Workers' Compensation Insurance Coverage: The State of the South Carolina Market

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1201 Main Street, Suite 1000
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December 21, 2015

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NIKKI HALEY
Governor

RAYMOND G. FARMER
Director of Insurance

December 21, 2015

The Honorable Hugh K. Leatherman, Sr.
President *Pro Tempore*
South Carolina Senate
111 Gressette Building
Columbia, South Carolina 29201

The Honorable James H. Lucas
Speaker
South Carolina House of Representatives
506 Blatt Building
Columbia, South Carolina 29201

RE: Report on the South Carolina Workers' Compensation Insurance Market

Dear Mr. President and Mr. Speaker:

Enclosed for your information and review is a report on the state of the South Carolina workers' compensation insurance market. South Carolina Code of Laws Section 38-73-526 requires the South Carolina Department of Insurance to submit a report to the General Assembly on the state of the market by January 1st of each year. That section reads as follows:

> The director or his or her designee must issue a report to the General Assembly by the first of January each year that evaluates the state of the workers' compensation insurance market in this State. The report must contain an analysis of the availability and affordability of workers' compensation coverage and document that the department has complied with the provisions of Sections 38-73-430 and 38-73-525 with regard to both workers' compensation loss cost filings submitted by an advisory or rating organization and multiplier filings submitted by every insurer writing workers' compensation insurance.

As you are aware, the South Carolina Department of Insurance exercises regulatory authority over workers' compensation insurance rates and not over the administrative components of the South Carolina workers' compensation insurance system.

The enclosed report provides the following: (1) an overview of the South Carolina workers' compensation insurance system, including an analysis of the availability and affordability of workers' compensation insurance coverage in South Carolina; (2) regulatory issues and trends in the South Carolina workers' compensation insurance market; (3) a summary of the impact of the changes to regulation of the loss cost multiplier on workers' compensation insurance rates; and (4) legislative recommendations.

My staff and I are available to discuss any of the issues raised in this report with you at your convenience and to provide technical assistance to you and members of your staff as necessary.

Please do not hesitate to contact me if you have any questions or if my staff or I may provide you with any additional information.

Sincerely,

Raymond G. Farmer

Raymond G. Farmer
Director of Insurance

Cc: The Honorable Nikki Haley, Governor
State of South Carolina

The Honorable Robert W. Hayes, Jr., Chairman
Senate Banking and Insurance Committee

The Honorable William E. Sandifer III, Chairman
House Labor, Commerce and Industry Committee

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I. REPORT SCOPE AND METHODOLOGY

This report is submitted in accordance with § 38-73-526 of the South Carolina Code of Laws. It provides statistical information on the state of the workers' compensation market. It also addresses regulatory issues within the South Carolina workers' compensation insurance system, including the affordability and availability of workers' compensation insurance coverage. It is based upon data collected from insurers concerning: 1) the loss cost multiplier; 2) loss cost multiplier filings received subsequent to the enactment of 2007 S.C. Act No. 111 and 3) detailed premium and exposure data compiled by the National Council on Compensation Insurance (NCCI) and the National Association of Insurance Commissioners (NAIC). Additionally, the South Carolina Department of Insurance staff reviewed various studies and reports on the South Carolina workers' compensation insurance system as well as other literature on issues and trends in the workers' compensation insurance industry.

II. REPORT LIMITATIONS

This report does not constitute an empirical study on regulatory issues affecting the South Carolina workers' compensation insurance system. It has been prepared from the best available information on workers' compensation insurance by sources considered experts in the field of insurance regulation and workers' compensation (see footnotes for identification of referenced sources). The data used in this report was compiled from a variety of sources. Consequently, those sources may have used different methods to collect and compile the data provided. The South Carolina Department of Insurance (Department) relied upon the expertise of these sources. Therefore, no independent verification of the data or information was performed by the Department.

III. EXECUTIVE SUMMARY

Workers' compensation insurance provides compensation for employees injured or killed on the job. This coverage includes, for example, payment of the costs of medical treatment and lost wages. It also provides disability and death benefits. The workers' compensation system replaced the common law tort system and the negligence standard for workplace injuries and is the exclusive remedy for work-related injuries and death. The workers' compensation system is a no-fault system under which employers are held strictly liable for providing health, death and wage replacement benefits for injured or killed workers. In return, injured workers waive most of their rights to seek redress for losses through the court system. Many believe that the system is important because it can influence the economic development of the state due to the impact that the cost of a state's workers' compensation system has upon the state's ability to attract businesses.

Amid growing concerns about the increasing costs of workers' compensation insurance in the state, the South Carolina General Assembly revised many aspects of the workers' compensation laws in 2007 via 2007 S.C. Act No. 111. The primary goal of this reform effort was to stabilize the costs of South Carolina's workers' compensation system. Since 2007, there have been no major regulatory changes involving the workers' compensation system.

In general, the South Carolina workers' compensation market appears to be stable. Since 2007, new carriers have entered the marketplace, continuously improving the availability of coverage. From 2009 to 2012, the number of policies in the Assigned Risk Plan decreased each year. In 2013 and again in 2014, the policy count increased. In 2014 there was a 7.7% increase in the policy count and a 3.6% increase in the total premium.

After three years of consecutive loss cost decreases (2009 to 2011), the National Council on Compensation Insurance (NCCI) overall loss costs increased in 2012 (+3.0%) and again in 2013 (+1.1%) but decreased by 7.4% in 2014. In 2015, the overall loss costs increased by +1.9% as noted in Graph 4.6.

The frequency of lost-time claims, a large component and cost driver, has been relatively flat over the past several years. The medical severity has also been relatively flat over the past three years while the indemnity severity increased for the first time since 2006 as shown in Graph 4.8.

In order to regulate the marketplace in a more efficient manner, the Department recommends the following legislative change:

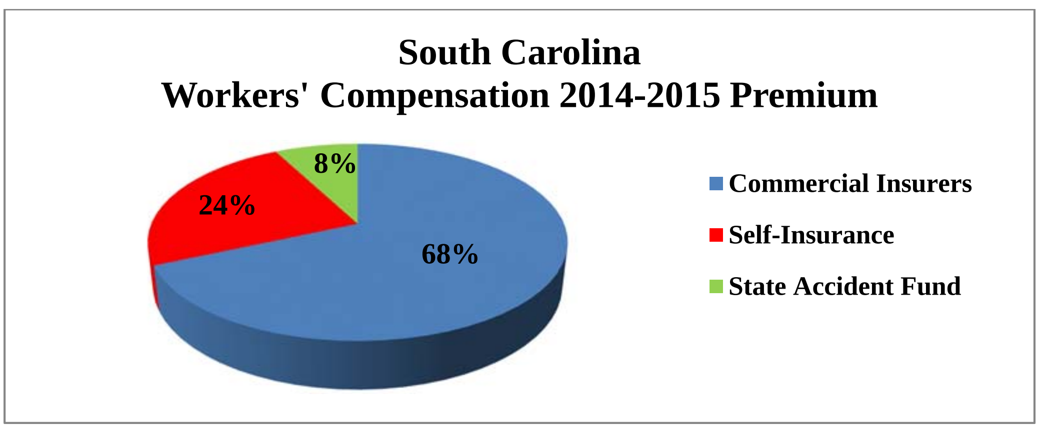
- Require workers' compensation insurers to file for approval their adoption of the most recently approved loss costs within 120 days of approval of NCCI's filed loss costs. Additionally, require that an insurer that is not using the most recently approved loss costs file to adopt the most recently approved loss costs upon submission of a loss cost multiplier filing. This change will codify the current regulatory practice.

IV. THE SOUTH CAROLINA WORKERS' COMPENSATION INSURANCE MARKET

A. OVERVIEW OF THE WORKERS' COMPENSATION SYSTEM

Workers' compensation laws were enacted to benefit both injured workers and employers: workers receive partial, but prompt, predictable and certain compensation without regard to fault in exchange for relinquishing their tort right to sue their employers for damages. As shown in Graph 4.1 below, the South Carolina Workers' Compensation Commission reports that 68% of South Carolina's workers' compensation coverage is provided by insurance companies. The remaining coverage is provided through group self-insured funds (such as the State Accident Fund) and individual self-insured employers. Both types of self-insureds share many of the same costs and expenses as an insurance company. Insurance company rates are the focus of this report, but differences will be noted, as appropriate.

