines of insurance. State involvement is necessary, but not in the area of setting rates.

It is not necessary to continue the current regulatory rate-making system in order to maintain the same and very necessary classification system and data base. Other states have successfully implemented competitive rating without losing essential information.

Price competition will not reduce loss prevention because loss prevention is the single most effective means of controlling costs and thus prices. Furthermore, nothing in the present regulatory system assures adequate loss prevention.

Our historical system of rigid rate regulation can be substantially improved upon. Competitive pricing would substantially reduce, but not eliminate, governmental oversight, while simultaneously providing more competitive prices.

Some segments of the workers' compensation insurance industry claim that a move to a competitive pricing system would result in substantial rate hikes. This claim is based upon an assumption that present rates are too low since rates have not been permitted to increase in three years. The last three NCCI rate filings showed "indicated" rate increase needs of at least 100%. Employers fear a doubling of rates.

FINDINGS:

The experience in all states which have adopted competitive rating is that prices for workers' compensation insurance have decreased.

The 100% "indicated" rate increases which cause employers to fear a doubling of rates are based upon the traditional rate setting formula which excludes investment income profits. Actual rate increase requests have been much less, on the order of 30%.

Insurance rates are not likely to uniformly increase in the 30% range. Some carriers would likely increase rates by this much, others by much less, and some not at all. Others may even file for rate decreases.

At least four carriers have already filed for downward rate deviations, even though there is little incentive to do so under the present regulatory situation. A truly competitive pricing system would eliminate the regulatory and institutional barriers to 'breaking from the pack.'

The present regulatory system discourages efficiencies by arriving at an average rate for the workers' compensation insurance industry as a whole. However, the expense ratios of insurance companies operating in Maine vary greatly. Competitive pricing would pass along savings from the more efficient carriers to the policyholders.

RECOMMENDATION:

As a means to allay the fears of those who believe insurance companies would file unreasonably high rates in a competitive pricing system, the Legislature should establish a state insurance fund. This fund, not necessarily a state agency, would provide an additional element of competition in the marketplace. It would also serve as a benchmark for comparing the performance and rates of private carriers.

V. State Insurance Funds

Nineteen states have established state insurance funds, 13 of which compete with private carriers, and 6 of which are exclusive. Some of the exclusive funds also prohibit self-insurance.

FINDING:

An exclusive state fund would require tremendous public investment in start-up costs, would be virtually irreversible once private carriers had left the state, and would deprive consumers of the benefits of a competitive marketplace.

RECOMMENDATION:

The study commission recommends that the State of Maine not establish an exclusive state fund.

FINDING:

There are two potential benefits to be had from the establishment of a competitive state fund:

1. a competitive state fund provides another element of competition in the marketplace;
2. a competitive state fund would serve as a benchmark against which private carriers' prices and performance could be measured.

RECOMMENDATION:

The State of Maine should establish a competitive workers' compensation insurance fund.

There are various issues to consider in establishing a competitive state fund. These issues include:

1. whether a state fund should compete on "a level playing field" with private carriers;
2. whether a state fund should absorb the assigned risk pool;
3. whether a state fund should be financially self-supporting without taxpayer subsidy;
4. whether a state fund should be isolated from legislative temptation to divert or direct its surplus and investment funds for other public purposes; and
5. whether a state fund should be constituted as a state agency, 'independent' state authority or non-profit mutual insurance company.

FINDING:

A competitive state fund in Maine should compete on a fair and equitable basis with private carriers.

RECOMMENDATION:

"Private sector adjustment" costs could be levied annually through a transfer to the state's general fund. Or the state could establish a non-profit mutual insurance company as Minnesota has done. Premiums collected in excess of what is necessary to cover costs and expenses and to ensure adequate surplus should be returned to policyholders through dividends.

FINDING:

In order for the competitive state fund to act as a true competitor in the marketplace, its role with respect to the assigned risk pool should be the same as that of the private carriers. Other states which have moved to competitive pricing systems have found that the size of the assigned risk pool diminished as private carriers begin to compete for the business in it.

RECOMMENDATION:

At least initially, the assigned risk pool should remain as it currently exists with the competitive state fund being required to participate in it along with private carriers. The state should consider a study of the assigned risk pool within two or three years after initiating a competitive pricing system.

FINDING:

Many of the fears about establishment of a competitive state fund have to do with the true costs of its operation and the possibility of an expanded bureaucracy.

RECOMMENDATIONS:

A competitive state fund should be financially self-supporting and any initial appropriation of public funds should be paid back with interest.

A competitive state fund should be isolated from any legislative ability to borrow or to otherwise divert its funds for any other state purposes.

A competitive state fund should be subject to the same investment standards which apply to private carriers. It should not be required by the Legislature to make particular investments.

A major issue in the consideration of establishing a competitive state fund is its initial start-up costs. The major portion of start-up costs would be required to establish a surplus sufficient to protect injured workers in the event of insolvency, and the size of the surplus is a function of the size of premium volume to be written by the insurance carrier, whether a state fund or private company. The insurance industry's standard for premium-to-surplus ratio is in the range of 2:1 to 3:1.

FINDING:

The state could begin a state insurance fund with whatever level of start-up surplus it could afford. This level of start-up capital would then determine how much insurance business, measured by premium volume, the state fund could safely underwrite.

RECOMMENDATION:

At least three options are available to the state in deciding how to raise the capital surplus required. These options include:

1. a direct appropriation by the Legislature;

2. raising surplus from outside investors through the sale of bonds or other instruments, with the state guaranteeing payment in the event of insolvency; and
3. minimizing the need for surplus by permitting the state fund to assess policyholders for losses in excess of a predetermined level.

VI. Self-Insurance

Maine law permits individual employers to retain the risk of workers' compensation costs; this is technically not insurance, but is generally referred to as such. Maine law also permits groups of employers to establish self-insurance funds. The principal advantages of self-insurance are: (1) cost savings, (2) increased incentive for safety and loss control, and (3) cash flow benefits. The principal disadvantage is increased risk of nonpayment of claims in the event of insolvency.

FINDINGS:

Self-insurance is a viable alternative to purchase from private carriers and should be continued.

Solvency of self-insured entities is a critical concern of the state.

RECOMMENDATION:

The study commission makes no recommendation with respect to regulatory oversight of the solvency of individual or group employers, other than to urge adoption of the NAIC model for regulation of public employer groups.

FINDING:

Under a competitive rating system there would be no manual rates for group self-insurers to follow.

RECOMMENDATION:

Under competitive rating, groups should be permitted to file and use rates, subject to standards established by the Superintendent of Insurance to ensure that groups rates are adequate to prevent insolvency of a fund.

VII. Assigned Risk Pool

Employers rejected by private insurance companies must purchase insurance from the assigned risk pool. All insurance carriers participate in sharing the risks in this pool. Employers assigned to the pool are often not 'bad' risks, but are there just because of their small premium size which makes them economically unattractive to an individual carrier.

Manual rates in the pool are the same as outside, but because many assigned risks are small, they do not qualify for various discount pricing policies.

The NCCI designates several of the largest carriers to service the pool. A 30% servicing fee is allowed the carriers covering pool participants. In 1982 these fees totalled approximately $9 million.

FINDING:

There is little apparent incentive for small employers or their insurance agents to 'shop around' among carriers and thus frequently they end up in the pool.

RECOMMENDATIONS:

The experience of other states using competitive rating indicates some carriers do make an effort to attract smaller employers, thereby 'depopulating' the assigned risk pool. The study commission again urges establishment of a competitive rating system.

We believe there will be incentives for small, good risks to leave the pool in a competitive rating system. As a further incentive for leaving the pool, we recommend that premiums collected from risks in the pool be sufficient to cover the actual costs of those risks, thereby ending a subsidy of assigned risks which may exist.

FINDING:

There may be a potential for cost savings in the servicing of assigned risk claims.

RECOMMENDATION:

The Bureau of Insurance should proceed with a study of the true cost of servicing, and should evaluate the feasibility of seeking competitive bids on servicing.

VIII. High Cost Claims

FINDING:

Our consulting actuary found that just 4% of Maine's workers' compensation claims account for 80% of the total cost of indemnity benefits. These claims are the permanent partial, permanent total disability and death benefits. An equally important observation is that 40% of benefit costs are attributable to our escalation of benefits (cost of living) adjustment which is annual and automatic. This provision is greatly affected by the 4% long-term claims referred to above.

RECOMMENDATION:

The State of Maine should conduct a thorough study of a valid sample of permanent disability and death claims to determine whether aspects of the present system should be changed or improved to reduce costs.

I. Role of Investment Income and Profitability in Workers' Compensation Insurance Ratemaking

The study commission's enabling legislation instructed us to examine the role which investment income and insurance company profitability play in the workers' compensation insurance rate-making process. This aspect of our study was one of the chief reasons the Legislature appropriated funds sufficient to engage the services of a consulting actuary.

The overall ratemaking process for workers' compensation insurance will be described in some detail in section III of this report. For purposes of this discussion, a brief overview is sufficient.

The individual insurance companies writing workers' compensation insurance in Maine subscribe to uniform rates or prices for their products. Those rates are determined by a rather complex formula which considers data from all the companies in the aggregate. What items go into the formula and how they are mathematically treated is central to the issue of insurance industry profitability.

The insurance industry periodically translates the results of this complex formula into a request for a change in rates. The request is in the form of a percentage above (or below) existing rates. This request is filed on behalf of the industry by the National Council on Compensation Insurance (NCCI) and is filed with the state's Superintendent of Insurance who, after conducting hearings, grants or denies the rate change requested.

The last four rate increase requests have actually included two percentage figures. One is the "indicated" rate increase, that is, the amount of increase which the ratesetting formula indicates is warranted. The other percentage is the increase which the industry is actually requesting. During the last four rate cases, the requested increase has been substantially lower than the indicated increase. <u>An understanding of these two figures - why and how they differ - is fundamental to understanding many of the issues which are part of this study</u>.

