

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



South Carolina Department of Insurance  
1201 Main Street, Suite 1000  
Columbia, South Carolina 29201

December 15, 2016

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# South Carolina Department of Insurance

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NIKKI HALEY  
Governor

RAYMOND G. FARMER  
Director of Insurance

December 15, 2016

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 1<sup>st</sup> 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.

December 15, 2016  
President *Pro Tempore* Leatherman and Speaker Lucas  
Page Two

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) Legislation.

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  
Director of Insurance

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

The Honorable Ronnie Cromer, 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 2016 S.C. Act No 213; 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 were 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.

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### **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. In 2016, the South Carolina General Assembly passed S.C. Act No. 213 (R.237, S. 1064) which amended Sections 38-73-525 and 38-73-1210 of the South Carolina Code of Laws effective June 3, 2016. These new laws now make it a legal requirement that every insurer writing workers compensation in South Carolina file to adopt the new loss costs within sixty days of the approval date of those loss costs and that the effective date of the adoption be within 120 days of NCCI's effective date of the approved loss costs. These changes were in response to concerns raised in the Department's previous annual

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reports and also noted in the Legislative Audit Council's 2009 report, which stated that the use of older, outdated loss costs is inappropriate.<sup>1</sup>

In general, the South Carolina workers' compensation insurance market appears to be stable. Since 2007, new carriers have entered the marketplace, continuously improving the availability of coverage. From 2008 to 2012, the number of policies in the residual market decreased each year. The policy count increased every year from 2013 to 2015. In 2015 there was a 5.0% increase in the policy count and a -1.7% decrease 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. The overall loss costs increased by +1.9% and +2.5% in 2015 and 2016 respectively, as noted in Graph 4.6.

The frequency of lost-time claims, a large component and cost driver, was stable over the past few years. The medical severity was relatively flat from 2010 to 2012 but increased 14.3% in 2013, while the indemnity severity increased for the second consecutive year as shown in Graph 4.8.

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<sup>1</sup> Source: "A Review of the Department of Insurance" [http://lac.sc.gov/LAC\\_Reports/2009/Documents/SCDOI.pdf](http://lac.sc.gov/LAC_Reports/2009/Documents/SCDOI.pdf), Accessed November 29, 2016.

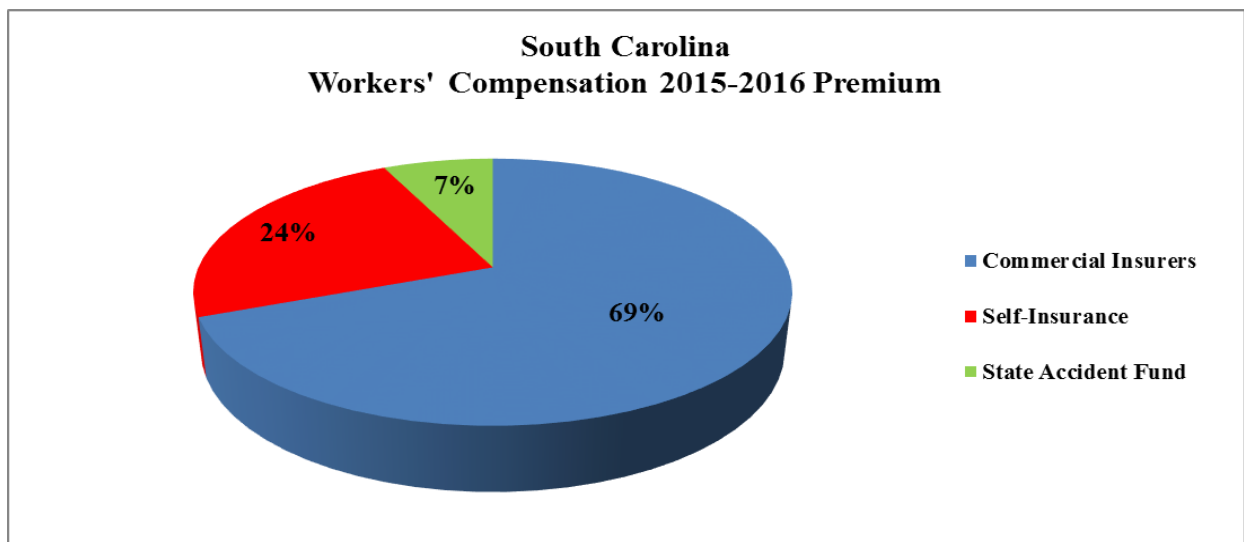
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## IV. THE SOUTH CAROLINA WORKERS' COMPENSATION INSURANCE MARKET

### 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 insurance companies provide 69% of South Carolina's workers' compensation coverage. 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 (2015-2016)"