Graph 4.1 - State's Workers' Compensation System Premium Analysis

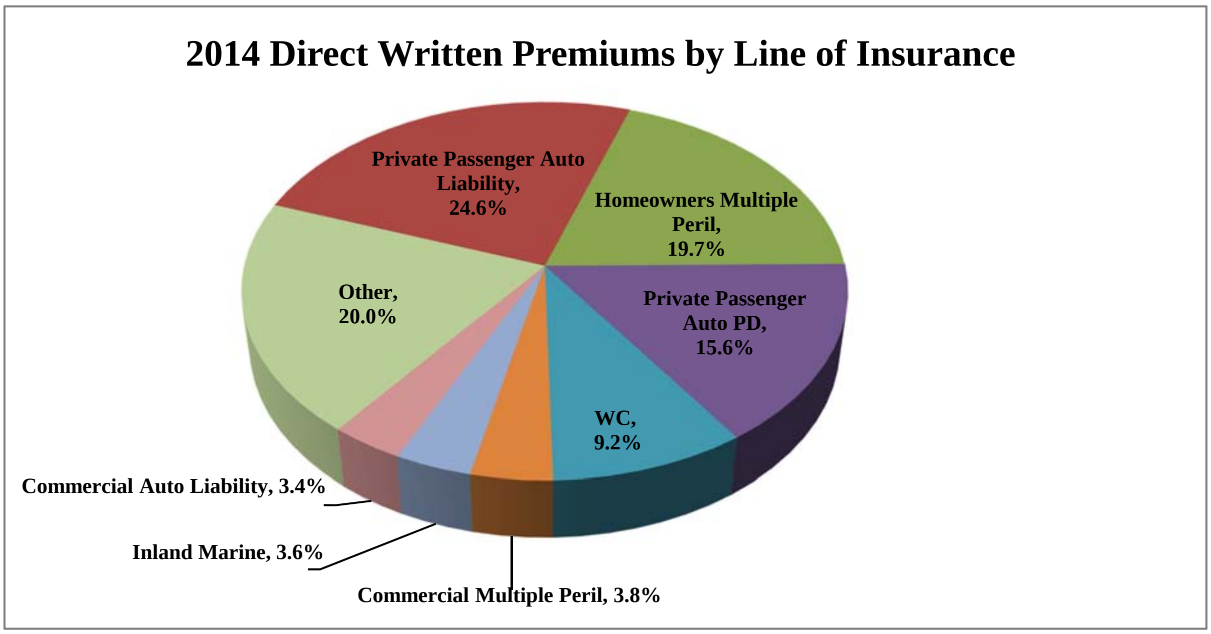


Source: "SC Workers' Compensation Commission Annual Report (2014 – 2015)"

B. STATE OF THE SOUTH CAROLINA WORKERS' COMPENSATION INSURANCE MARKET

South Carolina is considered a compulsory state for workers' compensation insurance coverage. Employers with four or more employees are required to provide workers' compensation insurance coverage for their employees.[1] Workers' compensation insurance coverage provided by insurance companies may be purchased in South Carolina in the voluntary market (private insurers) or through the residual market (the South Carolina Workers' Compensation Assigned Risk Plan). As Graph 4.2 illustrates, workers' compensation makes up 9.2% of all property and casualty premiums written in South Carolina, unchanged from 2013.

Graph 4.2 - Analysis of South Carolina Property and Casualty Insurance Market

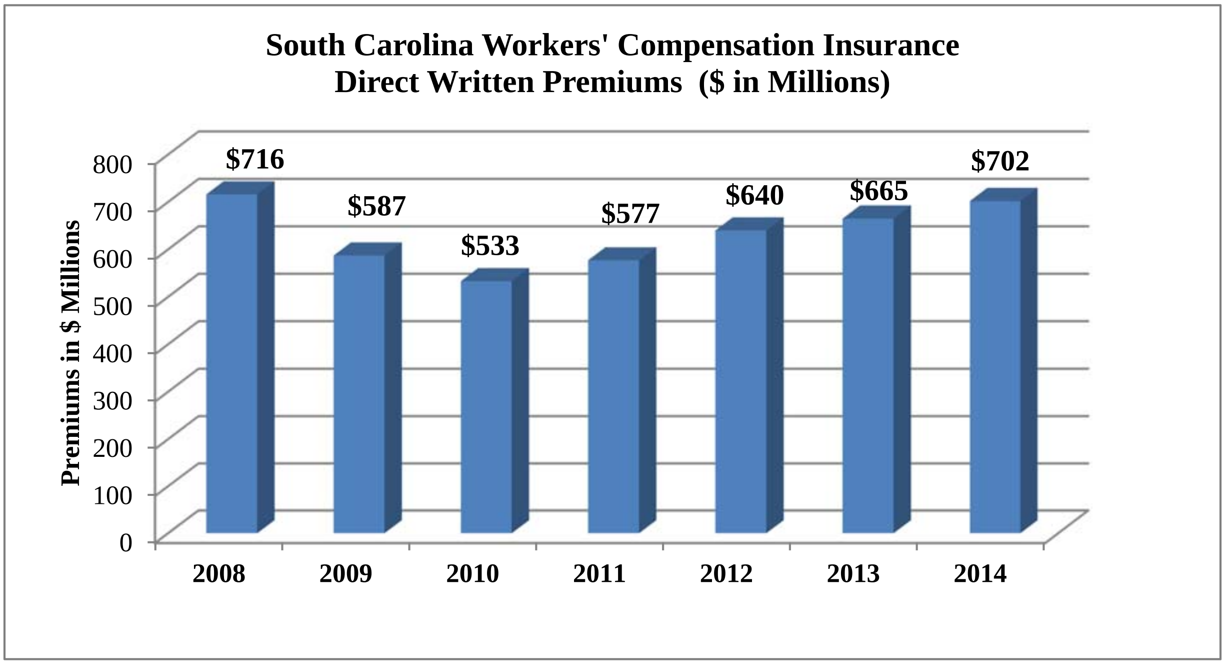


Source: "Line of Business by State" www.i-site.naic.org. Accessed: October 5, 2015

[1] *See* S.C. Code Ann. § 42-1-360 (2002)

Workers' compensation insurance direct written premiums totaled $702 million in 2014, an increase of $37 million from 2013, as illustrated in Graph 4.3. This increase in premium is likely the result of increased payrolls, loss cost increases for some job classifications, and occasional increases to company loss cost multipliers.

<u>Graph 4.3 - South Carolina Direct Written Premiums (2008 – 2014)</u>



Source: "NCCI State Advisory 2015 Forum Report" as of May 28, 2015

1. South Carolina's Voluntary Market

a. Availability

Insurance availability is generally described in terms of insurer capacity and the supply of insurance products within the market. Availability is typically affected by the number and capacity of insurers writing in the market. There were 987 companies included in the 2014 NAIC South Carolina Market Share Report[2], up from 982 companies in 2013 and 985 in 2012. As shown in

[2] Accessed October 6, 2015

Table 4.1, South Carolina's experience has been stable over the past five years when compared to the net gain (loss) of insurance groups entering the workers' compensation marketplace in the surrounding Southeastern States.

