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MINNESOTA DEPARTMENT OF COMMERCE

March 1, 2000

Gretchen Maglich, Commissioner
Department of Labor and Industry
443 Lafayette Road
St. Paul MN 55155

Dear Commissioner Maglich:

Minnesota Statutes 79.55, Subdivision 10, state that the Commissioner of Commerce shall annually issue a report comparing the average rates charged by workers' compensation insurers in the state to the pure premium base rates filed by the MWCIA. The statutes go on to state that the Rate Oversight Commission, of which you are the chair, shall review the report. I've attached for your review a copy of the current report.

Sincerely,

James C. Bernstein
Commissioner of Commerce

JCB:RBA

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Report on Workers Compensation Rates

as required by MN Stat 79.55, Subd. 10.

February 2000
Minnesota Department of Commerce

SUMMARY AND CONCLUSION

Minnesota Statute 79.55, Subdivision 10, states: "The commissioner shall issue a report by March 1 of each year, comparing the average rates charged by workers' compensation insurers in the state to the pure premium base rates filed by the association, as reviewed by the rate oversight commission." This is the fourth report required by that statute.

The pure premium base rates filed by the association (the MWCIA) decreased by 3.8% on January 1, 2000. The pure premium base rates have decreased 31.7% on a cumulative basis since 1996, the period covered by these reports. The average rates charged by workers' compensation insurers in Minnesota decreased by 1.8% between January 1, 1999, and January 1, 2000. Insurers' rates have decreased 39.0% on a cumulative basis since 1996. The Commissioner concludes that the market rates have reasonably reflected changes in pure premiums.

DISCUSSION AND ANALYSIS

Measurement of the Insurer Rate Level

The Commerce Department has rate filings from every insurer doing business in Minnesota. Insurers must file an explanation of any rate change, and the vast majority of them file a multiplier that they apply to the MWCIA loss costs to produce their rates. For this report, we compared the average multiplier filed as of January 1, 1999, to the average multiplier filed as of January 1, 2000. We adjusted the average multipliers so that both were on the same level, namely the level of the 2000 MWCIA loss costs. The average multiplier on January 1, 1999, was 1.614. The average on January 1, 2000, was 1.585. That represents a decrease of 1.8%.

Companies Compared

To calculate the average multipliers, this report uses the filed rates of the vast majority of the insurers writing workers' compensation in Minnesota. The calculations include 97.4% of the total market based on premiums written in 1998, the most recent year for which premiums are available. We exclude insurers who did not express their rates as the product of a multiplier and the MWCIA loss costs. In some cases the excluded insurers do not base their premiums on the MWCIA loss costs, but rather calculate their own loss costs, consequently they had no multiplier. In theory we could correct the data of the missing insurers and refine the estimated multipliers. Those few insurers' results would not materially change the estimates. We have percentage changes for the excluded insurers; their average is a decrease of 7.6%. Inclusion of those companies would change the overall 1.8% decrease to a 2.0% decrease.

Shifts in Market Share

The insurance marketplace is constantly changing in Minnesota. New employers and insurers come into the market; old insurers and employers leave the market; existing employers change insurers. Even if no insurer ever changed its rates, this continuing flux could have a big effect on the average premiums that employers pay. Consider the extreme example where one insurer writes the entire market at a rate of $2 in 1999, and a different insurer writes the entire market at a rate of $1 in 2000. Premiums would drop by 50% even if neither company changed its rates. For this report we took this flux into account in order to accurately measure how the market is responding to changing underlying loss costs. We used 1997 market shares for averaging the old rates and 1998 market shares for averaging the new rates. The market shares for 1998 and 1999 would have been better, but 1999 premiums are not available until after March 1, 2000. Using a one-year lag introduces a possible error, but it is much better than ignoring the shifts in market share, which would introduce an even larger error. The error caused by the lag becomes immaterial over time, but the error caused by ignoring the shifts would compound over time and could become truly enormous.

Timing

Insurers do not all change their rates at the same time. Furthermore, a particular insurer does not necessarily change rates at the same time every year. As a result, one can never measure an annual change in multipliers with total precision. One needs to look at an analysis such as this one over a period of years before reaching a firm conclusion. Insurers are currently in the midst of filings, most of which are rate reductions. At the end of another month or two, the average multiplier of 1.585 will probably have decreased further.

Schedule Rating

The multipliers estimated in this report do not present the entire rate picture. Insurers also give "schedule" credits or debits based on an insurer's individual risk characteristics. For the majority of insurers, that can mean adjustments to rates of up to ±40%. We do not now have a good way to measure the overall effect of schedule credits and debits. In the long run their use can not materially affect the cumulative changes in rates, but changes in their use can have a large impact in a shorter time span. Companies are giving more credits now than a few years ago, but we are seeing less requests for new credits now than we saw prior to 1999. The use of credits has probably leveled off, in which case they are probably not distorting the current analysis to any significant extent.

Other Credits

Schedule credits are not the only possible rate modifications. Some insurers, for example, give rate reductions to employers that participate in managed care programs. Most such programs are still relatively new, and their increased use may contribute to rates that are lower than otherwise indicated by this analysis. Insurers also give experience-rating modifications to many insureds, and at a time when experience is improving, the balance of such modifications becomes more favorable to insureds than in the past. The same thing applies to policyholder dividends.

Assigned Risk Plan

Changes in the Assigned Risk Plan market share can have the same result as shifts in other companies' market shares. The Assigned Risk Plan is currently losing market share, which generally means that its former customers have found coverage at lower rates in the voluntary market. We did not measure the effect of that price reduction in this report. Even if the 1998 and 1999 multipliers were exactly equal, the movement from the Assigned Risk Plan would mean that the overall average rate for employers decreased. The Assigned Risk Plan has gotten small enough now that its depopulation is probably not distorting the current analysis, but one should be aware that movement in or out of the Plan has an effect on the average premium that employers pay for workers' compensation coverage.

Expenses

Insurance company expenses do not necessarily change at the same rate as underlying pure premiums. Some expenses, such as commissions and premium taxes, are closely linked with pure premiums; other expenses, such as the cost of the insurer's physical plant, are only loosely related to pure premiums. When pure premiums drop, insurers' expenses usually drop, too, but more slowly than the pure premiums. Insurers still have the same buildings to heat, the same envelopes to mail, etc. By the same token, when pure premiums increase, expenses do not normally increase as fast. Thus when pure premiums change, insurers' total costs tend to change more slowly, and so one normally expects rates to change more slowly, too. When looking into the reasonableness of rate changes, one may need to consider shifts in expenses as well as shifts in pure premiums.