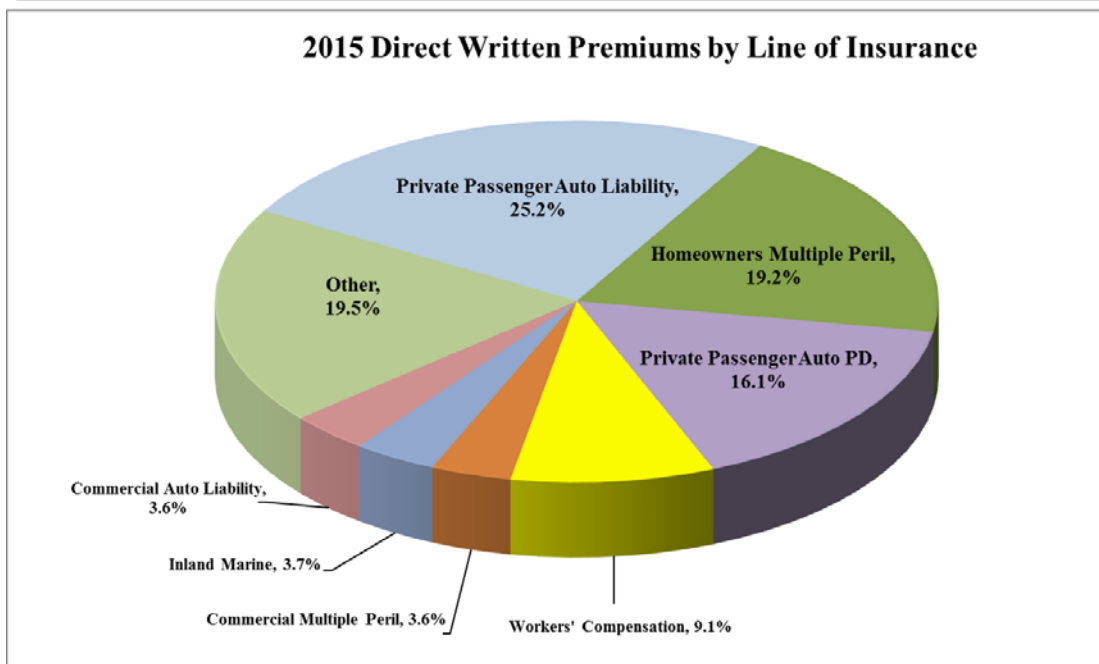


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## **B. STATE OF THE SOUTH CAROLINA WORKERS' COMPENSATION INSURANCE MARKET**

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.<sup>2</sup> 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 Insurance Plan). As Graph 4.2 illustrates, workers' compensation makes up 9.1% of all property and casualty premiums written in South Carolina, down slightly from 2014's 9.2%.

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



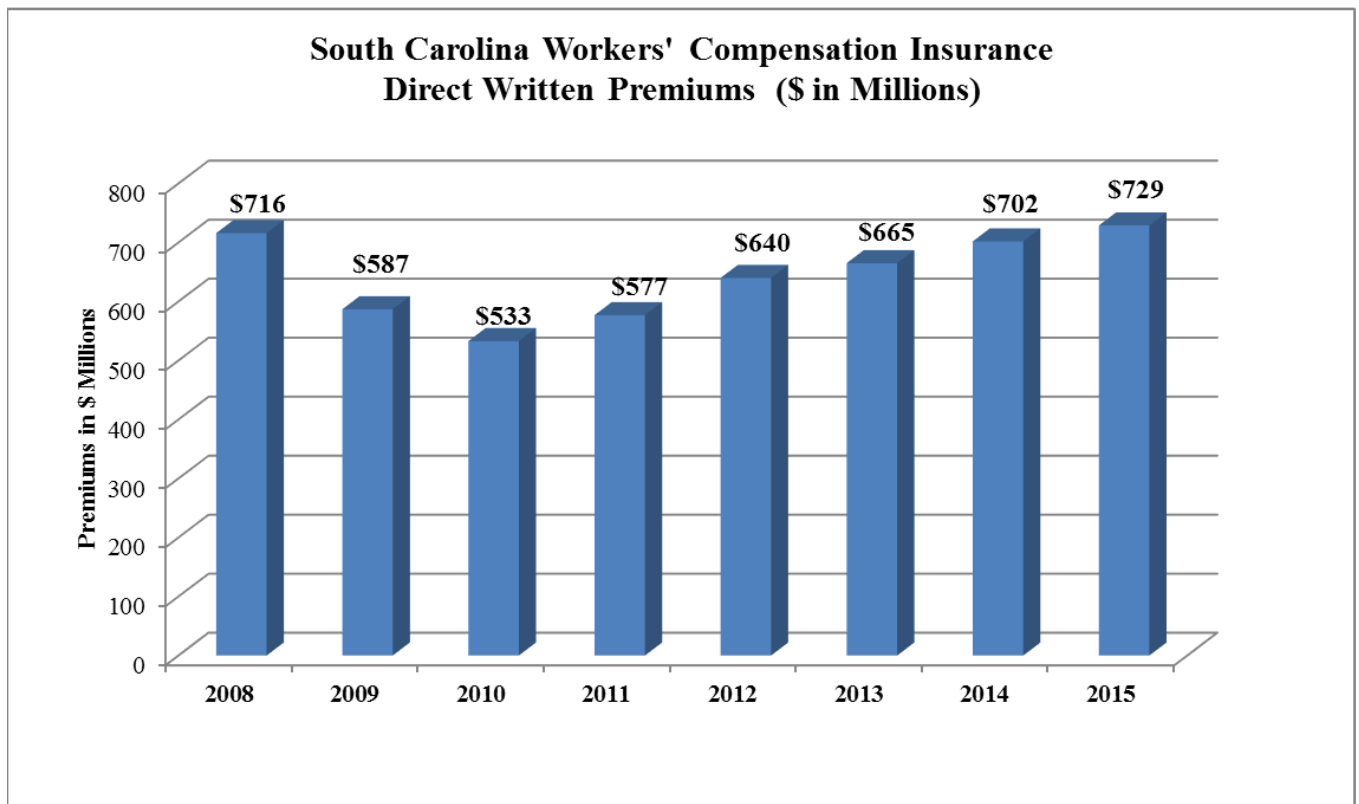
Source: "Line of Business by State" [www.i-site.naic.org](http://www.i-site.naic.org). Accessed: August 24, 2016

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<sup>2</sup> See S.C. Code Ann. § 42-1-360 (2002)

Workers' compensation insurance direct written premiums totaled \$729 million in 2015 (including \$33 million in residual market premium), an increase of \$27 million from 2014, 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.