The traditional ratemaking formula used by the insurance industry and accepted in most jurisdictions until recent years was based on the assumption that rates should be sufficient to provide a premium which would exactly equal the estimated to be paid out in a given year by the industry for claims losses, expenses and commissions plus a 2.5 percent underwriting profit margin. In other words, 97.5 percent of the premium dollar collected was to cover the insurance industry's various costs, and the remaining 2.5 percent was to provide a profit margin. This margin is known as an "underwriting" profit margin because it is built into the price or premium charged by insurance carriers for underwriting a risk.

This traditional method of insurance rate making, which equates premium yield with cost plus an underwriting profit margin, has come into question in a number of jurisdictions in recent years, including the State of Maine. <u>The shortcoming of this traditional approach lies in the fact that it excludes insurance industry profits which result from the investment of funds between the time when they are collected as premiums and the time when they are paid out for settlement of claims</u>. The duration or 'tail' of a company's holding funds between collection and payout is much longer in the workers' compensation line than in most other lines of insurance. A typical tail may be on the order of 15 years. The NCCI's position on this issue is that investment income is implicitly considered in their selection of an underwriting profit margin of 'only' 2.5%. However, selection of the 2.5% is fixed and arbitrary, and bears no relationship to constantly changing conditions in the investment markets.

In the most recent rate filing the NCCI used an underwriting profit margin of 0%, rather than 2.5%, in arriving at an indicated rate increase need of 100.5%. Figure 1 (p.17) gives an illustration of the relationship between costs and revenues if the industry were to receive a 100.5% increase in premium rates. Total premiums collected would be sufficient to cover all costs and expenses (except for federal taxes) and underwriting profits (zero in this case). Federal taxes are not included in the premium base in this formula because they are a function of investment income which is not explicitly calculated in the formula.

The top portion of each block, outlined in dashes, shows that investment income equals profits and federal taxes. The revenues and costs represented by the dashed portions fall outside the traditional ratesetting formula. It has been the industry's position that state regulators should accept the proposition that the underwriting profit margin is the only consideration of investment income needed. The proportional relationships between the upper portions in dashes and the lower portions in solid lines is fairly close to scale.

Figure 2 illustrates the relationship between costs and revenues assuming the 30% rate increase actually requested by NCCI. While NCCI did not disclose the method used to arrive at a 30% increase, the study commission's consulting actuaries, using a model described in Chapter 5 of the Tillinghast report, arrived at the data shown in Figure 2. The model assumes an after-tax investment income yield of 6% and results in after-tax return on equity of between 9.5% and 16.5%, depending upon an individual company's premium-to-surplus ratio.

The Tillinghast model explicitly considers investment income in calculating proper premium levels. The industry's revenues are the sum of premiums and investment income, and together equal all costs, expenses and profits. The segment in the right-hand box labelled "profit 2.5%" refers to gross profits as a percentage of total expenses and bears only a coincidental relationship to the 2.5% underwriting profit margin in the traditional NCCI rate-setting formula. The gross profit of 2.5% translates into the after-tax return on equity of 9.5-16.5%. Return on equity is the most meaningful indicator of industry profits.

The boxes in Figures 1 and 2 are approximately to scale and clearly show the significant difference in premium levels between a formula which implicitly considers investment income and one which explicitly considers it.

The Tillinghast study revealed that the industry's rate of return on equity is quite sensitive to its actual after-tax investment income yield. For example, were the Tillinghast model to rely on a 7% yield, rather than 6%, the same return on equity range could be achieved with a 23% rate increase rather than 30% (see Chapter 6, Exhibit 13 of the Tillinghast report).

The components of insurance industry costs are as follows:

--Loss costs. Loss costs include both indemnity payments associated with lost workers' time, medical costs, and claimants' legal fees.

--Loss adjustment costs. These represent the costs of settling claims, and include the costs of in-house or contract adjusters, insurers' legal expenses and other associated costs.

--Acquisition costs. These costs are associated with acquiring insurance business and include such things as agents' commissions.

--General overhead expenses and taxes. These are the costs not associated with individual cases, but are the costs of the general operations of an insurance company.

--Premium taxes (2%, foreign; 1%, domestic).

As was noted above, the last three NCCI rate filings in Maine "indicated" a need for a rate increase of approximately 100 percent or more based upon the traditional ratemaking method. However, the insurance industry through NCCI actually requested increases of 25.0 percent, 27.5 percent and 30 percent in 1982, 1983 and 1984 respectively. (See Appendix C). These requests were denied by the Superintendent of Insurance because NCCI failed to fully meet its burden of proof in proving the need for those requests or failed to provide sufficient data to support the requests. It appears the NCCI is unwilling to discontinue presenting the results of the traditional formula, even while not basing its actual rate requests on it. The reason for this stance appears to be that NCCI is reluctant to concede that investment income profits should be explicitly considered in any ratsetting formula. On the other hand, the fact that the rates actually requested happen to fall into range which Tillinghast finds reasonable when investment income profits are properly considered is probably more than coincidental.

<u>The study commission finds that the traditional formula for calculating workers' compensation insurance rates which excludes investment income profits and provides for a routine underwriting profit margin grossly inflates premium rate needs and should be abandoned.</u>

MAINE WORKERS' COMPENSATION
BREAKDOWN OF REVENUES AND COSTS

Analysis of premiums and costs based on Dec. 1983 NCCI rate filing "indicated" rate need of 100.5%, which assumes 0% underwriting profit margin and otherwise ignores investment income.

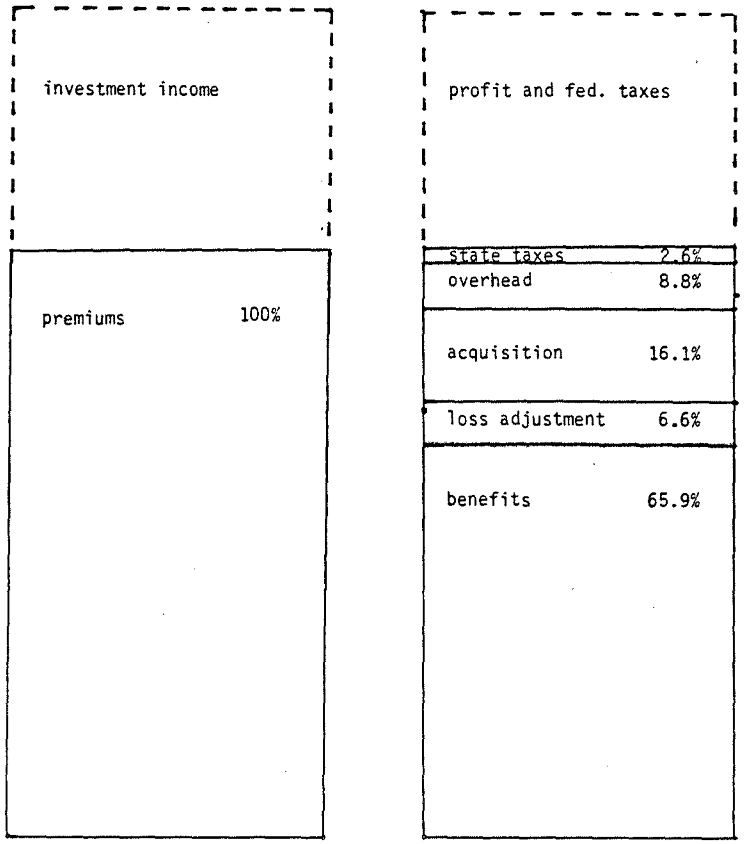

figure 1.

Analysis of revenues and costs prepared by Tillinghast which assumes 30% rate increase resulting in rate of return on equity of 9.5%-16.5%, depending upon individual company's premium to surplus ratio. (see Ch. 6, Exh. 1 of Tillinghast report)

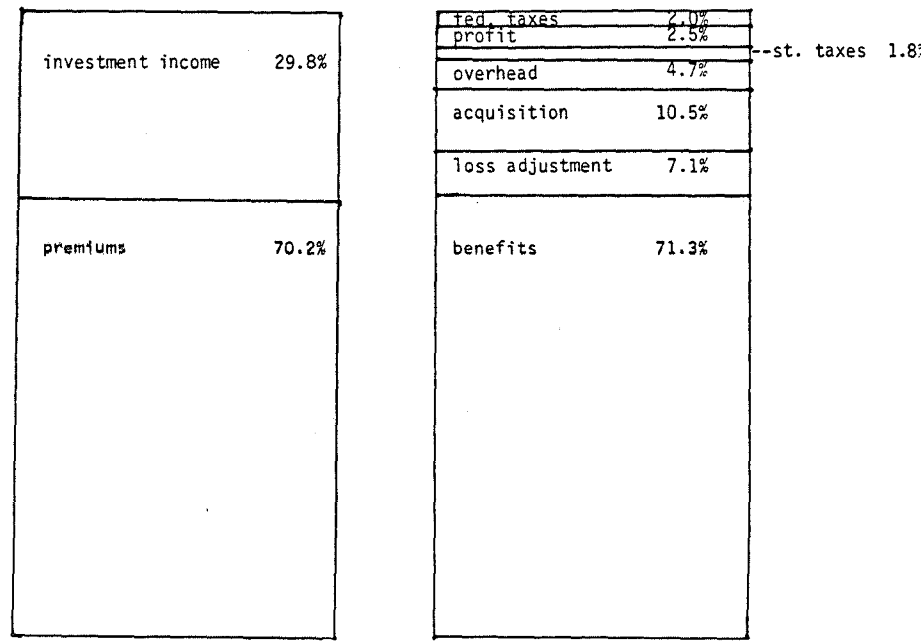

figure 2.