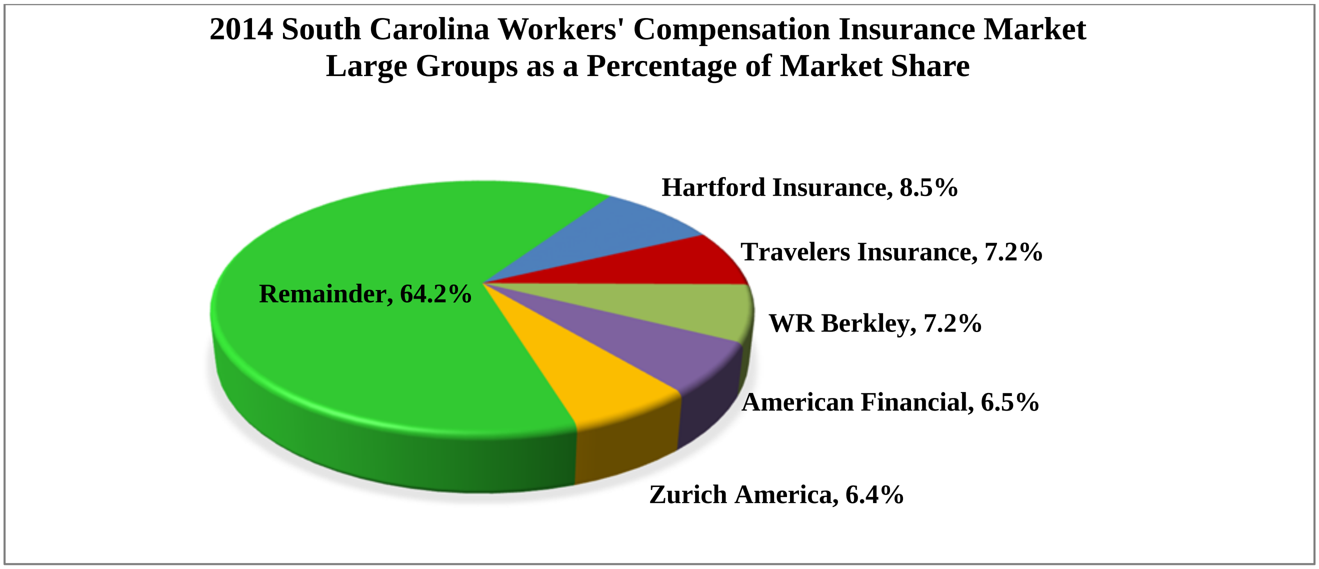
Table 4.1 - Southeastern States Insurer Net Gain (Loss) (2010-2014)

NAIC Zone Southeastern States	Net Gain (Loss) of Insurers
Alabama	5
West Virginia	5
Louisiana	4
Florida	3
South Carolina	**0**
Kentucky	(1)
Virginia	(1)
North Carolina	(2)
Tennessee	(2)
Georgia	(3)
Mississippi	(3)
Arkansas	(7)

Source: "NAIC 2014 Competition Database Report" (Draft as of 12-14-2015)

Many of the workers' compensation carriers are members of insurance groups that write a significant amount of the overall premium in the marketplace. Graph 4.4 provides the percentage of market share for the top five workers' compensation insurer groups. The market share held by the top five insurer groups accounted for 36% of South Carolina's 2014 workers' compensation market, down from 41% in 2013.

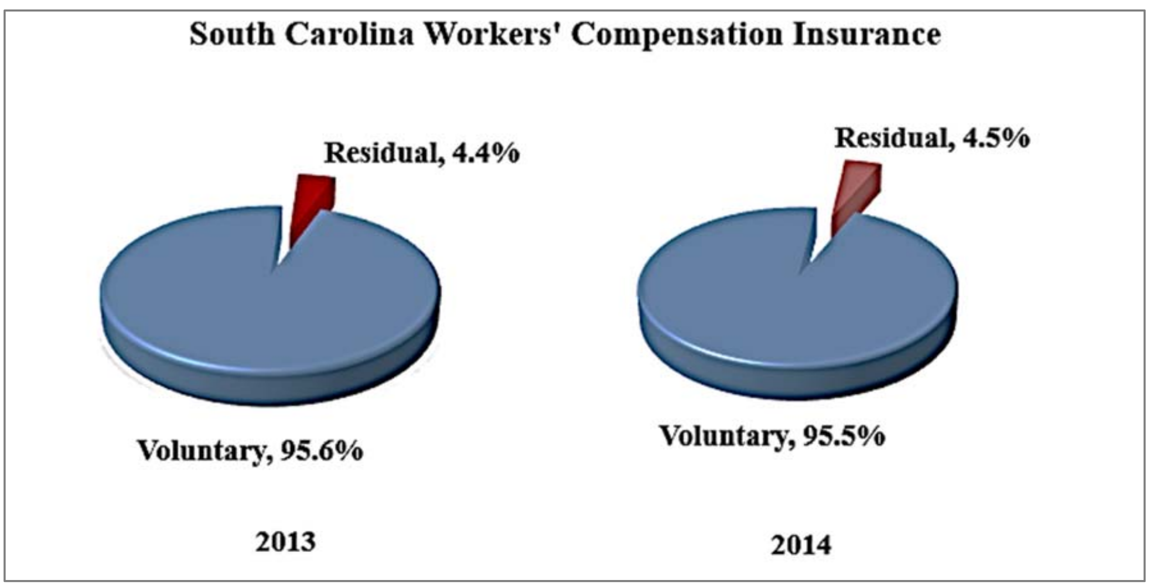
Graph 4.4 - Workers' Compensation Market Share Analysis for Large Insurer Groups



Source: "Market Share Reports - By Lines of Business" www.i-site.naic.org Accessed: October 6, 2015

As shown in Graph 4.5, the majority of all workers' compensation insurance coverage written in South Carolina is through the voluntary market.

Graph 4.5 - Residual Market as a Percentage of Total Market



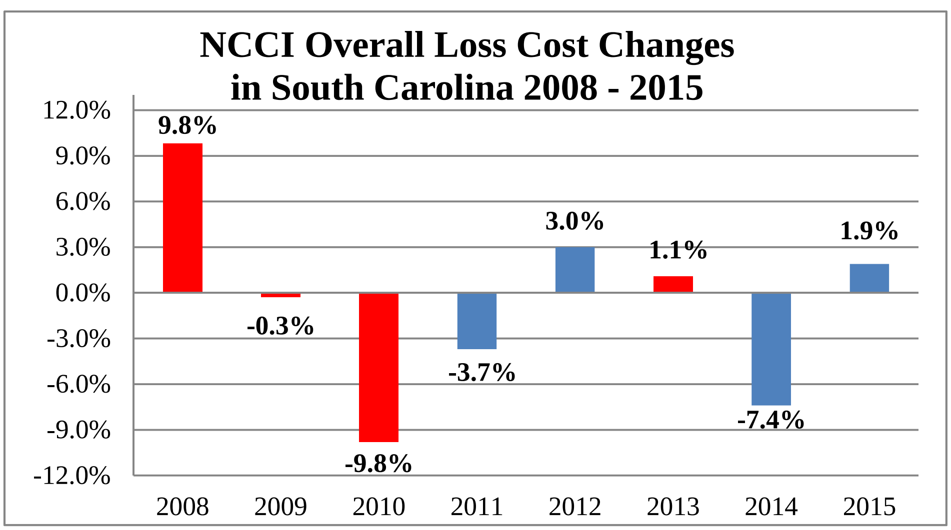
Source: "NCCI - SC Residual Market Performance Report January 1, 2014 - December 31, 2014"-- Page 1

As the foregoing indicates, workers' compensation insurance coverage is generally available for most South Carolina employers. However, small employers and those engaged in hazardous occupations have at times indicated that they have difficulty procuring insurance in the voluntary market. The residual market is discussed in greater detail in Section 2 – South Carolina's Assigned Risk Plan (found on page 13).

b. Affordability

While workers' compensation coverage continues to be available in the voluntary market, the cost of that insurance is always an issue of concern. As noted in Graph 4.6, South Carolina's loss costs decreased from 2009 to 2011, increased slightly in 2012 and 2013, and decreased 7.4% in 2014. In 2015, South Carolina experienced a 1.9% increase in its loss costs. The Department approved NCCI's proposed loss cost changes as filed, and NCCI implemented the new loss costs effective September 1, 2015 for all new and renewal policies. Including the latest change, this represents a cumulative impact of -6.6% for South Carolina over an eight-year period, which is an annualized change of - 0.8% per year.