**Graph 4.3 - South Carolina Direct Written Premiums (2008 – 2015)**



Source: "NCCI State Advisory 2016 Forum Report" as of May 26, 2016

## 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 979 companies included in the 2015 NAIC South

Carolina Market Share Report<sup>3</sup>, down from 987 companies in 2014 and 982 in 2013. As shown in 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)**

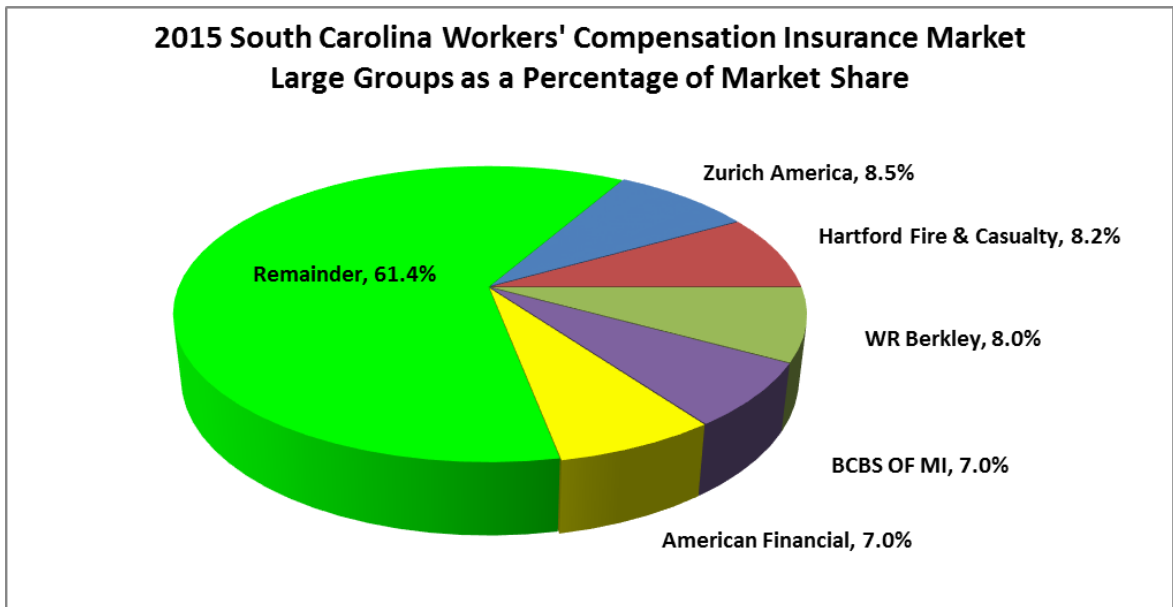
NAIC Zone Southeastern States	Net Gain (Loss) of Insurers
Alabama	5
West Virginia	5
Louisiana	4
Florida	3
<b>South Carolina</b>	<b>0</b>
Kentucky	-1
Virginia	-1
North Carolina	-2
Tennessee	-2
Georgia	-3
Mississippi	-3
Arkansas	-7

Source: “NAIC 2014 Competition Database Report”

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 39% of South Carolina’s 2015 workers’ compensation market, up from 36% in 2014.

<sup>3</sup> Accessed: September 27, 2016

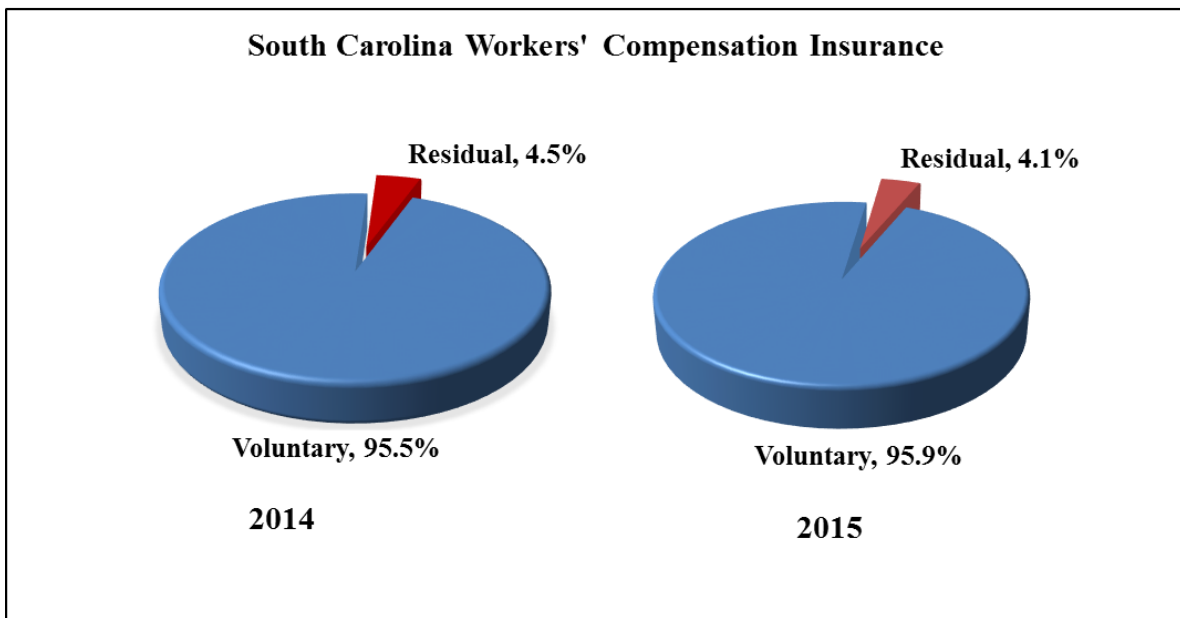
**Graph 4.4 - Workers' Compensation Market Share Analysis for Large Insurer Groups**



Source: "Market Share Reports - By Lines of Business" www.i-site.naic.org Accessed: August 24, 2016