II. Impact of Insurance Industry Reserving Practices

The Legislature charged the study commission with evaluating the impact of insurance industry reserving practices. Each individual insurance company sets aside funds as claims are filed in order to meet the future costs of those claims. These set aside funds are known as reserves. Reserve funds are not only sizable in the workers' compensation insurance business, but are set aside for longer periods of time than is the case in most other lines of insurance, as noted earlier in this report. While funds are in reserve, they are invested by insurance companies which realize substantial income from these investments (see section I of this report).

In evaluating the impact of industry reserving practices, the study commission relied extensively on its consulting actuary. Chapter 2 of the Tillinghast report is devoted to a study of industry reserving practices.

Typically, insurance companies annually set aside reserves for claims filed during the preceding policy year. In addition, the reserves on claims resulting on earlier policy years are adjusted as more information is available on those older claims. Historically, the insurance industry has tended to underreserve for claims in Maine, that is, it has not set aside sufficient funds in the first year of its newer claims to pay the ultimate total cost of those claims. However, Tillinghast found that this tendency to underreserve has diminished in recent years and that the degree of underreserving projected by the NCCI has in the past been too high.

While individual insurance company reserving practices vary, the Tillinghast evaluation did not uncover any substantial distorting influences from company to company. Tillinghast recommends that the State of Maine's reporting requirements be made more precise so that data supplied by insurance companies is more specific and meaningful. It is also recommended that the NCCI adopt improved methodology to include 5 or more years worth of loss development, rather than the 1 year present used. In addition, more information needs to be collected and analyzed concerning loss development beyond the eighth year of claims, known as the eighth report. Finally, there is currently no information available concerning the extent of discounting for pension and disability claims for industry case reserves; such information should be developed.

For a more complete and detailed discussion of the reserving issue, the study commission urges the reader to review Chapter 2 of the Tillinghast report.

In summary, nothing was uncovered with regard to insurance industry reserving practices that appears to have any significant impact on current Maine workers' compensation insurance rates, nor would any of the changes recommended by Tillinghast result in measurable cost savings to Maine employers.

III. Current System of Workers' Compensation Insurance Rate Making

The current system for establishing rates for workers' compensation insurance in Maine is similar to the system which exists in many states. The 179 individual insurance companies[1] writing workers' compensation insurance in Maine file jointly for rates through a common rating bureau known as the National Council on Compensation Insurance (NCCI). The NCCI is a private organization supported by the individual companies writing workers' compensation insurance which are its members. Rate requests are filed with the State Bureau of Insurance and public hearings are held on all rate requests before new rates may be implemented.

The NCCI collects data from the various insurance carriers and, after analyzing this data, generally if not always requests a percentage increase over the current rates. This percentage increase applies to the individual rate for each of the approximately 550 classifications of risk which have been developed to cover the entire workforce. A classification is essentially a job title describing a particular occupation or type of employment. Each classification is assigned its own premium price per $100 of payroll for providing insurance to cover the risk associated with that classification. This price is known as the manual rate.

Until the last three or four years, rate hearings were conducted by the Maine Bureau of Insurance with little or no intervention by third parties. However, as the indicated need for rate increases has risen dramatically in the State of Maine over the last few years, NCCI rate filings have come to be scrutinized more and more carefully by both the Maine Bureau of Insurance and intervening parties. As a result, the last three consecutive rate filings have been denied or dismissed for essentially the same reason, namely, that the NCCI failed to fully document its

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[1] Some companies belong to commonly owned groups of companies. If such groups are considered as single competitive entities, the total number of competitors is 91.

requests as required by ratemaking statutes and regulations. Thus, there have been no findings on the merits of the last three requests. For a history of Maine workers' compensation insurance rate changes since 1970, see Appendix C of this report.

Concurrently, during this three-year period, the ratemaking law in Maine has been amended requiring NCCI to provide information more highly detailed, more specific and directly related to the industry's experience in Maine, as opposed to average, countrywide data. These changes were aimed at companies' reserving practices, expenses and investment income earnings.

Most businesses and industries are subject to anti-trust laws which prevent individual companies from working together to establish common prices. However, the insurance industry enjoys the protection of the McCarren-Ferguson Act which exempts it from federal anti-trust laws. Instead, the act encourages the states to regulate the insurance industry and permits individual companies to act together in establishing prices. These prices have traditionally been subject to approval by state regulators. In most states, the insurance industry acts through the NCCI in filing for workers' compensation insurance rate increases. NCCI acts as a sort of industry cartel and, in doing so, takes on characteristics similar to a monopoly in the public utilities regulatory area.

The purpose of public utility rate regulation is to act as a substitute for a competitive market where none exists naturally. However, unlike public utilities, which are typically single companies or other entities providing a service in a given geographic area without competition, there is nothing inherently monopolistic about the insurance industry, given that there are 179 individual insurance companies providing workers' compensation coverage in Maine. Therefore, the study commission conducted a review of the current pricing system beyond merely analyzing whether the traditional ratemaking formula was appropriate.

Although the ratemaking system provides for uniform rates for each risk classification to be used by all insurance carriers, the price an employer actually pays for workers' compensation insurance may vary significantly from the rate, known as the manual rate, which is approved by the Superintendent of Insurance.[2] Three of the factors which influence the amount of deviation from the manual rate are determined by the size of the premium paid by the employer and the employer's safety record or experience. The first of these factors is known as discounting. Premiums in excess of $1,000 may be discounted by a factor which depends upon the size of the applicable manual premium rate. Thus, discounting is not available to smaller employers.

The second factor, known as experience rating, can cause the premium to be higher or lower than the manual rate depending upon the safety record of the employer. Only employers whose annual premium exceeds $2,500 qualify for experience rating.

The third factor is the amount of year-end dividend returned to policyholders by mutual and participating stock companies. The typical method of calculating dividends uses a sliding scale which incorporates two variables: premium size and loss ratio. The loss ratio represents the portion of premium which was paid out for claims in the year for which the dividend is calculated. (See Appendix D for a typical company dividend table.)

In addition to these factors, there are premium payment plans which have the effect of lowering the actual premium paid by permitting the employer to retain a portion of the premium due until needed for payment of claims. Such payment plans are known by various terms, such as "paid loss retros," and are available to larger employers.

Insurance carriers are also sometimes willing to reduce premiums for workers' compensation insurance when an employer agrees to purchase other lines of insurance from the same carrier, which has the effect of making workers' compensation insurance something of a loss leader in such cases.

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[2] The Superintendent of Insurance does not "set" rates, but merely approves or disapproves those filed by NCCI on behalf of the insurance industry. The standard used is that premiums must not be "excessive, inadequate, or unfairly discriminatory." (24A M.R.S.A. 2303).

In short, the study commission found that, despite the fact that the state regulates the pricing of workers' compensation insurance premiums, there is a significant amount of "backdoor" competition in the marketplace. However, because this form of competition is not obvious and sometimes must be negotiated, it is not conducive to easy shopping around by employers looking for the best insurance buy. Furthermore, these competitive price policies are unavailable to small employers. Therefore, the study commission believes that consumers of workers' compensation insurance are not able to take full advantage of the benefits of competition available in other lines of insurance, and virtually all other products and services which they purchase, because the present regulatory system severely inhibits true marketplace forces from operating.

Another serious drawback to the present system of pricing workers' compensation insurance is the fact that the manual rates established by the regulatory process are really only averages of all of the companies conducting business in Maine, regardless of how efficient or inefficient they may be operating. The study commission's consulting actuary determined that there is a great deal of variance in the expense ratios of workers' compensation insurance carriers operating in Maine. (See Exhibit 5, Chapter 4 of the Tillinghast report.) While it could be argued that a company such as Hartford with an expense ratio of 19.2% may be providing more services to its customers than Liberty Mutual with an expense ratio of 9.7%, it may be just as true that such a company is simply operating much less efficiently. This is no doubt true in at least some cases. In fact, only .3% of the 9.5% difference in expense ratios of Hartford and Liberty is attributable to loss control. The experience of an inefficient carrier tends to skew the aggregate data compiled by the NCCI, resulting in a higher manual rate for all insurance carriers that would be the case if that one carrier were more efficient. Thus, an inefficient carrier is thereby protected from the full forces of a competitive market because the cartel pricing system shields it from at least some of the adverse consequences of its inefficiency.

Some would argue that the current ratemaking process is necessary to assure the continued solvency of insurance carriers. Indeed, that is an historic justification for the current system.

Certainly this is a key concern of regulators and the Legislature, and it should be. However, a system which determines rates in the aggregate does not guarantee that an individual company will not fail. Indeed, the poorly managed carrier with an excessively high expense factor or a poor loss prevention record may go unnoticed in the setting of an average industry rate. Its experience will be factored into the rate, but the resulting rate may still be insufficient to save it.

Fortunately, state regulators conduct examinations of individual insurance companies outside the context of rate cases. This activity is much more likely to uncover a potentially insolvent carrier and should continue apart from any changes in the ratemaking process.

Over the last three years, as NCCI rate filings have come to be more closely scrutinized, the ratemaking process in Maine has become much more complex and is consuming considerably more time and resources of both the public and private sectors. Private industry has intervened in at least the last two rate cases, and in the most recent rate case the Legislature authorized the Office of the Public Advocate to intervene. In addition, amendments to the ratemaking law for workers' compensation insurance rates have made it considerably more complex. It has been argued that the complexity of the current law is a contributing factor in NCCI's failure to fully meet its burden of proof in the most recent rate case. It has been argued by others that insurance cases are much less costly, complex and time consuming than their public utility counterparts.