<u>Graph 4.6 - NCCI Overall Loss Cost Changes in South Carolina (2008 – 2015)</u>



Source: "NCCI Circular - Loss Costs or Rate Filing – SC-SC-2015-01" 2/13/15

NCCI attributed the 2015 loss cost increase of +1.9% to experience, trend, and benefits. While the 2015 loss cost filing resulted in an overall revision of +1.9% in voluntary workers' compensation loss costs, the changes in loss costs vary depending on the classifications as shown in Table 4.2 below:

Table 4.2 - Loss Cost Change by Industry Group

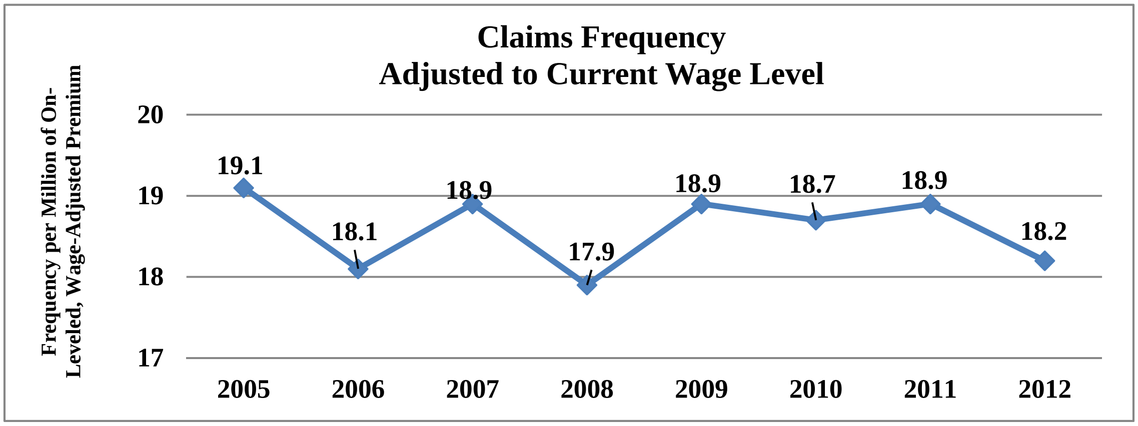
	Average	Minimum	Maximum
Manufacturing	3.9%	-21%	29%
Contracting	2.0%	-23%	27%
Office & Clerical	-1.9%	-27%	23%
Goods & Services	1.3%	-24%	26%
Miscellaneous	2.6%	-22%	28%

Source: "NCCI Circular - Loss Costs or Rate Filing – SC-SC-2015-01" 2/13/15

Loss costs reflect the main driver of workers' compensation costs: claims experience. Claims experience is primarily measured in two ways: (1) the number of workplace injuries (claim frequency) and (2) the average cost of each of these injuries (claim severity).

Graph 4.7 summarizes South Carolina's historical lost-time claims (claims where a worker has received wage replacement benefits due to a compensable workplace injury). The data in the chart has been updated to reflect past premiums at today's loss cost and wage levels. This graph illustrates that South Carolina's claim frequency has been fairly flat in recent years.

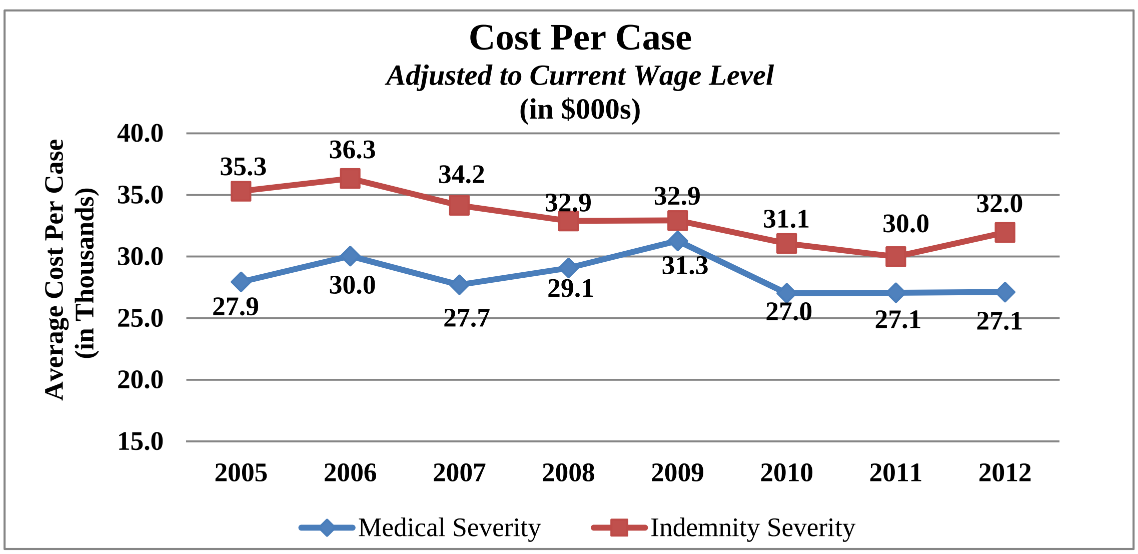
Graph 4.7 – South Carolina Claims Frequency per Million of Wage-Adjusted Premium



Source: "NCCI Circular - Loss Costs or Rate Filing – SC-SC-2015-01" 2/13/15

Graph 4.8 indicates that the medical severity has also been relatively flat over the past three years while the indemnity severity increased for the first time since 2006.

Graph 4.8 - South Carolina Average Cost per Case (Excess of Wage Growth)



Source: "NCCI Circular - Loss Costs or Rate Filing – SC-SC-2015-01" 2/13/15

2. South Carolina's Assigned Risk Plan

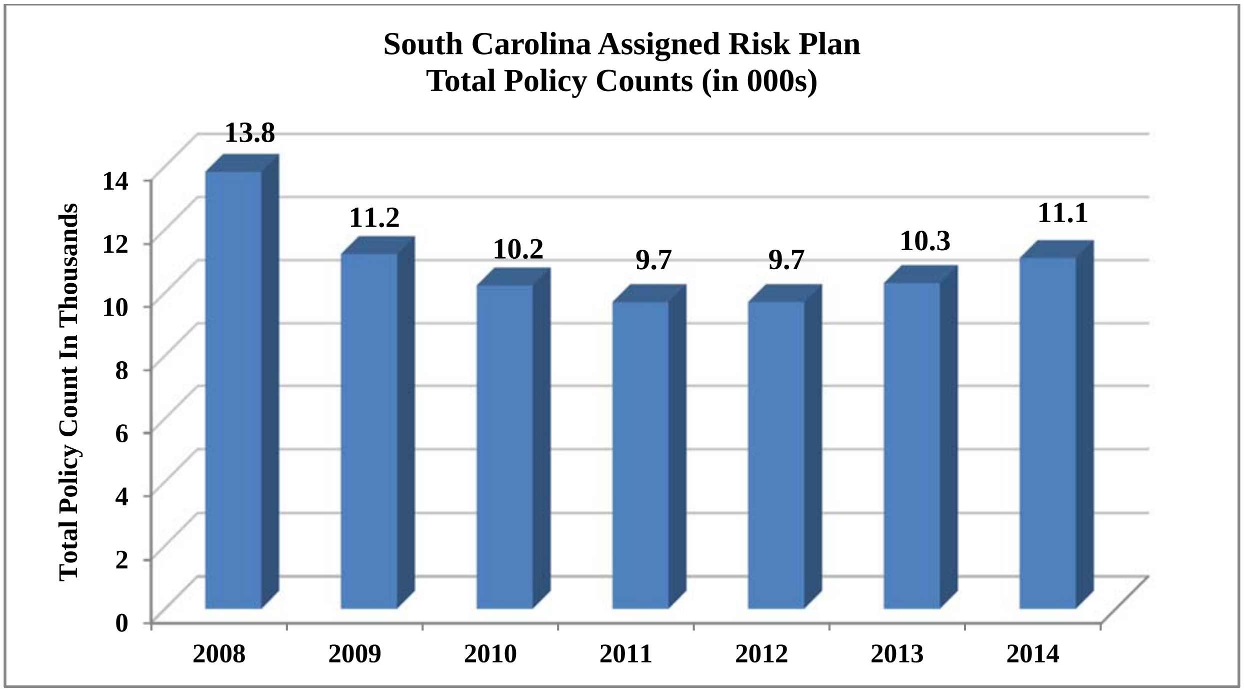
a. Availability

Residual markets are created by states to assure the availability of insurance coverage. The South Carolina Workers' Compensation Assigned Risk Plan (Assigned Risk Plan) is the state's residual market mechanism for workers' compensation insurance coverage. The Assigned Risk Plan is administered by NCCI and is available to employers who are unable to procure workers' compensation insurance coverage in the voluntary market.[3] The Assigned Risk Plan exists not only for high-risk employers but also for those who cannot obtain workers' compensation insurance in the voluntary market because (1) no South Carolina insurer insures the employer's type of business; (2) the employer has a poor claims history; or (3) the employer has a small number of employees.