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**



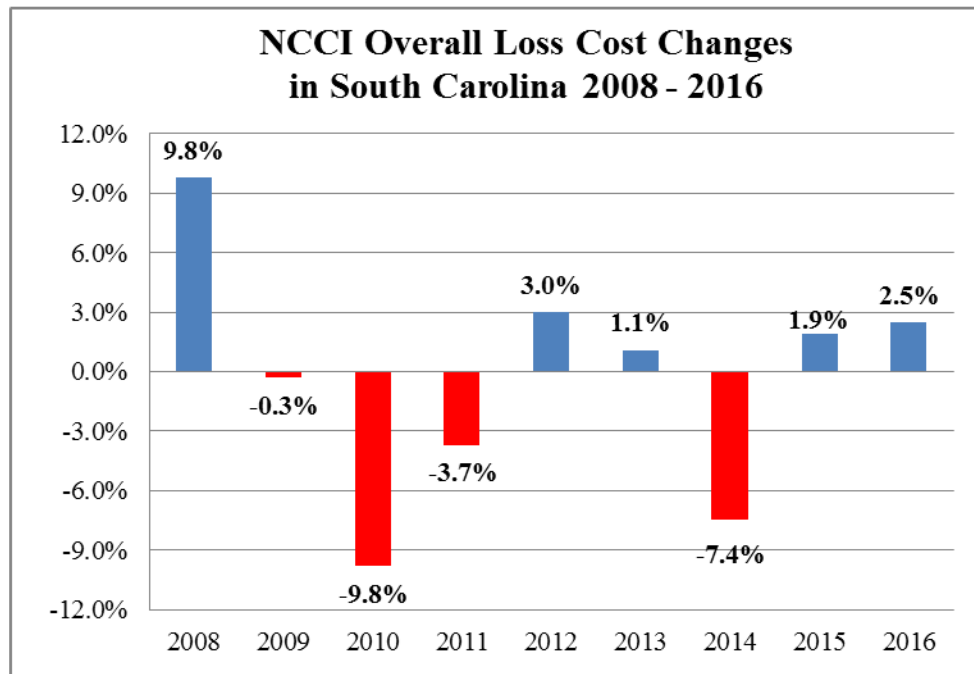
Source: "NCCI - SC Residual Market Performance Report January 1, 2015 - December 31, 2015"-- Page 1

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. Section 2 – South Carolina's Assigned Risk market includes additional information about the residual market (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. The overall loss costs increased by +1.9% in 2015.

**Graph 4.6 - NCCI Overall Loss Cost Changes in South Carolina (2008 – 2016)**



Source: "NCCI Circular - Loss Costs or Rate Filing – SC-SC-2016-01" 2/16/2016

In 2016, South Carolina experienced a 2.5% increase in its loss costs. The Department approved NCCI's proposed loss cost changes as amended. NCCI originally requested an overall average increase of 4.1%. After talking with the Department of Insurance and the Consumer Advocate, NCCI agreed to modify their filing. NCCI implemented the new loss costs effective September 1, 2016 for all new and renewal policies. Including the latest change, this represents a cumulative impact of -2.7% for South Carolina over a nine-year period, which is an annualized change of -0.3% per year.

NCCI attributed the 2016 loss cost increase of +2.5% to experience, trend, and benefits. While the 2016 loss cost filing resulted in an overall revision of +2.5% in voluntary workers' compensation loss costs, the changes in loss costs vary depending on the classifications. The changes by industry group are as shown in Table 4.2 below:

**Table 4.2 - Loss Cost Change by Industry Group**

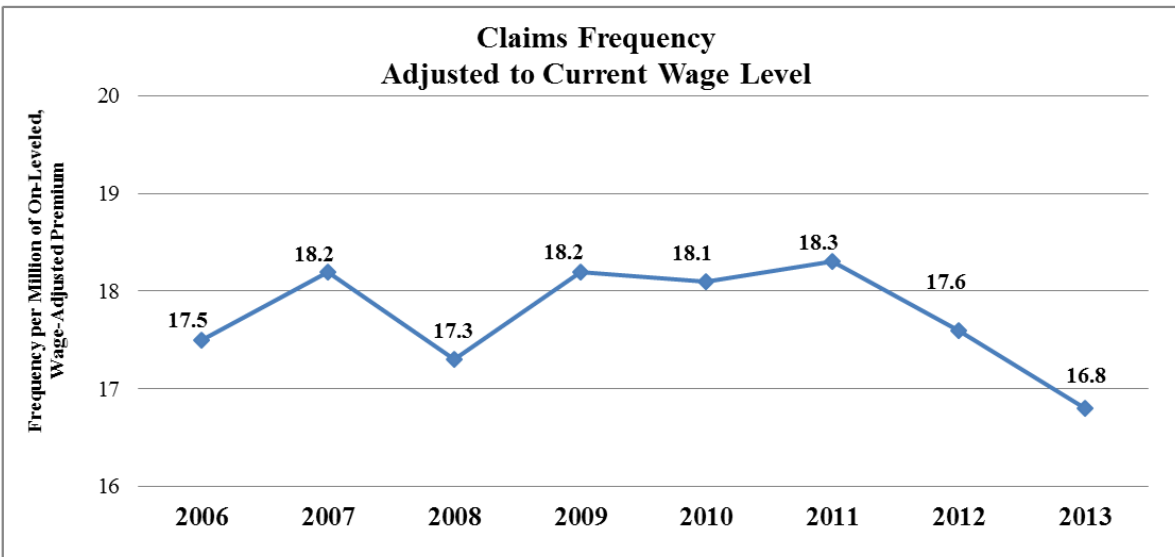
<b>Industry Group</b>	<b>Average</b>	<b>Minimum</b>	<b>Maximum</b>
Manufacturing	+4.6 %	+30 %	-20 %
Office & Clerical	-0.8 %	+24 %	-26 %
Goods & Services	+0.9 %	+26 %	-24 %
Contracting	+3.6 %	+29 %	-21 %
Miscellaneous	+3.3 %	+28 %	-22 %

*Source:* "2016 Public Notice of Workers' Compensation Rate Filing and Corrective Action Order"  
<http://doi.sc.gov/documentcenter/view/8950>

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 decreasing since 2011.