Regardless of who is right on the complexity debate, the study commission finds that the information required in the present ratemaking law is probably necessary and justifiable if the state is to make a fair and objective analysis of NCCI filings. A prior approval ratemaking process, by definition, requires detailed analysis of large quantities of data and no one should be surprised at the complexity of the process. The only aspect of the current system which the study commission finds unnecessary and inappropriate in a prior approval ratesetting system is the requirement that the Superintendent of Insurance grant a rate increase request exactly as filed or to deny it totally. Together with the statutory requirement that rate requests include data from the most recently ended policy year, this "all or nothing" approval authority effectively means that, if NCCI does not file for a percentage increase at exactly the level the Superintendent finds justifiable, it may be another six to twelve months before another request can be filed. This aspect of the insurance ratemaking system appears to be more rigid than the approval authority of the Maine Public Utilities Commission. It does not appear, however, that this provision has played a role in the denials of the last two or three rate increase requests.

Even if the Superintendent's approval authority were amended to permit greater latitude in granting a reasonable rate increase, the many liabilities of the current system would still exist.

<u>The study commission finds that the present system of regulatory ratemaking is</u>:

1. <u>unnecessarily cumbersome</u>;
2. <u>wasteful of public and private resources</u>;
3. <u>deprives insurance buyers of the benefits of a competitive market, i.e., efficient pricing and comparison shopping</u>;
4. <u>rewards inefficient insurance carriers; and</u>
5. <u>does not guarantee individual carrier solvency</u>.

In addition, the system lacks the confidence of consumers because virtually the sole source of information upon which state regulators must rely in setting rates is the insurance industry itself which has a vested interest in securing rate increases. On this latter point, the study commission emphasizes that nothing in its work or that of the consulting actuary was found that raises any question about the accuracy or reliability of NCCI's data. However, the public perception of a conflict in the dual role of the NCCI has called into question the credibility of the present ratesetting process.

<u>For the reasons cited above, the study commission urges the State of Maine to adopt a system of workers' compensation ratemaking which requires insurance carriers to compete on their rates</u>.

IV. Competitive Rating System for Workers' Compensation Insurance

The rating or pricing of most lines of insurance in Maine, as in other states, is governed through open competition among private insurance carriers. This is true in homeowners, automobile, and other property and casualty lines, life, disability income and group health insurance rates.[3] And, as in most states, rates for workers' compensation insurance in Maine are set by a full-blown state regulatory 'prior approval' process. This system of rate regulation has been in effect since the inception of workers' compensation laws in the second decade of the 20th Century.

Several explanations are offered by the insurance industry and state regulators for the present ratemaking system. A 1977 U.S. Justice Dept. study[4] summarized them as follows: Workers' compensation is a form of social insurance requiring substantial state involvement; there is a need for a fixed, standardized classification system in order to collect loss data; deregulation would have disruptive effects by giving emphasis to price competition over loss prevention, and compensation insurance historically has been subject to rigid regulation. These explanations all have been advanced before the study commission. With respect to each, the study commission has come to the following conclusions.

"Workers' compensation is a form of social insurance requiring substantial statement involvement." While this statement is accurate insofar as it goes, it is also true that other lines of insurance can be described as "social insurance." Automobile insurance is a form of social insurance, as well, in which the states, through no-fault insurance laws or financial responsibility laws, require

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[3]Technically, these rates are set by the carriers under a 'file and use' rule, and may, in Maine, go into effect 30 days following the day on which they are filed with the Bureau of Insurance. Rarely do state regulators call for public hearings on these rates.

[4]"The Pricing and Marketing of Insurance," A report of the U.S. Dept. of Justice to the Task Group on Antitrust Immunities, January 1977.

that drivers obtain certain minimum levels of insurance protection. Similarly, most states compel certain insurers to participate in a residual market or assigned risk pool, and impose certain restrictions on cancellation or non-renewal of policies in automobile insurance as well as in compensation insurance. Thus, while there is substantial state involvement in several lines of insurance, that involvement need not be in the matter of setting rates as opposed to other areas of concern.

"There is a need for a fixed standardized classification system in order to collect loss data." The study commission agrees that there are two reasons for preservation of the data base: small insurers claim they need access to loss data of other carriers in order to make actuarially sound calculations, and the public needs information about the workers' compensation system. However, <u>the study commission has found in our study that it is not necessary to continue the prior approval ratemaking system in order to maintain the necessary classification system and data base</u>. States which have moved to competitive rating have also taken steps to maintain an adequate data base.

"Deregulation would have disruptive effects by giving emphasis to price competition over loss prevention." This claim supposes that insurance companies will be less concerned about preventing accidents if the state does not continue to require prior approval of a common rate. The study commission finds this claim inherently illogical for the reason that loss prevention is probably the most effective way of reducing loss costs and, thus, reducing prices or rates for workers' compensation insurance. Furthermore, there is nothing built into the present ratemaking system to encourage better loss prevention on the part of insurance carriers. As indicated earlier in this report, carriers with higher expense ratios may be providing better services such as more loss prevention than their competitors, or they may simply be less efficiently managed than their competitors. <u>There is no reason to believe that under a competitive rating system companies which are actively practicing loss prevention now will not continue to do so</u>.

"Compensation insurance historically has been subject to rigid regulation." It is also true that before Copernicus, even the best informed people thought that the Sun revolved around the Earth. Simply because a system has existed for many years does not mean it cannot be improved upon.

A final justification for continuation of 'prior approval' ratemaking which has been advanced repeatedly by the insurance industry is that, "Given the present situation of rate inadequacy in Maine, competitive rating would lead to substantial rate increases." This claim cannot be categorically dismissed; however, it is also far from certain that substantial rate increases would uniformly result from competitive rating. More will be said about this issue below.

There is nothing in the present 'prior approval' ratemaking system which assures consumers that prices are determined in an efficient manner. In fact, <u>the study commission finds that the present system discourages efficiencies by arriving at an average rate for the workers' compensation insurance industry as a whole</u>. It may theoretically be possible to alter the present ratemaking system in order to approximate the effects of a competitive marketplace. But to do so would require tremendous expenditures of public and private resources to fully analyze the data from 179 individual companies.

The only justification we can find for continuation of the 'prior approval' rating system would be if a competitive marketplace did not exist. The only other line of insurance in Maine which requires prior approval is individual health insurance where there is not a highly competitive marketplace, but rather a market heavily dominated by a single carrier. Since that is not the case with the workers' compensation market in Maine, <u>the study commission recommends the adoption of a competitive rating system along the lines of those adopted in several other states in recent years</u>.

The study commission, through its consulting actuary and through direct testimony before it, reviewed the experience of several states which have moved away from the traditional regulatory rate setting approach to a more competitive pricing system. We looked most closely at the experience of the State of Michigan whose competitive rating system became effective in January of 1983. The experience in Michigan, Illinois and Kentucky, as in all other states which have moved to competitive rating, is that prices for workers' compensation insurance significantly decreased. The experience in Michigan was particularly dramatic.

The law establishing competitive rating in Michigan required that, for the twelve-month period preceding implementation of competitive rating, manual rates established by the regulatory process be cut 20 percent. Then, one year later, on January 1, 1983, private insurance carriers were permitted to establish whatever rates they chose and, despite the fact that the legislature had already mandated a 20 percent decrease in manual rates, average rates in Michigan dropped another 20 percent, according to Kevin Clinton, chief actuary of the Michigan Insurance Bureau. While in 1980 the total premium volume in Michigan for workers' compensation insurance was approximately $930,000,000, by 1983 it had dropped to about $500,000,000. The average premium dropped from about $4/$100 payroll to slightly over $2. Although there were also workers' compensation benefit law changes made during the intervening period, Mr. Clinton, appearing before the study commission on May 24, 1984, was of the opinion that the total benefit changes were a "wash" and had no significant effect on premium rates. According to NCCI, these changes had a +4.6% impact on costs.[5] This would mean that price drops would have likely been even greater, but for the benefit changes.

A similar, if less dramatic, downward premium trend occurred during Illinois' first year of competitive pricing which also took effect on January 1, 1983. Premium volume for the preceding year was $797,000,000. A year later it had dropped to $698,000,000, a decrease of 12.5 percent. According to Robert Heisler of the Illinois Insurance Commission, the change was not accompanied by benefit law changes, nor was it attributable to a drop in employment levels.

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[5]"Annual Statistical Bulletin," 1983 edition, NCCI.

Although the Michigan experience may not be repeated in Maine, given the fact that rates in Maine have not been increased since March of 1981, rate decreases by at least some carriers are likely. At the public hearing on the study commission's draft findings and recommendations, a representative of one workers' compensation carrier, John Hughes of Maine Bonding and Casualty Co., assured us that some carriers find workers' compensation insurance profitable under today's rates. In any case, we are convinced that rates in Maine would come nowhere near doubling under competitive rating, as some fear.

Part of this fear seems attributable to the "indications" in the three most recent NCCI rate filings which purport to show a need for the doubling of rates (see section I of this report). These "indicated" rates are separate from the rate actually requested and, in the last four filings in Maine, have greatly exceeded the requested rate increase. These "indicated" rates are based on the traditional ratemaking formula which ignores profits from investment income and which furthermore includes a 2.5% underwriting profit margin. Although the NCCI reduced the underwriting profit margin from 2.5% to 0% in the last filing, the NCCI seems unwilling to abandon this basic formula even though it has been rejected in many jurisdictions. In fact, the National Association of Insurance Commissioners (NAIC) voted very recently to reject this formula, an action which may cause the NCCI finally to adopt a "total income" approach.

While the "indicated" rate increases in the last three NCCI filings were each at least 100%, the actual rates requested ranged from 25% to 30%. Although it did not explicitly say so, the NCCI data in the latest filing reveals that a 30% rate increase would result in a -36% underwriting profit factor rather than +2.5% (see Chapter 5, page 11 of Tillinghast report). Therefore, the NCCI's actual rate increase request takes into consideration investment income in a way which the study commission's consulting actuary finds reasonable. But at the same time, the NCCI continues to maintain the fiction of the traditional ratesetting formula by filing an "indicated" rate need far in excess of what it actually requests or which the industry deserves.

