

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Elliott F. Elam, Jr., Consumer Advocate for the)	
State of South Carolina,)	
)	DOCKET NO. 05-ALJ-09-0406-CC
Petitioner,)	
)	
v.)	
)	
South Carolina Department of Insurance,)	
)	
Respondent,)	
)	
In Re: Self-Funded Rates for Workers')	
Compensation Assigned Risk Plan.)	
)	
)	
_____)	

**Direct Testimony
of
Martin M. Simons, MAAA, ACAS, FCA**

**On Behalf of
Consumer Advocate**

January 27, 2006

1 Q. Please state your name and address for the record.

2 A. My name is Martin M. Simons. My business address is Post Office Box 61020,
3 Columbia, South Carolina, 29260.

4

5 Q. What is your educational background?

6 A. I have a Bachelor's degree in mathematics with a minor in economics.

7

8 Q. How long have you been involved in insurance?

9 A. I have 39 years of insurance experience, in marketing, actuarial, financial, branch
10 management, agency, regulatory, and consulting positions. After 19 years of
11 insurance industry experience, I accepted the position as Chief Casualty Actuary
12 with the South Carolina Department of Insurance, and served until 1997 when I
13 resigned to concentrate on public consulting.

14

15 Q. What are your qualifications to testify in this proceeding?

16 A. Please refer to Appendix 2 at the end of this testimony for a copy of my current
17 curriculum vitae. References in Appendix 2 that specifically relate to these
18 proceedings include the following:

19

20 ♦ I am an Associate of the Casualty Actuarial Society, a Member of the American
21 Academy of Actuaries, and a Fellow of the Conference of Consulting Actuaries.

22

1 ♦ I have performed an actuarial analysis on each voluntary and assigned risk loss
2 cost and rate filing made in South Carolina by the National Council on
3 Compensation Insurance (NCCI) for the past twenty years.

4

5 ♦ I have produced reserve analyses for the South Carolina and Georgia Second
6 Injury Funds, and reserve analyses for the South Carolina Uninsured Employers
7 Fund for each of the past sixteen years.

8

9 ♦ I provide expert testimony for the Oklahoma Attorney General and have testified
10 at each NCCI loss cost hearing in that state during the past 18 years. I provided
11 expertise to the Oklahoma Senate on workers' compensation reserves and benefit
12 levels.

13

14 ♦ I have assisted Insurance Departments in Hawaii, Arkansas, Delaware, New
15 Mexico, Illinois, Minnesota, North Dakota, Ohio and Georgia.

16

17 ♦ My clients have also included the Hawaii Departments of Labor, and Commerce
18 and Consumer Affairs, the Louisiana Association of Business and Industry, the
19 Colorado Workers' Compensation Education Association, the Ohio Public
20 Interest Campaign, ABC News - Nightline, and the Provincial Insurance Board of
21 Manitoba. My work with the Hawaii Insurance Division spans over nineteen years
22 and includes all areas of insurance regulation and legislation. I was integrally

1 involved in successful automobile and workers' compensation insurance reform
2 legislation in Hawaii. Following the auto reforms, Hawaii moved from having
3 the 2nd highest to the 22nd highest rates in the nation. Following the workers'
4 compensation reforms in Hawaii, NCCI loss costs were reduced 27.3% in 1996,
5 reduced an additional 10.5% in 1997, and reduced another 8.9% in 2000. The
6 combined effect of NCCI loss cost changes since 2000 has been an additional
7 decrease of 8.4% for a total combined decrease of 45.7% over the past ten years.

8
9 ♦ I was involved in the establishment and approval of Hawaii Employers Mutual
10 Insurance Company (HEMIC), a privately owned insurer that has written
11 Hawaii's previous "involuntary" workers' compensation business at actuarially
12 sound rates since its inception. As a result, there are no longer any workers'
13 compensation insurance assigned risk policies in Hawaii.

14
15 ♦ I was the formal reviewer of the regulation and statutory compliance sections of a
16 new Casualty Actuarial Society textbook, "Workers Compensation Ratemaking:
17 A Textbook for the Practicing Actuary".

18
19 ♦ I have assisted the Actuarial Standard # 23 Committee on Data Quality, the
20 Actuarial Standard #12 Committee on Risk Classification, and the Actuarial
21 Standards Board which oversees all actuarial standards.

1 ♦ I have been a speaker at meetings of the Conference of Consulting Actuaries on
2 the Insurance Expense Exhibit, regulation and the development of a specialized
3 actuarial consulting practice.

4

5 ♦ My South Carolina clients have included the Department of Consumer Affairs,
6 the Uninsured Employers' Fund, the Self-Insured Employers Association,
7 Reimbursement Consultants, inc., and the Second Injury Fund.