The number of policies written in the residual market is a prime indicator of the health of the voluntary market. Generally, having a large number of policies in the residual market is a signal that the voluntary market is either unhealthy or nonexistent. As noted in Graphs 4.9 and 4.10 the Assigned Risk Plan experienced a small increase in both the policy count (7.7%) and in total premium written (3.6%) in 2014. Please note that additional indicators such as the residual market's share, trends, etc., should also be considered when assessing the viability of South Carolina's workers' compensation market and are discussed in the following pages.

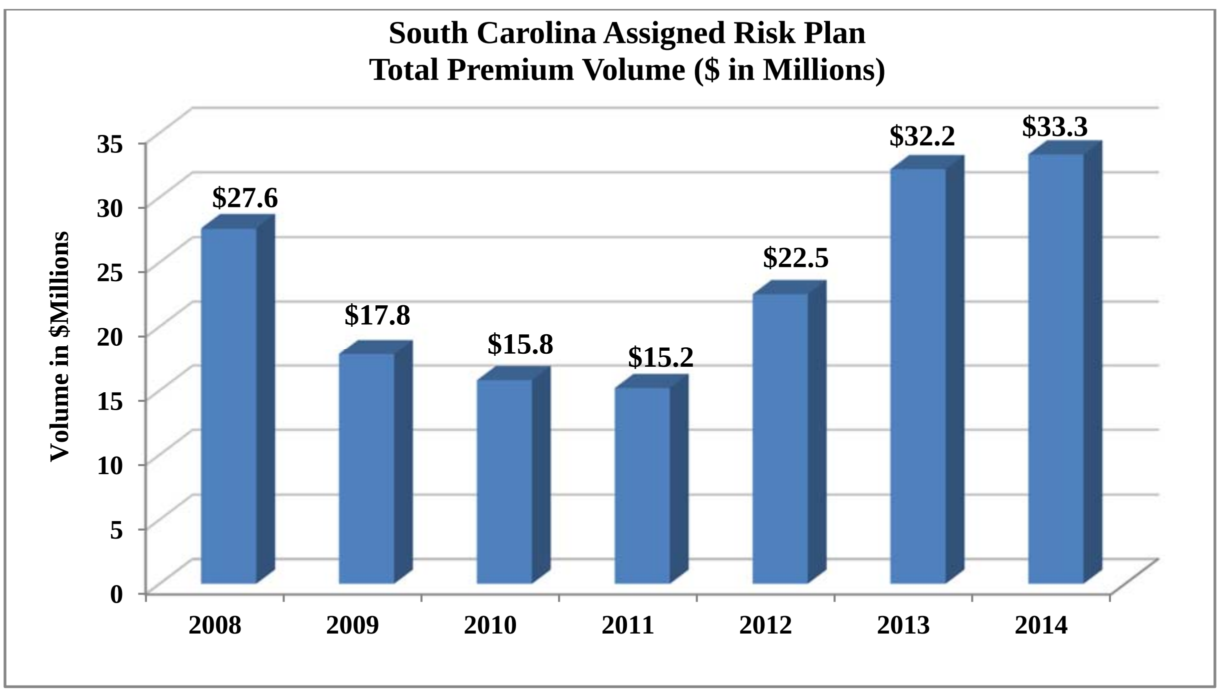
[3] Insurers are selected via a competitive bid process to write assigned risk coverage and must accept all applications of eligible employers.

Graph 4.9 - South Carolina Residual Market Policy Counts (2008 – 2014)



Source: "NCCI State Advisory 2015 Forum Report" as of May 28, 2015

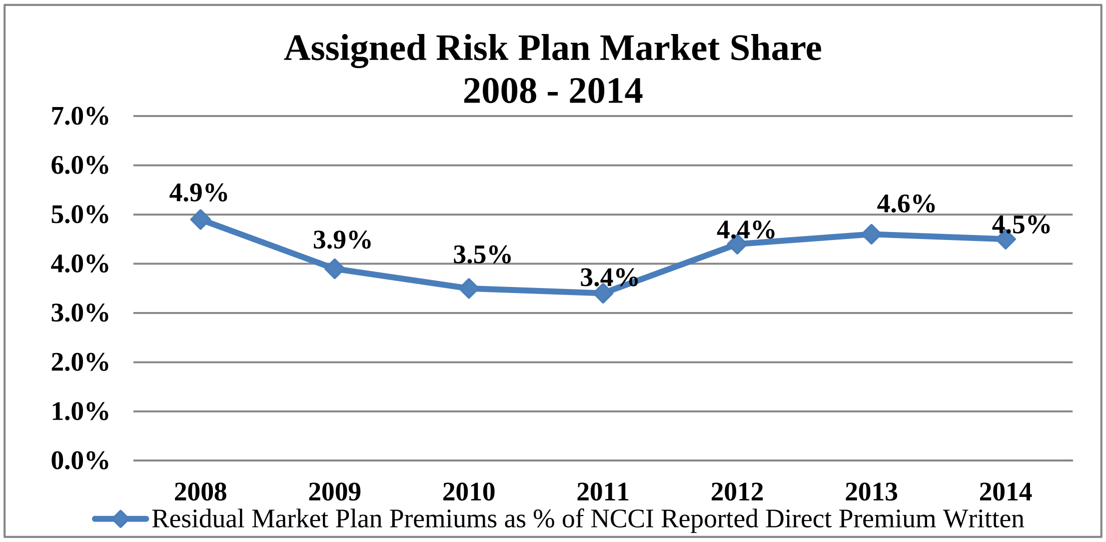
Graph 4.10 - South Carolina Residual Market Total Premium (2008 – 2014)



Source: "NCCI State Advisory 2015 Forum Report" as of May 28, 2015

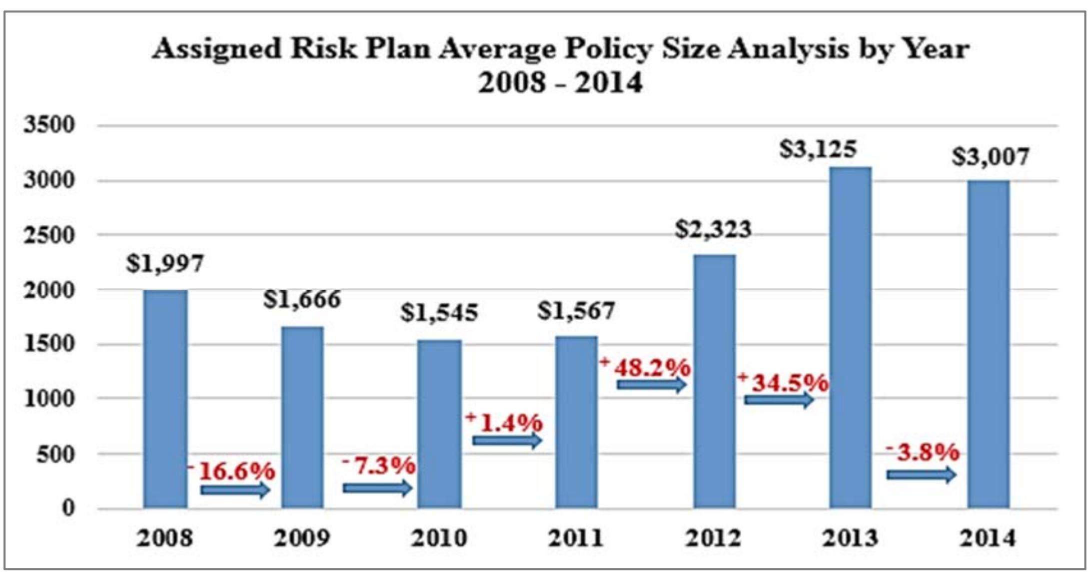
As shown in Graph 4.11, South Carolina's Assigned Risk Plan wrote 4.5% of 2014's total direct premium writings in the state, down slightly from 4.6% in 2013. Graph 4.12 shows that the average policy size decreased in 2014 by 3.8%.