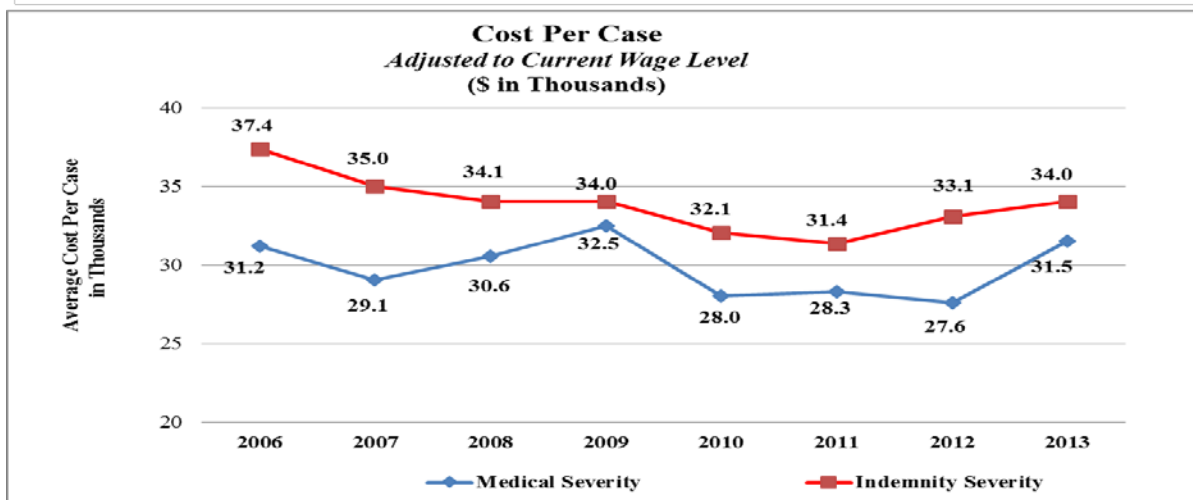
**Graph 4.7 – South Carolina Claims Frequency per Million of Wage-Adjusted Premium**



Source: “NCCI Circular - Loss Costs or Rate Filing – SC-SC-2016-01” 2/16/2016

Graph 4.8 indicates that the medical severity increased significantly in 2013 (the latest data year available) while the indemnity severity remained relatively flat.

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



Source: “NCCI Circular - Loss Costs or Rate Filing – SC-SC-2016-01” 2/16/2016

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## **2. South Carolina's Assigned Risk Market**

### **a. Availability**

Residual markets are created by states to assure the availability of insurance coverage. The South Carolina Workers' Compensation Insurance Plan (Insurance Plan) is the state's residual market mechanism for workers' compensation insurance coverage. The Insurance Plan is administered by NCCI and is available to employers who are unable to procure workers' compensation insurance coverage in the voluntary market.<sup>4</sup> The Insurance 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.

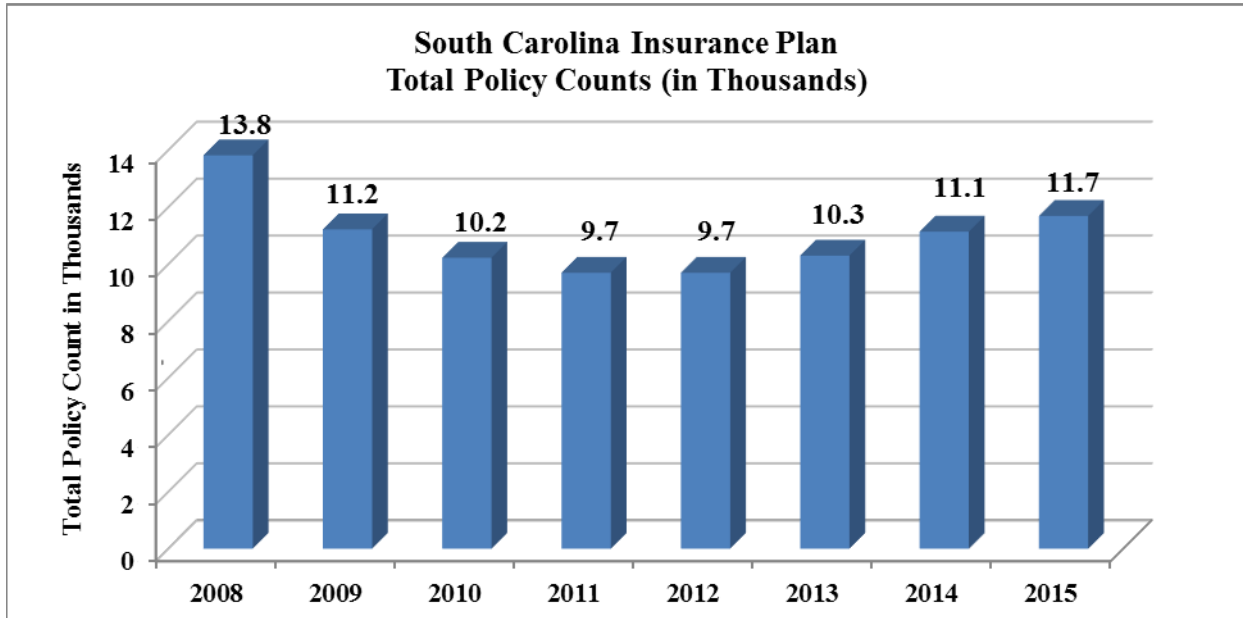
The number of policies written in the residual market is a prime indicator of the health of the voluntary market. Generally, having a large number of policies in the residual market is a signal that the voluntary market is either unhealthy or nonexistent. As noted in Graphs 4.9 and 4.10 the Insurance Plan experienced a small increase in the policy count (5.0%) and a slight decrease in total premium written (-1.7%) in 2015. 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.

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<sup>4</sup> Insurers are selected via a competitive bid process to write assigned risk coverage and must accept all applications of eligible employers.