Our commission's consulting actuary believes a rate increase on the order of 30% may be reasonable in order to provide a return on equity (ROE) sufficient to attract investors. His analysis assumes that a target rate of return range of 15-25% is reasonable for the insurance industry. He also assumes the use of a 'risk averse' investment strategy in U.S. Treasury bills yielding a relatively modest interest rate.

In actuality, the insurance industry cannot expect to realize a ROE much in excess of the low end of the 15-25% range for more than brief periods before marketplace competition forces it down. Exhibit 4 of Chapter 5 of the Tillinghast report shows actual national returns on net worth for several major Maine industries over a 10-year period. The 10-year average for property/casualty carriers was 13.5%. That is below the low end of the consultant's target range, but it is a rate in line with other Maine industries.

Furthermore, many insurance investment departments realize greater returns on investments than that provided by Treasury bills, although some may realize less. As noted above, industry ROE is very sensitive to changes in after-tax investment yields (see pp 15-16).

Given the above factors, we do not anticipate overall rate increases in the 30% range. Some companies will no doubt raise rates under competitive rating, perhaps by as much as 20% or even 30%. Some will raise rates much less, and some not at all. Still others, we expect, will file rate decreases as has already occurred to a limited degree under a Maine ratemaking law amendment passed last year.

Unfortunately, there is little incentive under current law for existing carriers to 'break from the pack' and file downward rate deviations while their competitors continue to be sheltered from true market forces. This belief is borne out by Illinois' experience. Prior to competitive rating, Illinois carriers could file downward deviations. But, according to Heisler, only two carriers did so. However, during 1983, 36 carriers filed rates below the advisory rates provided by the NCCI under competitive rating.

<u>The study commission would like to stress the point that some degree of overall rate increase may occur whether or not the state changes the current ratemaking system</u>. In fact, if a rate increase is justifiable, it will occur under either the present regulatory system, if it is doing its job properly, or under competitive rating. <u>The current regulatory system should not be kept in place solely to artificially depress rates</u>. Yet some advocates of the present system who purchase compensation insurance are counting on just this to avoid an increase in insurance cost.

It is very possible that a finding <u>on the merits</u> of the last rate filing would have resulted in a rate increase. If such an increase occurs under the present regulatory system, virtually <u>all</u> insurance companies will increase their rates by a uniform amount. On the other hand, under a competitive rating system we believe only those companies which truly need a rate increase will choose to increase their rates. <u>We are convinced that, in the long run, workers' compensation insurance rates in Maine will be lower under a competitive rating system than they would be under the present regulatory system</u>.

Safeguards must be built into any competitive rating system to prevent the insurance industry from implementing unjustified or unreasonable rate increases.

There are several issues which must be considered in developing the elements of a competitive rating system for workers' compensation insurance. Among them are:

1. maintaining a useful classification system and information base;
2. prevention of antitrust activities by private carriers;
3. establishment of conditions under which the Superintendent of Insurance could intervene in the marketplace;
4. determination of which components of the premium price are subject to competition by carriers, and
5. regulatory protection against company insolvency.

With regard to the first of these issues, the study commission recommends a somewhat more moderate approach to deregulating workers' compensation insurance ratemaking than that which was adopted in Michigan.

The State of Michigan has gone so far as to permit individual insurance carriers to establish their own rate classification systems, so long as they are "compatible" with the state's data base. The study commission finds that while there may be some advantages in permitting carriers to individualize their classification systems, the risk of destroying a useful data base outweighs any such advantages and Maine should continue to require insurance carriers to use a uniform classification system. That classification system is currently established by the NCCI on behalf of the industry and there is no reason why the NCCI could not continue to do so under competitive rating.

In order to prevent antitrust activities, a competitive rating law should have language prohibiting insurers from undertaking any concerted ratesetting action, including concerted rate level analyses and projections. In addition, due to the widespread concern shared by many Maine employers that insurance rates will 'skyrocket' under competitive rating, the Superintendent of Insurance could be permitted to find individual company rates excessive.

With respect to pricing of workers' compensation insurance, a competitive rating law should require individual companies to consider investment income in determining the reasonableness of the margin of profit and contingencies in the rates they place on file with the Bureau of Insurance. The criteria the Superintendent of Insurance uses in determining whether a particular company's rates are excessive could include a finding of whether investment income is being considered in the rates individual companies file.

In order that employers have a reasonable opportunity to "comparison shop" for workers' compensation insurance, it was suggested by Mr. Kevin Clinton of the Michigan Insurance Bureau that premium plans ought to be limited to four elements. These elements would be the only components upon which insurance carriers could compete. By thus limiting pricing plans, some degree of standardization among carriers results, assisting consumers in making comparisons from one carrier to another. This restriction will also aid in preserving the data base. The four elements suggested by Mr. Clinton are: (1) dividend plans, (2) manual rates, (3) scheduled rating plans which provide for a risk adjustment based upon an individual risk's characteristics, e.g. safety plan, work conditions, and so forth, and (4) premium discount plans which provide an adjustment to expenses based upon payroll size.

However, the third element, scheduled rating plan deviations, is based on rather subjective criteria which could be used in an unfairly discriminatory fashion by carriers in selecting what risks they wish to underwrite. Therefore, the study commission suggests not permitting scheduled rating plan deviation.

Another possible element of competition, in lieu of scheduled rate deviations, which should be considered is in the area of experience rating. Experience rating is an upward or downward deviation of the premium charged a particular employer based upon the actual safety record of that employer. Currently in Maine, carriers subscribe to a uniform experience rating policy which denies experience rating to employers whose annual premiums are less than $2,500. This policy is established under NCCI's rules. Some competitive rating states require a uniform experience rating system, and others do not. Given our desire to maximize the benefits of competitive pricing for small employers, permitting carriers to compete on this element may provide innovative policies of benefit to small employers.

The study commission notes that Maine law presently requires an 8% premium credit for employers with less than $200,000 of payroll whose loss ratios are under 60%. While this provision is perhaps better than no experience adjustment for smaller employers, it is fixed and arbitrary, bearing no relationship to an employer's actual experience record.

Under several states' competitive rating laws, the starting point for determining what manual rates will be is the "advisory pure premium" established by the NCCI. This is the only component of pricing which is shared among insurance carriers, and it is advisory only. In Michigan, for example, advisory pure premiums are filed by the NCCI with the Bureau of Insurance and are examined by the Bureau. The advisory pure premium includes an actuarial analysis of loss and loss adjustment costs only. This enables insurance carriers to have the benefit of one another's experience on actual loss data. Advisory pure premiums do not include data with respect to company expenses, trending or profit margins. Michigan law permits NCCI to make projections as to the ultimate future development of losses, in other words, the ultimate cost of claims. However, this constitutes a judgment by a central body on loss development, an item on which Maine may instead choose to require companies to compete. In short, the less data interpretation or analysis companies share through NCCI, the greater is the state of competition.

Michigan permits insurance carriers to compete on their discounting plans. A premium discount is an adjustment to the manual rate based upon the size of the employer's payroll. Premium discounts permit some consideration of the economies of scale in writing workers' compensation insurance, given that there are certain fixed costs, commissions and general expenses regardless of how small or large the account. By permitting carriers to compete on their premium discount plans for all sizes of employers, the State of Michigan has seen some insurance carriers make a determination to compete for the smaller insureds, while other carriers are more interested in larger accounts.

Michigan places some restrictions on various payment plans. A carrier may require no more than 25% or the first $2500 of premium, which is greater, be paid at the beginning of the policy year. Thus, small employers whose premiums are less than $2500 annually are penalized by having carriers charge them their full year's premium at the beginning of the year, while larger employers enjoy the benefits of paid loss retro and similar payment plans which improve their cash flow. In this regard, Maine's current restriction in 39 M.R.S.A. 22(A) prohibiting more than 25% of premium up front is preferable.

All of the states which have moved to competitive rating in workers' compensation insurance seem to have included other regulatory safeguards against price fixing by insurance carriers.

One key element is whether the marketplace is, in fact, truly competitive. This can be determined by regulators through examining individual company rates placed on file. Upon finding that there is insufficient competition, the regulator may require prior approval of rates or even intervene to actually set rates. This should be an aspect of competitive rating adopted in Maine. Standards for intervention are offered in the model competitive pricing law developed by the National Association of Insurance Commissioners.

In addition to the criteria for determining when the Superintendent of Insurance may intervene in a non-competitive market, consideration must be given to the individual rates filed by insurance carriers. According to testimony submitted by the National Association of Independent Insurers (NAII), proponents of competitive pricing, all current state competitive pricing laws and the NAIC model law state that a rate may be disapproved as inadequate at any time. This provides some protection against individual company insolvency. On the other hand, individual company rates may be found excessive only if the market is determined to be non-competitive. However, given the widespread fear of skyrocketing rates, we recommend that the superintendent be given authority to disapprove individual rates as excessive.

The study commission is convinced that a system substantially similar to that which has been described above will provide meaningful competition in the workers' compensation insurance market in Maine and will lead to the most efficient pricing of insurance, and prices which in the long run will be lower than those provided by the traditional prior approval cartel pricing system. <u>The study commission believes that the above include all elements necessary for an efficient competitive marketplace, with the exception of one important element to be discussed in the following section of this report, namely, a standard of comparison or benchmark against which private carrier rates can be compared</u>.

The study commission has purposely not made unequivocal recommendations with respect to certain elements of a competitive rating system. Rather, we have in some cases simply chosen to point out options in the belief that Maine's Superintendent of

Insurance ought to be provided a certain degree of regulatory latitude within the parameters of a competitive pricing statute.