<u>Graph 4.11 - South Carolina Residual Market as a Percentage of Total Market Share</u>



2014 Source: "NCCI - SC Residual Market Performance Market Report January 1, 2014 – December 31, 2014", https://www.ncci.com/Articles/Documents/RM_StateActivityReportState_SC_2014.pdf, page 1

<u>Graph 4.12 - South Carolina Residual Market Average Policy Size</u>



2014 Source: "NCCI - SC Residual Market Performance Market Report January 1, 2014 – December 31, 2014", https://www.ncci.com/Articles/Documents/RM_StateActivityReportState_SC_2014.pdf, page 1

b. Affordability

Residual markets are the markets of last resort. They are not designed to compete with the voluntary market. Accordingly, the rates charged for policies in this market are typically higher than those available in the voluntary market. However, 82% of employers insured in the Assigned Risk Plan have premiums less than $2,500 (*see* Table 4.3), which is well above the countrywide average of 70.7%[4].

Table 4.3 -- South Carolina Assigned Risk Plan (2013 and 2014)

	Policy Year 2014		Policy Year 2013		% Change from 2013 to 2014	
Premium Size	**# of Policies**	**Premium**	**# of Policies**	**Premium**	**# of Policies**	**Premium**
$0 - $2,499	9,098	$ 8,907,046	8,545	$ 7,622,501	6.5%	16.9%
$2,500 - $4,999	850	2,987,274	762	2,672,316	11.5%	11.8%
$5,000 - $9,999	551	3,791,718	485	3,343,549	13.6%	13.4%
$10,000 - $19,999	323	4,512,288	248	3,478,187	30.2%	29.7%
$20,000 – $49,999	192	6,007,346	176	5,301,884	9.1%	13.3%
$50,000 - $99,999	48	3,397,590	38	2,732,657	26.3%	24.3%
$100,000 - $199,999	19	2,598,431	30	4,376,624	-36.7%	-40.6%
$200,000 +	4	1,125,574	9	2,646,093	-55.6%	-57.5%
TOTAL	**11,085**	**$33,327,267**	**10,293**	**$32,173,811**	**7.7%**	**3.6%**

Source: "NCCI - SC Residual Market Performance Market Report January 1, 2014- December 31, 2014" -- https://www.ncci.com/Articles/Documents/RM_StateActivityReportState_SC_2014.pdf, page 6

As with the voluntary market, the rates charged for policies in the Assigned Risk Plan must comply with the statutory requirement that rates not be inadequate, excessive, or unfairly discriminatory. Moreover, South Carolina law requires the Assigned Risk Plan to operate on a self-funded basis. Accordingly, rates may be adjusted in the Assigned Risk Plan as necessary to ensure that it continues to operate on a self-sustaining basis.[5]

[4] *Source*: "NCCI - Residual Market Management Summary 2014", https://www.ncci.com/Articles/Documents/RM_ManagementSummary_2014.pdf , page 24

[5] *See* S.C. Code Ann. § 38-73-540(C) (2014)

On June 11, 2015, the Department issued a Corrective Action Order[6] that decreased the overall average assigned risk rate level that had been in effect since September 1, 2014. The updated assigned risk rates became effective September 1, 2015.

The Order specified that for the industrial classification codes, a loss cost multiplier of 2.112 shall be applied to the September 1, 2015 South Carolina voluntary market loss costs, subject to the constraint that changes to individual class codes be limited to the applicable industry group change in the voluntary loss cost filing +/- 35%. After incorporating the +/- 35% constraint, as specified in the Corrective Action Order, the overall assigned risk premium level change realized is a decrease of 0.3%.

The average changes by industry group are as follows[6]:

Industry Group	Average	Minimum	Maximum
Manufacturing	+0.6%	-31%	+39%
Contracting	- 1.2%	-33%	+37%
Office & Clerical	- 4.0%	-37%	+33%
Goods & Services	+2.4%	-34%	+36%
Miscellaneous	- 0.8%	-32%	+38%

The Corrective Action Order states that the above changes were made so that assigned risk rates can be self-sustaining, and so that the assigned risk plan can continue to provide a market of last resort for employers who are unable to secure workers' compensation insurance in the voluntary market.

[6] "South Carolina Department of Insurance Corrective Action Order 2015-002" (June 11, 2015) http://doi.sc.gov/DocumentCenter/View/8311

V. The South Carolina Workers' Compensation Ratemaking Process

Workers' compensation insurance rates are regulated by the Department[7] and consist of two basic components: (1) losses, referred to as "loss costs," and (2) expenses, reflected in the "loss cost multiplier." These terms are more specifically defined as follows:

(1) **<u>Loss costs</u>** are the amounts needed to pay medical, indemnity, and disability claims as well as loss adjustment expenses, which are those expenses directly associated with handling claims, including attorneys' fees of both the claimant and the employer.

(2) **<u>Loss cost multipliers</u>** reflect the insurer's other costs of doing business such as salaries, commissions, rent, utilities, and assessments, including the guaranty fund, Second Injury Fund, and the Assigned Risk Plan. The insurer's profit load is also included in the loss cost multiplier.

For workers' compensation insurance, the premium is a function of loss costs, the loss cost multiplier, and the insured employer's payroll. Loss costs vary by class and are expressed as an amount per $100 of payroll. The loss costs reflect the potential for loss associated with a group of employers engaged in the same type of business or industry. These loss costs are multiplied by the loss cost multiplier and then by the employer's payroll divided by 100 to determine the manual premium.

[7] *See* Chapter 73, Title 38 (2014) of the S.C. Code of Laws

The manual premium is then multiplied by the employer's experience modification factor to determine the standard premium. The experience modification factor is developed by NCCI and compares an employer's actual loss experience by class code to the average experience for that class code. Insurers other than workers' compensation carriers generally use their own historical loss experience, expenses, and profit factors to calculate their rates, which are filed with the Department for approval.

The ratemaking process for insurers writing workers' compensation insurance is unique. Workers' compensation insurers do not rely solely on their own loss experience to set their rates. Rather, a third-party rating organization (such as NCCI) collects, compiles, and analyzes loss data from hundreds of insurance companies for hundreds of job classifications.

The third-party rating organization then files loss costs on behalf of its member insurers with the Department. The most recent loss costs may be adopted by individual insurers for developing their own rates. Individual insurers file their own rates reflecting the adopted loss costs of the rating organization and their own loss cost multipliers. Self-insured funds and employers do not use rating organizations.

A. LOSS COSTS

1. Role of Rating Organizations in the Ratemaking Process

In South Carolina, workers' compensation insurers are required by statute to be members of a non-partisan rating bureau or rating organization.[8] Rating organizations must be licensed by the Department.[9] NCCI has been licensed as a rating organization in South Carolina since 1947. It is a nonprofit organization which compiles and reports workers' compensation data, statistics, and research. NCCI collects statistical and financial information concerning workers' compensation exposure and claims from insurers in nearly 40 jurisdictions, including South Carolina.

As South Carolina's licensed rating organization, NCCI files loss costs on behalf of its member insurers. The Department reviews these filings to ascertain that the loss costs are not excessive, inadequate or unfairly discriminatory.[10]

If the Department disapproves a loss cost filing, NCCI or the Consumer Advocate has the right to request a hearing before the South Carolina Administrative Law Court. If the Department approves the filing, the Consumer Advocate may request a hearing before the Administrative Law Court.

NCCI generally updates loss experience annually and makes filings based on the updated experience. However, due to the lengthy nature of the review and approval process for increases,

[8] *See* S.C. Code Ann. § 38-73-510 (2014)
[9] *See* S.C. Code Ann. § 38-73-1230 (2014)
[10] *See* S.C. Code Ann. § 38-73-430 (2014)

which has involved extensive litigation in the Administrative Law Court in the past, the approved loss costs can change less frequently than annually. This impacts the ratemaking process. Although workers' compensation insurers must use loss costs approved by the Department, South Carolina law has not required that insurers use the most recently approved loss costs. As stated previously, an insurance company may adopt the most recently approved loss costs and apply its loss cost multiplier or file for a change in the loss cost multiplier by changing its "loss cost modification factor" or any other expense component.