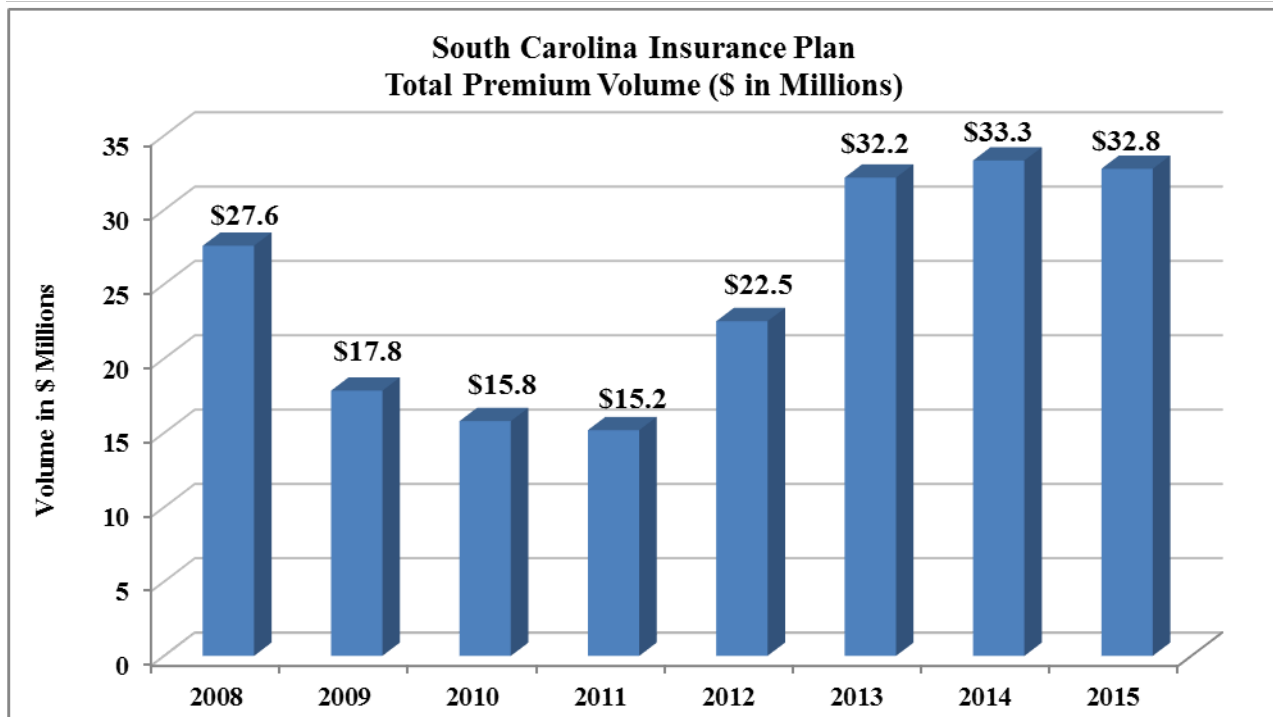


**Graph 4.9 - South Carolina Residual Market Policy Counts (2008 – 2015)**



Source: "NCCI State Advisory 2016 Forum Report" as of May 26, 2016

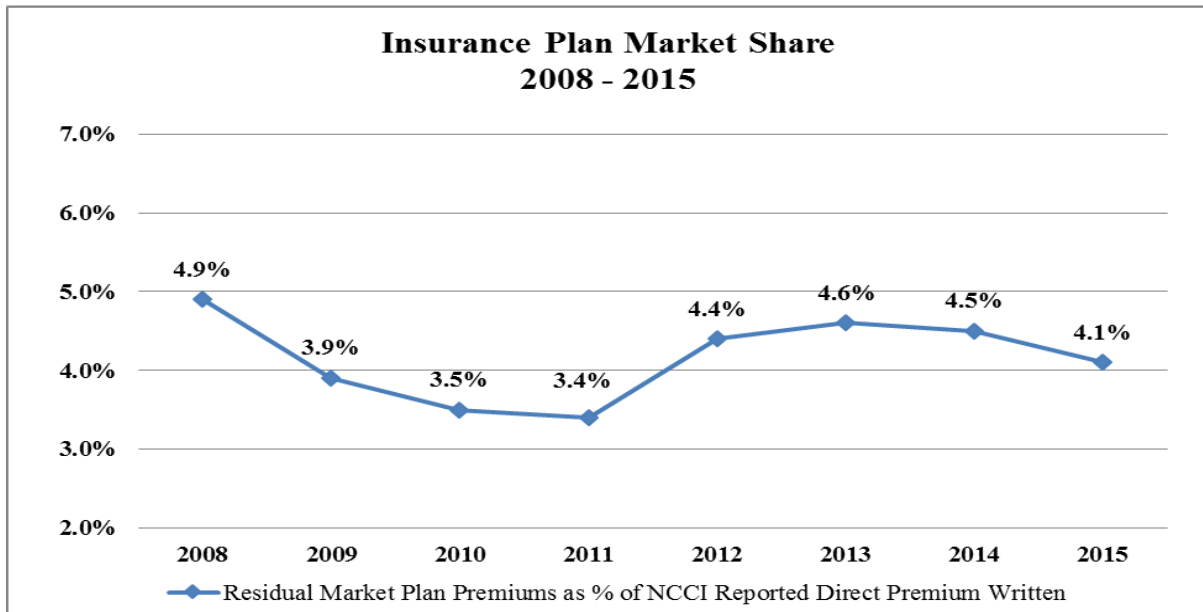
**Graph 4.10 - South Carolina Residual Market Total Premium (2008 – 2015)**