The study commission has tried to pay particular attention to the needs of smaller employers in making its recommendations. We believe that a competitive rating system would offer small employers the following advantages over the current Maine rate-making system:

1. overall efficient pricing benefits of a competitive market;
2. discounting and experience rating made available to small employers;
3. depopulation of Assigned Risk Pool as certain carriers intentionally go after small insureds to establish their niche in the market, offering better prices than they can get in the pool; and
4. "up front" premium competition facilitating easier price comparison than under present system.

V. State Insurance Funds

At the present time 19 states have established funds which provide workers' compensation insurance to employers, 13 of which compete with private carriers, and six of which are exclusive. Four of the exclusive funds are truly monopolistic in that they also prohibit self-insurance. The study commission took a close look at the competitive state fund in New York State and the exclusive fund in the State of Ohio. We have also reviewed the competitive Minnesota State Workers' Compensation Mutual Insurance Company which began writing policies in April of this year.

The study commission rejects any thought of recommending that Maine establish an exclusive state fund for three reasons. First, such a fund would require tremendous public investment in startup costs. Second, such a move would be virtually irreversible once the private insurance providers had been driven from the state. Third, and most importantly, an exclusive state fund would deprive consumers of the benefits of a competitive marketplace.

On the other hand, the study commission finds that there are two potential benefits to be derived from the establishment of a competitive state fund which we feel are sufficient reason for the State of Maine to establish such a fund. First, a competitive state fund provides another element of competition in the marketplace. Second, it can also serve as a benchmark against which private carriers' performance and price can be measured.

The State Insurance Fund could be established as an independent state authority, directors of which would be appointed by the Governor and the Legislature. In order for it to provide the two benefits outlined above on a fair and equitable basis, this independent authority would be subject to essentially the same cost elements to which private carriers are subject, such as premium and other taxes, and rental or occupancy costs. These "private sector adjustment" costs could be levied annually through a transfer to the state's general fund. Beyond such a transfer, any premiums collected in excess of what is necessary to cover costs and expenses and to insure an adequate surplus ought to be returned to policyholders in the form of dividends. A competitive state fund structured in this manner would act as a useful competitive element in the marketplace and as a benchmark for comparison with private carriers.

Another option for structuring a state fund is the nation's newest state insurance fund located in Minnesota, the first established since 1933. The fund's enabling legislation passed in March of 1983, and it was incorporated as a mutual insurance company on November 8, 1983. It obtained a Certificate of Authority to write insurance on March 28, 1984, and began binding and issuing policies on April 1st.

Capitalization for the Minnesota State Workers' Compensation Mutual Insurance Company was provided by a legislative appropriation of $5.7 million spread over a two-year period, and must be paid back to the state with interest. Of the eight-member board, the governor appoints four, policyholders elect three, and the Commissioner of Labor and Industries serves ex-officio. No more than one director, other than the Commissioner, can represent a governmental body, at least two directors must represent private, for-profit enterprises, and no director may represent or be employed by an insurance company. All other provisions of articles or by-laws are the same as any other mutual insurance company. It uses both the direct writing and agent system in marketing policies.

It appears that establishment of a state fund in this manner would answer virtually all of the concerns expressed in opposition to a state fund. It is not a state agency. Its only public subsidy is a low interest loan. The legislature does not control its assets or direct its investment policy. It is subject to the same regulation to which private carriers are subject.

It has been suggested to the study commission that a competitive state fund could also act as a substitute for the present assigned risk pool. The assigned risk pool in Maine might better be referred to as a residual market since many of the employers which are placed in it are not high risks, but merely small employers for whom the fixed costs of writing insurance make them unattractive customers for private carriers. It has been suggested that a state fund could provide more favorable rates to employers presently in the assigned risk pool. However, this objective would probably be inconsistent with the goal of using the state fund as a market competitor. Therefore, the study commission recommends that, at least initially, the assigned risk pool remain as it currently exists with the competitive state fund being required to participate in it along with the private carriers.

Under competitive rating, the States of Michigan and Illinois have witnessed a depopulation of their assigned risk pools as certain carriers in the private market make a conscious decision to compete for some of the business in the pool, a trend which should be helpful to smaller employers who constitute the bulk of the assigned risk pools.

We believe a competitive market in which a state fund is an equal competitor holds greater cost savings potential for smaller employers now in the assigned risk pool than would a state fund which absorbs the assigned risks. A study of the effects upon Maine's assigned risk pool after the first two or three years under a competitive rating system would be useful in determining whether a depopulating trend had also occurred in Maine.

One of the drawbacks to a competitive state fund can be its potential startup costs. A fully funded state fund with a substantial market share could require a sizeable initial appropriation in order to provide a surplus sufficient to protect its customers in the event it failed to collect enough in premiums to cover its losses. The insurance industry generally recommends a premium to surplus ratio of 2:1 to 3:1.

However, startup costs need not be a roadblock to establishment of a state fund. The state could begin a state insurance fund with whatever level of startup surplus capital it could afford. Of course, the smaller the initial surplus, the smaller would be the volume of initial insurance business it could write, unless it chose to transfer some of its risk to excess insurance coverage. One option of providing the surplus would be a legislative appropriation for the full amount. A second option would be to have the state guarantee payments on workers' compensation claims in the event the state fund became insolvent, but to have the actual capital in the surplus provided by outside investors through the sale of bonds or by other means. This option avoids the need of any direct legislative appropriation for surplus, and could also rely on a less conservative premium to surplus ratio because the state's credit would be supporting the surplus funds. It also gives the state fund a public subsidy unavailable to its competitors. An option for minimizing the need for startup surplus capital would be to permit the state fund to assess its policyholders for losses which exceeded some predetermined level, thereby avoiding a drain on the fund's surplus. While the study commission sees certain drawbacks to this approach, it is an approach used by many of today's mutual insurance companies in their infancy.

Under any surplus arrangement, other startup costs for operations would be relatively small and could come out of the initial appropriation for surplus. The Minnesota experience may be instructive.

The first-year operating budget is $650,000 and includes a staff of ten. It does not include claims handling, rehabilitation and loss prevention services which are contracted out for an estimated annual expense of $90-120,000. These services will later be provided in-house. This budget represents between 13 and 13.5% of the loan from the state, and leaves approximately $4,950,000 available for surplus. Using a 2:1 premium-to-surplus ratio, this would permit the fund to write just under $10,000,000 of premium volume. For comparison's sake, this is about 8% of Maine's 1982 premium volume (excluding self-insurance). The average market share of the 12 competitive state funds existing since at least 1933 is 20%. If the Maine Legislature chose to give its state fund an initial capacity of 5% of the market, total startup costs might be in the neighborhood of $3.6 million.

Figure 3 shows several combinations of surplus capital volume, premium-to-surplus ratios and premium volume.

In order to ensure that the competitive and benchmark comparison benefits of a state fund are available as Maine moves to a competitive rating system, the study commission recommends that competitive rating be implemented no sooner than the competitive state fund becomes fully operational. Furthermore, between the time a competitive rating law becomes effective and the time it is actually implemented, the manual rates than in effect would remain in effect.

VARIOUS STATE FUND SURPLUS FUNDING OPTIONS

Potential State Fund Premium Volume x 000	Premium Volume As Percentage of Total 1982 Maine Premium Volume[1]	Premium to Surplus Ratio	State Fund Surplus Needed x 000
$ 6,250	5%	3:1	$ 2,083
"	"	2:1	3,125
"	"	1.5:1	4,167
12,500	10%	3:1	4,167
"	"	2.1	6,250
"	"	1.5:1	8,333
20,000	16%	3:1	6,667
"	"	2:1	10,000
"	"	1.5:1	13,333
30,000	24%	3:1	10,000
"	"	2:1	15,000
"	"	1.5:1	20,000

[1] $125,000,000 excluding self insurance

figure 3

VI. Self-Insurance

A textbook definition of insurance would read essentially as follows: "The pooling of liabilities and the spreading of risk." By definition, an individual employer cannot "self-insure;" only groups of employers can. However, for the sake of simplicity, the term self-insurance used below, unless otherwise indicated, refers both to individual employers and groups of employers who provide their own workers' compensation programs rather than purchasing insurance from an insurance company.

Individual employers are permitted to retain the risk of paying the cost of their injured workers' claims under the laws of Maine and 46 other states. Groups of employers are permitted to pool their liabilities and spread their risks, i.e. self-insure, in Maine and 27 other states and the District of Columbia.

The principal advantages of risk retention and self-insurance are potential cost savings, increased incentive for loss control and safety engineering, and improved cash flow. The principal disadvantage is the increased risk of nonpayment of benefits to injured workers due to insolvency of the self-insured entity. For a more detailed discussion of the elements of self-insurance and an analysis of potential cost savings, see the Tillinghast report, Chapter 7, pp. 4-11.

The study commission heard testimony about self-insurance from individual employers, group self-insurers, the insurance industry, the AFL-CIO and the Maine Bureau of Insurance. The chief criticisms of the present system of self-insurance regulation in Maine concerned the manner in which the Bureau of Insurance conducts it. It was pointed out that there have been no new self-insurance groups formed in Maine since July 3, 1980, when the responsibility for overseeing self-insurance was transferred by the Legislature from the Workers' Compensation Commission to the Bureau of Insurance. The Bureau was criticized for being overly concerned with both the solvency and internal financial management of self-insured employers.

Another criticism had to do with the Bureau's regulation of municipalities wishing to self-insure. Maine has a separate enabling statute for municipalities which wish to individually self-insure. Some of the Bureau's regulatory standards were thought to be more appropriate for private sector businesses than for municipalities which have the power of taxation and which need not rely heavily upon the value of their current assets in order to pay claims. In this regard, the study commission takes note of the fact that the National Association of Insurance Commissioners (NAIC) has considered two different models of self-insurance regulation, one for private sector businesses and the other for governmental entities. The Bureau may wish to review these two models as a possible response to this criticism.