To help stabilize workers' compensation rates, the Department has instructed all insurers to adopt the most recently approved loss costs via Department of Insurance Bulletin 2009-18.[11] The Department has recommended this as a legislative change to the South Carolina workers' compensation laws.

Loss costs vary by job classification and are expressed as an amount per $100 of payroll. Changes in approved loss costs normally include varying changes in rates for different job classifications. For example, an overall +10.0% change in loss costs may be made up of changes in class rates that vary from -5.0% to +25.0%. The overall loss cost change is calculated by weighting the various class changes according to the percentage represented by each class in an insurer's total book of business.

2. The Department's Role in the Regulation of Rating Organizations

When NCCI makes a loss cost filing, the Department reviews it to determine whether it is actuarially supported and that the rates are not excessive, inadequate or unfairly discriminatory.

[11] "South Carolina Department of Insurance Bulletin 2009-18: Workers' Compensation Loss Cost and Loss Cost Multiplier Filing Requirements" (September 22, 2009), http://doi.sc.gov/DocumentCenter/View/2849

Because of the complexity of workers' compensation insurance, the Department's property and casualty actuary performs a comprehensive review and analysis of the filing and supporting data as well as industry statistics provided by NCCI. In determining whether to approve or disapprove a workers' compensation loss cost filing, the Department considers applicable statutory standards and factors specified in Sections 38-73-10 and 38-73-430. Pursuant to these provisions, the Department is also required to consider factors such as the past loss experience, the conflagration of catastrophe hazards, reasonable margin for underwriting profits and contingencies, dividends, savings, investment income, and all other relevant factors.

B. LOSS COST MULTIPLIER

1. Individual Components of the Lost Cost Multiplier

The other component of workers' compensation rates is the loss cost multiplier (LCM). Individual insurance companies develop their own LCM.

The LCM consists of several components that represent expenses to the insurance company over and above the loss costs, including:

- Commission and other acquisition expenses
- General expenses
- Taxes, licenses and fees
- Profit
- Guaranty fund assessment[12]
- Second Injury Fund assessment[13]
- Residual market load (RML)
- Loss cost modification factor

[12] The guaranty fund assessment is an amount that insurance companies pay to cover the losses of insolvent workers' compensation insurers.

[13] South Carolina's Second Injury Fund was created in 1972 and was eliminated pursuant to 2007 S.C. Act No. 111.

The weight of these characteristics may vary from year to year depending on the insurer's book of business as reported on the insurer's Insurance Expense Exhibit (IEE). Discussed below are some of the components that impact an insurer's LCM.

At the time of the last major reforms (2007 S.C. Act No. 111), the South Carolina Second Injury Fund assessment had a major impact on an insurer's LCM. At that time, the Second Injury Fund was funded by assessments on insurers, self-insured employers and funds, and the State Accident Fund at 175% of each entity's prior year's paid claims. In the early 2000s, assessments ranged from $77 million to as high as $253 million.

Pursuant to Act No. 111, South Carolina law called for the termination of the Second Injury Fund by 2013. To achieve this goal, a working group, made up of various stakeholders and interested parties, came together to formulate a plan to close the Fund. After reviewing an actuarial report developed by the consulting firm KPMG, the group reached an agreement on a transitional plan that would allow for the closing of the Fund while dealing with the projected unfunded liabilities of approximately $300 million.[14] The plan calls for all participants in the workers' compensation system to pay an overall assessment of $60 million per year for five years, beginning in 2013 and ending in 2017. Under this plan, these assessments are to provide sufficient funding to resolve all unfunded liabilities and, as a result, negate the need for any further Second Injury Fund assessments of the industry. At this time, the average expense provision in insurers' LCM filings for the Second Injury Fund is 5.0%. However, the Department is hopeful that SIF assessments

[14] *Source*: "South Carolina Second Injury Fund: Review of Unfunded Liabilities and Alternative Funding Methods as of June 30, 2013" KPMG.

will no longer be an issue or a component of loss cost multiplier filings as the Fund is closed out in the coming years.

The residual market load represents expenses incurred as a result of an insurer's mandatory participation in South Carolina's Assigned Risk Plan. By statute, the rates of the Assigned Risk Plan must be self-sustaining; premiums charged must cover all losses and expenses. To the extent that assigned risk rates are inadequate, the deficit is reinsured or made up by assessments on all workers' compensation insurers in the state. An insurer's assessment – its portion of the deficit – is the residual market load, which is included in its loss cost multiplier and passed on to employers insured in the voluntary market.

The loss cost modification factor component is developed by the insurer to adjust the loss costs if an individual insurer's experience indicates loss costs that are higher or lower than NCCI's approved loss costs. An insurer may have more specific and accurate underwriting, loss control, claims management, etc. that is not reflected in NCCI's composite data, and the Department is compelled to consider this information to ensure the adequacy of workers' compensation insurance rates.

2. The Department's Role in the Regulation of Lost Cost Multipliers

Section 38-73-525 requires insurers to file loss cost multipliers with the Department at least 30 days in advance of using new rates and, further, requires these filings to be reviewed by a credentialed actuary employed or retained by the Department. Since 2008, the Department has approved all LCM filings for each individual carrier that wishes to write workers' compensation in the state. In order for the Department's actuary to approve each filing, data must be provided to clearly support each individual element of the LCM.

As a result of the changes to the regulatory process brought about by Act No. 111, the Department has taken an active role in issuing guidance for carriers and developing standard procedures for the filing and review of LCMs. The Department has issued several bulletins to advise carriers of these requirements, the most recent of which was Bulletin 2009-18, Workers' Compensation Loss Cost and Loss Cost Multiplier Filing/ Adoption Procedures (September 22, 2009). These bulletins allow for the Department to address industry questions regarding the regulatory process while directing insurers to provide the information that is needed in a filing in order for the Department to fulfill its statutory obligations.

As a standard procedure, the Department's staff works to identify trends and issues that commonly slow the filing review process. For example, the Department produces filing exhibits to serve as an additional tool to enhance speed to market. By providing active information and confronting problems before they develop, the Department has been able to maintain an effective regulation process for loss cost multipliers.

C. ASSIGNED RISK PLAN LOSS COST MULTIPLIER

NCCI administers South Carolina's Assigned Risk Plan and submits data to the Department supporting the assigned risk loss cost multiplier. The Department then sets the assigned risk rates and establishes a differential from the voluntary market to help maintain its stability. Any change in the assigned risk rate should be proportionate to the corresponding change in the voluntary market.

As with the voluntary market, the rates charged for policies in the Assigned Risk Plan must comply with the statutory requirement that rates not be inadequate, excessive, or unfairly discriminatory.

S.C. Code Ann. § 38-73-540(C) (2014) requires that the rates of the Assigned Risk Plan be self-sustaining; premiums charged must cover all losses and expenses. In the event of excessive losses in the Assigned Risk Plan, NCCI will notify the Department. After the Department completes its review of the data, the Director will issue a corrective order to amend the assigned risk loss cost multiplier. By adjusting these rates as necessary, the Department can ensure that the Assigned Risk Plan will continue to operate on a self-sustaining basis.

VI. IMPACT OF 2007 S.C. ACT NO. 111 ON THE REGULATION OF WORKERS' COMPENSATION INSURANCE

In June 2007, the South Carolina General Assembly passed and the Governor signed Act No. 111 reforming the South Carolina workers' compensation system. This legislation, *inter alia*:

- Requires medical evidence of a direct causal connection between the injury and the claimant's regular job activities in repetitive trauma cases;
- Eliminates the Second Injury Fund;
- Creates a rebuttable presumption of permanent total disability for claims involving back injuries, which means that employers may present evidence to rebut the presumption of permanent total disability; and
- Eliminates the prior approval exemption for any filing by a workers' compensation insurer for its loss cost multiplier and any modifications to the approved loss costs.