Source: "NCCI State Advisory 2016 Forum Report" as of May 26, 2016

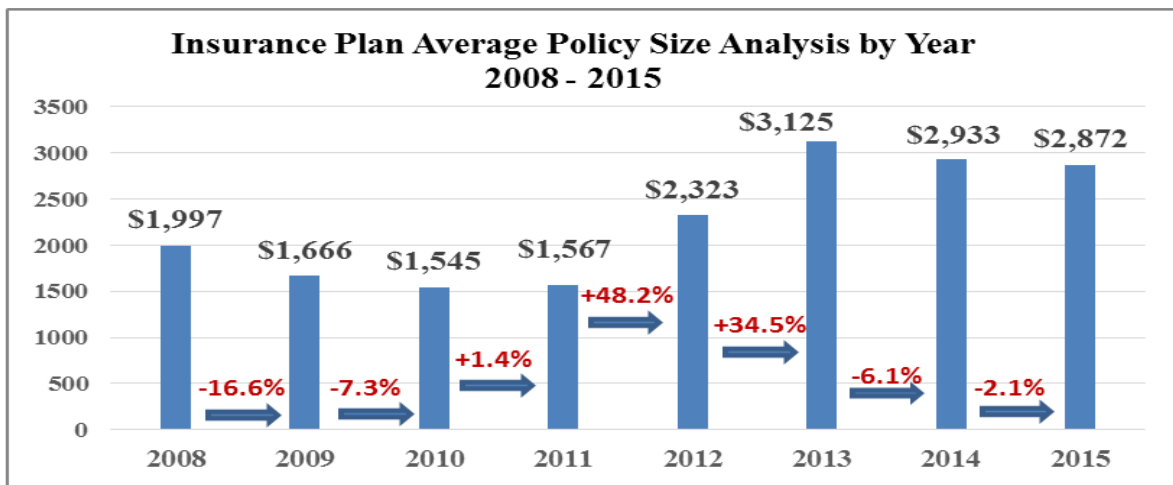
As shown in Graph 4.11, South Carolina’s Insurance Plan wrote 4.1% of 2015’s total direct premium writings in the state, down slightly from 4.5% in 2014. Graph 4.12 shows that the average policy size decreased in 2015 by 2.1%.

**Graph 4.11 - South Carolina Residual Market as a Percentage of Total Market Share**



2015 Source: “NCCI - SC Residual Market Performance Market Report January 1, 2015 – December 31, 2015”, [https://www.ncci.com/Articles/Documents/RM\\_StateActivityReportState\\_SC\\_2015.pdf](https://www.ncci.com/Articles/Documents/RM_StateActivityReportState_SC_2015.pdf), page 1

**Graph 4.12 - South Carolina Residual Market Average Policy Size**



2015 Source: “NCCI - SC Residual Market Performance Market Report January 1, 2015 – December 31, 2015”, [https://www.ncci.com/Articles/Documents/RM\\_StateActivityReportState\\_SC\\_2015.pdf](https://www.ncci.com/Articles/Documents/RM_StateActivityReportState_SC_2015.pdf), page 1 and 6

**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, 82.3% of employers insured in South Carolina’s Insurance Plan have premiums less than \$2,500 (see Table 4.3), which is well above the countrywide average of 71.1%<sup>5</sup>.

**Table 4.3 - South Carolina Insurance Plan (2014 and 2015)**

Premium Size	Policy Year 2015		Policy Year 2014		% Change from 2014 to 2015	
	# of Policies	Premium	# of Policies	Premium	# of Policies	Premium
\$0 - \$2,499	9,629	\$9,394,281	9,132	\$8,841,799	5.4%	6.2%
\$2,500 - \$4,999	906	3,187,305	848	2,988,228	6.8%	6.7%
\$5,000 - \$9,999	608	4,180,337	565	3,877,082	7.6%	7.8%
\$10,000 - \$19,999	300	4,100,029	339	4,710,759	-11.5%	-13.0%
\$20,000 - \$49,999	183	5,408,971	187	5,799,907	-2.1%	-6.7%
\$50,000 - \$99,999	42	2,990,538	42	3,001,943	0.0%	-0.4%
\$100,000 - \$199,999	18	2,548,898	20	2,715,659	-10.0%	-6.1%
\$200,000 +	7	1,769,687	3	723,663	133.3%	144.5%
<b>TOTAL</b>	<b>11,693</b>	<b>\$33,580,046</b>	<b>11,136</b>	<b>\$32,659,040</b>	<b>5.0%</b>	<b>2.8%</b>

2015 Source: “NCCI - SC Residual Market Performance Market Report January 1, 2015 – December 31, 2015”, [https://www.ncci.com/Articles/Documents/RM\\_StateActivityReportState\\_SC\\_2015.pdf](https://www.ncci.com/Articles/Documents/RM_StateActivityReportState_SC_2015.pdf), page 8

As with the voluntary market, the rates charged for policies in the Insurance Plan must comply with the statutory requirement that rates not be inadequate, excessive, or unfairly discriminatory. In fact, South Carolina law requires the Insurance Plan to operate on a self-funded basis. Accordingly, rates may be adjusted in the Insurance Plan as necessary to ensure that it continues to operate on a self-sustaining basis.<sup>6</sup>

<sup>5</sup> Source: “NCCI - Residual Market Management Summary 2015”, [https://www.ncci.com/Articles/Documents/RM\\_ManagementSummary\\_2015.pdf](https://www.ncci.com/Articles/Documents/RM_ManagementSummary_2015.pdf), page 26

<sup>6</sup> See S.C. Code Ann. § 38-73-540(C) (2015)

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On June 30, 2016, the Director of Insurance issued a Corrective Action Order<sup>7</sup> that increased the overall average assigned risk rate level that had been in effect since September 1, 2015. The updated assigned risk rates became effective September 1, 2016.

The Order specified that for the industrial classification codes, a loss cost multiplier of 2.184 shall be applied to the September 1, 2016 South Carolina voluntary market loss costs. Based on the most recently available distribution of payroll by class code in the assigned risk market, the change in the assigned risk loss cost multiplier, and the voluntary market loss cost level changes effective September 1, 2016, an estimated increase of 6.0% in the assigned risk rate level results. The average changes by industry group are as follows<sup>7</sup>:

**Table 4.4**

<b>Industry Group</b>	<b>Average</b>	<b>Minimum</b>	<b>Maximum</b>
Manufacturing	+ 8.1 %	+ 33 %	- 32 %
Contracting	+ 7.2 %	+ 63 %	- 18 %
Office & Clerical	+ 2.5 %	+ 28 %	- 22 %
Goods & Services	+ 4.4 %	+ 65 %	- 21 %
Miscellaneous	+ 6.8 %	+ 40 %	- 50 %

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

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<sup>7</sup> Source: "South Carolina Department of Insurance Corrective Action Order 2016-01" (June 30, 2016)  
<http://doi.sc.gov/DocumentCenter/View/8949>

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## V. THE SOUTH CAROLINA WORKERS' COMPENSATION RATEMAKING PROCESS

Workers' compensation insurance rates are regulated by the Department<sup>8</sup> 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) **Loss costs** 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) **Loss cost multipliers** reflect the insurer's other costs of doing business such as salaries, commissions, rent, utilities, and assessments, including the guaranty fund, the Second Injury Fund (SIF), and the residual market. 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 code 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.