Another criticism was made of the Bureau's regulation of self-insured groups in that no "heterogeneous" groups (groups of unlike employers) have been established in Maine. This criticism was made despite the fact that no application for such a group has ever been submitted for consideration. Only relatively large employers can qualify to be individual self-insurers for workers' compensation benefits. Smaller employers must participate in a self-insurance group, be it homogeneous or heterogeneous.

The study commission finds that self-insurance is a legitimate alternative to purchase of insurance on the private market and ought to continue to be available to Maine employers. <u>The study commission also finds that the increased risk of nonpayment of benefits which might result from the insolvency of a self-insured employer or group of employers justifies the current level of regulation of such entities by the Bureau of Insurance</u>. The study commission noted that Maine's oversight of self-insurers is conducted under regulations which are similar to those which are being considered by the NAIC in drafting its suggested model regulations. Therefore, while the study commission recommends that individual and group self-insurance continue to be made available to qualified employers in Maine, it makes no recommendations to lessen regulatory oversight of the solvency of self-insured employers.

However, there is one area which needs to be addressed as Maine moves towards a competitive pricing system. Under current law, self-insurance groups must adopt the rates set by the regulatory process for private carriers, the NCCI rates, unless they file for a rate deviation with the Bureau of Insurance as they have done in the past. Under a competitive rating system, there would be no NCCI rates for groups to follow. Therefore, the study commission recommends that self-insurance groups follow a procedure similar to that for private carriers under competitive rating. Groups would file their rates and proceed to use them unless the Superintendent of Insurance found cause to conduct hearings. Standards would have to be developed by the Superintendent of Insurance to ensure that group rates filed were sufficient to protect the solvency of the group fund.

VII. Assigned Risk Pool

Any employer who attempts to purchase workers' compensation insurance from a private carrier and is rejected by the carrier is nevertheless able to purchase insurance through what is known in Maine as the assigned risk pool. The pool results from a requirement in Maine law, similar to that in the laws of many states, which requires all writers of workers' compensation insurance jointly to bear the risk of writing insurance for those employers which no single company is willing to write. These employers or "risks" are not necessarily bad risks, although some definitely have poor safety records. Many employers are in the assigned risk pool simply because the premium they are required to pay is very small and even a single serious injury or accident could wipe out years of earned premiums collected by an insurance company. Also, the fixed costs of writing a policy for these small employers are high relative to the premium generated by these risks, so they are also undesirable from the point of view of economies of scale. Presently, about half of all Maine employers (excluding self-insurers) are in the assigned risk pool. They represent about one-fourth of the total premium volume paid to private carriers.

The manual rates for risks in the assigned risk pool are the same as those for other risks. Whatever rate increase may be granted under the present regulatory ratemaking system applies to all rates inside and outside the pool. As was noted earlier in Section IV, the study commission is not making any recommendations for major alterations to the assigned risk pool. However, adoption of a competitive rating system raises certain questions with regard to the setting of rates for those in the assigned risk pool. Several options exist.

The first option is that the State Bureau of Insurance could continue to hold hearings on rates for the assigned risk pool. However, such a system would continue to have the same disadvantages which exist in the current regulatory system of setting rates for all insured. It would seem undesireable to perpetuate a cumbersome and expensive regulatory system for only a portion of the present workers' compensation insurance market. Another option would be to index the rates for the assigned risk pool to rates in the competitive market by using either a weighted average of market rates or the highest available market rate for each classification.

Another question which needs to be addressed is whether the assigned risk pool should stand on its own financially. While there was no finding on the last NCCI rate case partly due to insufficient data on assigned risks, NCCI apparently claims that the rest of the insurance market subsidizes the risks in the assigned risk pool. One method of enabling the assigned risk pool to stand on its own financially would be to permit insurance carriers to surcharge the employers in the pool. The State of Michigan permits surcharging of assigned risks, but only those with a demonstrably poor record.

It appears that the actual practice with the assigned risk pool now is that employers often end up being placed in the pool even though they have not actually been turned down by two or more insurance carriers. There is little incentive for employers or insurance agents to make a diligent search for insurance outside of the assigned risk pool since the rates are the same in the pool. This fact would seem to argue for making the assigned risk pool financially self-sustaining. <u>If rates within the pool were sufficient to fully cover the costs and expenses associated with those risks, thus ending any subsidy of those risks, there would be an incentive for employers to seek insurance in the competitive market. This incentive, coupled with a competitive rating system which will likely result in certain insurance carriers making their prices attractive to small employers, should result in greatly diminishing the size of the assigned risk pool</u>.

The NCCI currently manages the assigned risk pool and has designated several carriers to service the claims arising from risks in the pool. Those servicing carriers levy a service fee amounting to 30% of the premiums collected. Those service fees currently total about $9 million. The study commission did not analyze the actual cost of servicing the assigned risk pool. We understand that the Superintendent of Insurance was planning to conduct such a study in the course of the last NCCI rate case prior to its dismissal. The study commission urges that such a study be conducted to determine whether substantial savings could be accomplished in this area, and to determine the feasibility of putting out to competitive bid the servicing of assigned risk claims.

VIII. High Cost Cases

The study commission was not charged by the Legislature with reviewing a number of aspects of the Maine's workers' compensation system in Maine, such as benefit levels or injured worker rehabilitation. However, in the course of our study we took special note of our consulting actuary's findings that a small minority of all workers' compensation cases result in a very large portion of total costs of the system. In Exhibits 3 and 4, Chapter 6 of the Tillinghast report (reproduced here as figure 4), Maine workers' compensation benefits are broken down into their component pieces by type of injury. The dominant share (60%) of benefits is paid for permanent partial disabilities, even though these claims comprise only 3.7% of all claims. Permanent partial disabilities, a term used by the NCCI, include all cases where there is a permanent impairment of the worker's ability to perform work. Another 15% of the total cost of benefits arises from fatalities which comprise less than 1/10th of 1% of all claims. And another 5% of cost results from permanent total disabilities which comprise less than 1/20th of 1% of all claims. Thus, only 4% of claims generate 80% of benefit costs.

Due to the permanent nature of these three types of claims, the duration of payment of claims is obviously extensive, assuming there is no lump sum settlement. Such extensive claim payment "tails" are subject to the provision in Maine law providing for the escalation of benefits to match the increasing cost of living. According to the Tillinghast report (Exh. 9, Ch. 6), the escalation of benefits provision accounts for an estimated 41.5% of the total cost of benefits.[6]

The study commission studied one alternative structure which may have the potential for controlling the cost of these claims, or at least providing the state with valuable information about the nature of these claims. That structure is known as a workers' compensation reinsurance association, such as that which was established within recent years in the State of Minnesota. A workers' compensation reinsurance association (WCRA) requires that all individual claims exceeding a certain threshold

[6] This estimate does not consider lump sum settlements. Cases settled for a sum less than the present value of future payments would tend to reduce the cost of the escalation provision by some unknown amount.

cost level be reinsured with the WCRA. The WCRA is a private, non-profit agency established by the Minnesota Legislature. All insurers, whether private carriers or self-insurers, must purchase reinsurance on these high cost claims (see Ch. 7, pp. 11-14 of the Tillinghast report and transcript of meeting of March 12, 1984).

The WCRA in Minnesota appears to provide a central entity which oversees the handling of the relatively small number of high cost claims, including the rehabilitation of injured workers, and to provide the state with valuable information about how the costs of these claims can be controlled.

The study commission does not feel that enough information is known about the small number of high cost claims in Maine to know whether a WCRA would generate cost savings with regard to these claims. The study commission recommends that the State of Maine conduct a study of a valid sample of permanent disability and fatality cases. Such a study might uncover deficiences in the current loss prevention and rehabilitation programs, which are areas that a WCRA may be able to more adequately address. On the other hand, such a study may find that savings opportunities exist which can best be addressed on a legislative or administrative level, which are areas which a WCRA would not necessarily be able to address.