The legislative change that has had the most significant impact on workers' compensation insurance is the reinstatement of regulatory oversight of loss cost multiplier filings. Act No. 111 requires insurers to file and receive approval of the LCM and any modifications to the approved loss costs 30 days prior to using new rates. The Act also requires the Department to engage the services of a credentialed actuary to review these filings. As a result of this legislation, the Department now has the resources to employ a credentialed property and casualty actuary to review these filings. The Department will continue to review the loss cost multiplier filings made by carriers to ensure that their resulting rates are not inadequate, excessive, or unfairly discriminatory.

VII. LEGISLATIVE RECOMMENDATIONS

Based upon its review of the South Carolina workers' compensation insurance market, the Department recommends that a legislative change be enacted by the South Carolina General Assembly to further stabilize workers' compensation insurance rates and improve the effectiveness and efficiency of the workers' compensation system.

Although the Department of Insurance issued a Bulletin in 2009 (Bulletin 2009-18) instructing all carriers to adopt the most recently approved loss costs, it is possible that some carriers may continue to use previously approved loss costs by class rather than the latest approved loss costs. As noted in the Legislative Audit Council's 2009 report, the use of older, outdated loss costs is inappropriate.[15] Specifically, since experience modifications are based on the latest approved loss costs, this practice results in experience modification factors that are inconsistent with the loss costs used. To promote consistency and accuracy, adoption of the most recent loss costs should be statutorily required.

[15] *Source*: "A Review of the Department of Insurance" http://lac.sc.gov/LAC_Reports/2009/Documents/SCDOI.pdf, Accessed December 18, 2014.

In sum, the Department recommends the following legislative action:

- Require workers' compensation insurers to file for approval their adoption of the most recently approved loss costs within 120 days of approval of NCCI's filed loss costs. Additionally, require that an insurer that is not using the most recently approved loss costs must file to adopt the most recently approved loss costs upon submission of a loss cost multiplier filing.

VIII. TERRORISM RISK INSURANCE ACT

The Terrorism Risk Insurance Act of 2002 (TRIA) was enacted to provide a federal shared loss program for incurred losses resulting from certain acts of terrorism. This program was designed to ensure the widespread availability and affordability of property and casualty insurance for terrorism risks.[16] TRIA requires the private insurance industry to make the coverage available and bear primary financial responsibility for covered losses from terrorism (up to $100 million) and, in return, essentially caps the magnitude of losses and provides for the recoupment of federal funds (if expended) in subsequent years.[17]

Prior to 2015, TRIA has been reauthorized twice by the United States Congress via the Terrorism Risk Insurance Extension Act of 2005 (Pub. L. 109-144, 119 Stat. 2660) ["TRIEA"] and the Terrorism Risk Insurance Program Reauthorization Act of 2007 (Pub. L. 110-160, 121 Stat. 1839) ["TRIPRA"]. The 2007 reauthorization under TRIPRA extended the Terrorism Risk Insurance Program through December 31, 2014. The South Carolina Department of Insurance has issued

[16] *Source*: "NAIC Resolution to Support Reauthorization of the Terrorism Risk Insurance Act" (adopted 8/26/13 by the NAIC Government Relations Leadership Council), http://www.naic.org/documents/committees_c_triawg_tria_resolution.pdf

[17] *Source*: "NAIC Letter to Federal Insurance Office Regarding Terrorism Risk Insurance Analysis" (September 16, 2013), http://www.naic.org/documents/committees_c_tiiwg_related_docs_naic_letter.pdf

two bulletins to provide procedures for compliance with provisions of TRIA in response to its enactment and subsequent reauthorizations.[18]

On January 12, 2015, President Obama signed the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) of 2015 (H.R. 26) into law. The TRIPRA Act of 2015 extended the Terrorism Risk Insurance Act (TRIA) through December 31, 2020 and increased the insurance industry's exposure[19,20] under the initial TRIA program by:

- Increasing the program's trigger annually to reach $200 million in 2020
- Increasing the carrier's deductible from 15% to 20%
- Increasing the carrier's 15% coinsurance share annually until it reaches 20% in 2020
- Increasing the industry aggregate retention and the mandatory recoupment of government expenditures
- Requiring several terrorism risk-related studies

[18] "South Carolina Department of Insurance Bulletin 2003-01: Voluntary Expedited Filing Procedures for Compliance with the Provisions of the Terrorism Risk Insurance Act of 2002" (January 13, 2003), http://doi.sc.gov/documentcenter/view/166; and "South Carolina Department of Insurance Bulletin 2008-01: Filing Procedures for Compliance with the Provisions of the Terrorism Risk Insurance Program Reauthorization Act of 2007" (February 20, 2008), http://www.doi.sc.gov/DocumentCenter/View/2887

[19] *Source:* "NCCI State Advisory Forum 2015 Report (SAF_SC)" May 28, 2015 Presentation, page 7

[20] *Source:* "NAIC & The Center for Insurance Policy Research (CIPR)", CIPR Topics, http://www.naic.org/cipr_topics/topic_tria.htm

IX. GLOSSARY

As used in this report, the following terms have the meaning set forth below:

Class Code	An individual job classification (e.g., roofer, office worker, truck driver).
Experience Modification Factor	A factor used in determining rates and developed by NCCI, which compares an individual employer's loss experience by class code to the average experience of all insurers. Also called the experience rating factor.
Guarantee Fund Assessment	The guaranty fund assessment is an amount that insurance companies pay to cover the losses of insolvent workers' compensation insurers. The assessment is based on each insurer's market share in South Carolina and is capped at two percent of premium per year. All companies are assessed the same percentage by the guaranty fund, and companies are permitted, but not required, to pass this assessment on to policyholders. Self-insured funds and employers do not have guaranty fund protection in the event they are unable to pay claims and, accordingly, do not pay guaranty fund assessments.
Indemnity Benefits	Monetary compensation due to loss or damage. Workers' compensation indemnity benefits compensate an employee for lost wages due to an on-the-job injury, accident or event

	that prevents him/her from returning to work (loss-time, wage replacement costs).
I-Site	**I**nternet – **S**tate **I**nterface **T**echnology **E**nhancement; an online interface designed by the NAIC for state insurance departments to obtain comprehensive financial, market conduct, producer licensing, and securities information.
Loss Costs	The losses, per $100 of payroll, an insurer expects to incur for medical, lost wage, and disability payments. Loss costs are developed by NCCI on behalf of all workers' compensation insurers.
Loss Cost Modification Factor	A factor developed by insurers and used in developing the loss cost multiplier, which accounts for the deviation of an insurer's loss costs, based on the insurer's individual loss experience, from the approved loss costs to which the insurer will apply its loss cost multiplier. Also called the loss cost modifier.
Loss Cost Multiplier	A factor developed by workers' compensation insurers that accounts for underwriting expenses, such as commissions and brokerage expenses, other acquisition expenses, general expenses, second injury and guaranty fund assessments, taxes, licenses, and fees, and profit and contingencies. The loss cost multiplier includes any loss cost modification factor developed by the insurer.

Loss Frequency	The number of claims occurring over a specific period of time.
Loss Severity	The average amount of loss per claim, in dollars.
Medical Benefits	All necessary and reasonable medical treatment, prescriptions, and hospitalization services related to a work related injury paid by an insurance carrier or directly by the employer if self-insured.
NAIC	National Association of Insurance Commissioners **--** The U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and the five U.S. territories.
NCCI	National Council on Compensation Insurance **--** The nation's most experienced provider of workers' compensation information, tools, and services. It gathers data, analyzes industry trends, and prepares objective insurance rate and loss cost recommendations.
Premium	The amount paid by an employer to an insurer for workers' compensation insurance. Premium = Loss Costs x Loss Cost Multiplier x (Payroll/ 100).
Rate	The cost per unit of insurance. Rate = Loss Costs x Loss Cost Multiplier.
Ratemaking	The process of calculating a premium so that it is not *excessive, inadequate*, or *unfairly discriminatory*.

Residual Market Load	A factor used in developing the loss cost multiplier that accounts for expenses associated with required participation in the assigned risk plan.
Standard Premium	The type of premium that accounts for differences by class code. Standard Premium = Manual Premium x Experience Modification Factor