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<sup>8</sup> See Chapter 73, Title 38 (2015) of the S.C. Code of Laws

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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 filed loss costs are 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.

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## **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.<sup>9</sup> Rating organizations must be licensed by the Department.<sup>10</sup> 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.<sup>11</sup> 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, 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.

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<sup>9</sup> See S.C. Code Ann. § 38-73-510 (2015)

<sup>10</sup> See S.C. Code Ann. § 38-73-1230 (2015)

<sup>11</sup> See S.C. Code Ann. § 38-73-430 (2015)

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As stated previously, South Carolina law now requires that all insurers writing workers compensation in South Carolina 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.

## **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. 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.

## **B. VOLUNTARY 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<sup>12</sup>

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<sup>12</sup> The guaranty fund assessment is an amount that insurance companies pay to cover the losses of insolvent workers’ compensation insurers.



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- Second Injury Fund (SIF) assessment<sup>13</sup>
  - Residual market load (RML)
  - Loss cost modification factor

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.

Prior to the 2007 reforms (2007 S.C. Act No. 111), the South Carolina SIF assessment had a major impact on an insurer's LCM. At that time, SIF 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 SIF 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.<sup>14</sup> 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 SIF is 5.0%.

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<sup>13</sup> South Carolina's Second Injury Fund was created in 1972 and was eliminated pursuant to 2007 S.C. Act No. 111.

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

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Please note that following the 2017 assessment, additional analysis will be necessary to determine whether there is a need for an additional assessment before the SIF is finally closed. However, the Department is hopeful that SIF assessments will no longer be an issue or a component of loss cost multiplier filings in the near future.

The residual market load represents expenses incurred as a result of an insurer's mandatory participation in South Carolina's Insurance Plan. By statute, the rates of the Insurance 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**

In 2016, the South Carolina General Assembly amended Section 38-73-525 with a June 3, 2016 effective date. The revised law requires insurers to file loss cost multipliers with the Department at least 60 days in advance of using new rates. The previous version required filings 30 days in advance. This law also requires that a credentialed actuary employed or retained by the

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Department review all workers compensation LCM filings. Since 2008, the Department has reviewed all LCM filings for each individual carrier that wishes to write workers' compensation in the state. In determining whether to approve or disapprove a workers' compensation LCM 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.

Because of the 2016 changes to the regulatory process brought about by Act No. 213, the Department issued Bulletin 2016-02 which advised the industry of the changes and formally withdrew Bulletins 2007-13, 2007-13B, and 2009-18. In this bulletin, the Department provided guidance on the procedural requirements related to LCM workers compensation filings. Accurate and thorough data must be included in every LCM filing that clearly supports each individual element of the LCM in order for the Department's actuary to approve a filing.

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.

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## **C. ASSIGNED RISK LOSS COST MULTIPLIER**

NCCI administers South Carolina's Insurance 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 residual market must comply with the statutory requirement that rates not be inadequate, excessive, or unfairly discriminatory. S.C. Code Ann. § 38-73-540(C) (2015) requires that the residual market rates be self-sustaining; premiums charged must cover all losses and expenses. In the event of excessive losses in the residual market, 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 residual market will continue to operate on a self-sustaining basis.

## **VI. LEGISLATION**

### **A. 2007 S.C. Act No. 111**

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;

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- 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.

## **B. 2016 S.C. Act No. 213**

In June 2016, the South Carolina General Assembly passed and the Governor signed Act No. 213 reforming the South Carolina workers' compensation system for the first time in almost a decade. This bill made the following changes to Sections 38-73-525 and 38-73-1210 of the South Carolina Code of Laws effective June 3, 2016:

- State law now requires all insurers writing workers' compensation insurance to adopt the most recent NCCI loss costs. This was previously required by Department bulletins.

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- Companies must file to adopt NCCI's loss costs within 60 days of the NCCI loss costs approval date.
  - All adoptions must be implemented within 120 days of NCCI's effective date.
  - Companies must file all workers' compensation loss cost adoption and LCM filings.
  - The Department's review time for LCM filings has been extended from 30 to 60 days.

## VII. GLOSSARY

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

<b><i>Class Code</i></b>	An individual job classification (e.g., roofer, office worker, truck driver). South Carolina currently has 581 individual class codes.
<b><i>Experience Modification Factor</i></b>	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.
<b><i>Guarantee Fund Assessment</i></b>	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

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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***

Internet – State Interface Technology Enhancement; 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

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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.



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<b><i>Premium</i></b>	The amount paid by an employer to an insurer for workers' compensation insurance. $\text{Premium} = \text{Loss Costs} \times \text{Loss Cost Multiplier} \times (\text{Payroll} / 100)$ .
<b><i>Rate</i></b>	The cost per unit of insurance. $\text{Rate} = \text{Loss Costs} \times \text{Loss Cost Multiplier}$ .
<b><i>Ratemaking</i></b>	The process of calculating a premium so that it is not <i>excessive, inadequate, or unfairly discriminatory</i> .
<b><i>Residual Market Load</i></b>	A factor used in developing the loss cost multiplier that accounts for expenses associated with required participation in the residual market.
<b><i>Standard Premium</i></b>	The type of premium that accounts for differences by class code. $\text{Standard Premium} = \text{Manual Premium} \times \text{Experience Modification Factor}$