MAINE WORKERS' COMPENSATION

DISTRIBUTION OF CLAIMS

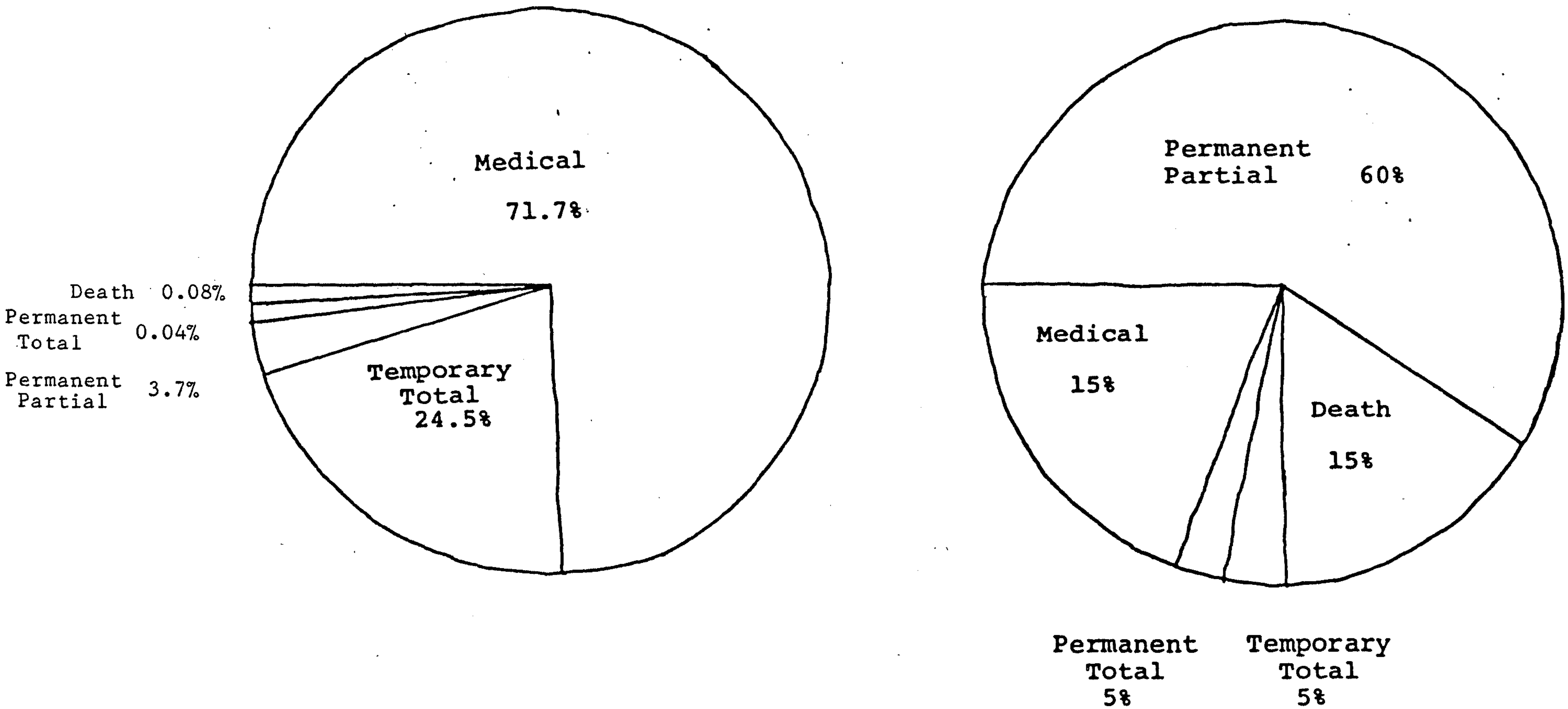

Figure 4

CHAPTER 479

H.P. 1019 - L.D. 1322

AN ACT to Reform the Workers' Compensation System.

Emergency preamble. Whereas, Acts of the Legislature do not become effective until 90 days after adjournment unless enacted as emergencies; and

Whereas, the Workers' Compensation System in Maine suffers from structural problems which cause higher costs to Maine employers and delays in benefits due Maine's injured workers; and

Whereas, these problems should be addressed as soon as possible; and

Whereas, the implementation of these changes should be phased in over a period of time; and

Whereas, in the judgment of the Legislature, these facts create an emergency within the meaning of the Constitution of Maine and require the following legislation as immediately necessary for the preservation of the public peace, health and safety; now, therefore,

Be it enacted by the People of the State of Maine as follows:

* * * *

Sec. 31. Study commission. There is established a special commission to review and make recommendations to the Governor and the Legislature concerning workers' compensation alternative systems. The commission shall evaluate the impact of reserving practices, return on investments and profitability on workers' compensation ratemaking and structural alternatives, such as state funds.

The commission shall be composed of 3 persons, appointed by the Governor: A chairman without any ties to an interest group, a representative of business and a representative of labor. Advisory, nonvoting representation from the insurance industry and the Department of Business Regulation may be provided. For purposes of this study, the commission shall have the same powers as those provided to the Superintendent of Insurance under Title 24-A, chapter 3, to garner information from insurers and individual and group self-insurers.

The commission may employ an actuary and such other staff as may be required. The 3 commission members shall be entitled to receive $150 per day, plus expenses for each day actually spent conducting business of the commission.

The commission shall report its full findings to the Governor, the President of the Senate and the Speaker of the House of Representatives, together with any recommended legislation, no later than April 30, 1984.

Sec. 32. Appropriation. The following funds are appropriated from the General Fund to carry out the study provided in section 32.

	1983-84
COMMISSION TO STUDY WORKERS' COMPENSATION INSURANCE	
Personal services	$30,000
All Other	70,000
Total	$100,000

Effective June 24, 1983, unless otherwise indicated.

LIST OF MEETING DATES AND WITNESSES

November 3, 1983

organizational matters; discussion of mission
no witnesses

November 17, 1983

Theodore Briggs, Superintendent of Maine Bureau of Insurance

Richard Johnson, Actuary, Maine Bureau of Insurance

William Johnson, Legal Counsel, Workers' Compensation Commission

December 15, 1983

interviews with five consulting actuary applicants

January 5, 1984*

Thomas Whelton, Assist. V.P., Alliance of American Insurers

John Purkis, V.P. for Underwriting, Liberty Mutual, on behalf of Alliance of American Insurers

Peter Burton and Harold Pachios, National Council on Compensation Insurance (NCCI)

January 19, 1984*

Roy Kallop, Actuary, NCCI

February 2, 1984*

Hank Magnuson, Paper Industry Information Office

Kenneth Allen, Assistant to the Speaker of the House

Patrick N. McTeague, counsel, Maine AFofL-CIO

February 27, 1984*

David Scheffler, Penn General Service Co.

Larry Sallinger, Fred S. James Co.

Douglas Smith, Northern Woods Loggers self-insurance group

Christopher Lockwood and Raphael St. Pierre, Maine Municipal Association self-insurance group

Leland Crawford, Maine Self-Insurance Guarantee Fund

Jude Cyr, City of Auburn

John Salisbury, Maine State Chamber of Commerce

Patrick N. McTeague, counsel, Maine AFofL-CIO

March 12, 1984*

Richard P. Lutenski, President, Workers' Compensation Reinsurance Association of Minnesota

Darlene Evans, Executive Secretary, Ohio State Insurance Fund

Arnold Kideckel, Executive Director, New York State Insurance Fund

April 19, 1984*

Timothy Wakely, Maine Insurance Council

Charles Coakley, counsel, American Insurance Association

Sam Sorich, National Association of Independent Insurers

May 10, 1984*

Everard Stevens and Richard Johnson, Maine Bureau of Insurance

May 24, 1984*

Kevin Clinton, actuary, Michigan Bureau of Insurance

June 7, 1984

John P. Tierney, Tillinghast, Nelson & Warren, consulting actuary (At this and the three previous meetings, Mr. Tierney discussed his findings; these discussions were taped, but not transcribed.)

June 20, 1984*

public hearing on draft findings and recommendations

*Copies of transcripts of these meetings are available.

WORKERS COMPENSATION RATE CHANGES 1970 AND LATER

Effective Date	Indicated Per NCCI	Filed		Approved: Overall	Approved: Excl. Law Amendment	Cumulative Index: Overall	Cumulative Index: Excl. Law Amendment
6-1-70	3.9%	3.9%		3.9%	1.6%	1.039	1.016
6-1-71	5.8	5.8	1	5.8	4.1	1.099	1.058
4-1-72	35.2	35.2	2	23.5	-3.3	1.358	1.023
1-1-73	17.2	14.7	3	12.3	10.9	1.525	1.134
6-1-74	31.2	24.4	4	24.4	-4.5	1.897	1.083
5-15-75	10.0	10.0		10.0	0	2.086	1.083
10-1-75	7.7	7.7		7.7	6.4	2.247	1.153
1-1-77	15.0	15.0		7.1	0	2.406	1.153
2-15-78	38.3	38.3	5	20.9	10.9	2.909	1.278
5-21-79	39.0	39.0		20.0	19.8	3.491	1.531
3-2-81	142.4	25.0		25.0	24.3	4.364	1.903
not implemented 10-29-81*	109.2	25.0		disapproved			
not implemented 3-4-83*	110.1	27.5		disapproved			
not implemented 5-11-84*	100.5	30		dismissed			

Note: Effective September 1979, Maine law required the Superintendent of Insurance to grant a rate increase exactly as filed or to deny totally. (39 M.R.S.A. 22). Previously, the Superintendent had authority, in effect, to grant a partial increase.

*Date of Superintendent's decision.

Source: Maine Bureau of Insurance.

1. Appears that latest law amendments were filed separately, w/o 6/1/71 law amend. 4.1%
2. Reduced to 23.5 partially due to economic stabilization program
3. Subsequently amended to 14.3%
4. Reduced from indicated due to economic stabilization program
5. changed to 36.3 at hearing

DIVIDEND TABLE - PROGRAM 1

	LOSS RATIO								
STANDARD PREMIUM	0-5	5.1-10	10.1-15	15.1-20	20.1-25	25.1-30	30.1-35	35.1-40	40.1-45
Under 5,000	22.8	22.8	22.8	22.8	20.3	15.3	10.3	5.3	0.3
5,000 - 9,999	28.3	27.9	27.5	27.1	24.2	18.8	13.4	8.0	2.6
10,000 - 14,999	31.0	30.3	29.6	28.9	25.7	20.0	14.3	8.6	2.9
15,000 - 19,999	33.3	32.3	31.3	30.3	26.8	20.8	14.8	8.8	2.8
20,000 - 24,999	35.4	34.2	33.0	31.7	28.0	21.8	15.6	9.4	3.1
25,000 - 34,999	37.7	36.2	34.7	33.2	29.2	22.7	16.2	9.7	3.2
35,000 - 49,999	42.9	40.8	38.7	36.6	32.0	24.9	17.8	10.6	3.5
50,000 - 74,999	48.6	45.8	43.1	40.3	35.0	27.2	19.4	11.7	3.9
75,000 - 99,999	53.6	50.3	46.9	43.5	37.7	29.3	20.9	12.6	4.2
100,000 - 149,999	60.8	56.6	52.4	48.1	41.4	32.2	23.0	13.8	4.6
150,000 and over	68.6	63.5	58.4	53.2	45.6	35.5	25.4	15.2	5.1

Dividends are estimated and not guaranteed and payable as declared by the Board of Directors.

Note: This table is representative of dividend-paying companies. Dividend payments are not required by law, and dividend plans vary from company to company.

Source: Maine Bureau of Insurance.