8

9 ♦ My Insurance Department responsibilities included management of the Property
10 and Casualty, Life Accident and Health, and State Rating and Statistical
11 Divisions.

12

13 ♦ I was involved in the adoption by the National Association of Insurance
14 Commissioners of loss costs as the recommended rate regulatory procedure. I was
15 the only non-Commissioner voting member at hearings held across the United
16 States to assess the benefits and challenges involved in implementing loss cost
17 regulation, and I chaired the NAIC working groups that drafted prior approval
18 and file-and-use legislative language that have become the basis for the loss cost
19 statutes in most states.

1 ♦ I have testified on several hundred occasions in Arkansas, British Columbia,
2 Colorado, Connecticut, Georgia, Hawaii, Illinois, Louisiana, Minnesota, New
3 Mexico, Ohio, Oklahoma, and South Carolina.

4

5 Q. Have you authored any technical insurance papers or articles?

6 A. Included in Appendix 2 is a listing of technical insurance papers and articles that I
7 have authored or co-authored.

8

9 Q. On whose behalf are you testifying?

10 A. I am testifying on behalf of the Consumer Advocate.

11

12 Q. Have you reviewed the NCCI South Carolina workers' compensation insurance
13 voluntary loss cost filing proposed to become effective on November 1, 2005?

14 A. Yes. I received the filing by electronic mail on July 11, 2005 in two separate
15 documents; the Filing, and the Technical Supplement. The filing is based upon
16 data from policies that were written in 2002 and 2003.

17

18 Q. What is meant by "loss costs"?

19 A. Loss costs (sometimes referred to as "pure premiums") represent the claims
20 portion of the premium paid by employers for workers' compensation insurance
21 coverage. Since we need to project what we expect these loss costs to be in the
22 future, it is necessary that we have a large amount of experience from which to

1 make those projections. Individual insurance companies do not have enough
2 experience from which to estimate their future loss costs. That is why insurers
3 pool their claim experience through NCCI. It is the pooled experience of all
4 South Carolina workers' compensation insurers that comprises the loss costs. The
5 loss costs include the dollars that are directly related to benefit payments, but do
6 not include the insurance company expenses or rate of return calculations.
7 Following the approval of these loss costs, insurers must add a factor to include
8 their own expenses in "loss cost multiplier filings". The loss cost multiplier
9 filings include the part of the premium needed to pay the insurance company
10 expenses. The loss cost multiplier filings also generally allow for a calculation of
11 the investment income earned by the insurer, and the rate of return on equity that
12 is expected to be earned by the insurer if the loss costs and loss cost multipliers
13 are placed into effect. It is through the rate of return process that a determination
14 can be made that the rates are not excessive, inadequate or unfairly
15 discriminatory.

16

17 Q. What is meant by an excessive rate?

18 A. An excessive rate is one that will earn the insurance company a return on its
19 equity that is above rates of return being earned by industries with similar
20 investment risk.

1 Q. What is meant by an inadequate rate?

2 A. An inadequate rate is one that may be expected to cause the insurance company to
3 suffer financial jeopardy. As can be seen, there is a range of possible rates that
4 will fit between these two definitions; that is, rates that are at or below those
5 being earned by average risk industries, but are high enough so as to not place the
6 insurer in financial jeopardy.

7

8 Q. What is meant by unfairly discriminatory?

9 A. Differences in rates among classifications must be supported by differences in the
10 expected costs associated with providing insurance to those classifications.
11 Otherwise, the rates for those classifications are unfairly discriminatory. As I will
12 discuss later in this testimony, this is currently an extremely important issue in
13 South Carolina.

14

15 Q. Does the data used in the filing provide an appropriate and reliable base from
16 which to calculate loss costs that are not excessive, inadequate or unfairly
17 discriminatory?

18 A. No.

19

20 Q. Did the Consumer Advocate seek additional information to assist in your analysis
21 of the filing?

1 A. Yes. In order to properly analyze the filing, the Consumer Advocate served
2 discovery requests on NCCI, the South Carolina Department of Insurance (DOI),
3 and Companion Property and Casualty Insurance Company (Exhibits SCCA-1).

4

5 Q. Did the responses to the Consumer Advocate's discovery requests provide you
6 with adequate information?

7 A. No. There are several areas of concern regarding the accuracy of the data used in
8 this filing as well as the functioning of the South Carolina workers' compensation
9 insurance market during and since the experience period analyzed in the filing.
10 My review also found that the filing fails to adequately account for recent trends
11 in South Carolina that directly impact upon the loss cost calculations.

12

13 Q. What causes the data accuracy concerns you mentioned?

14 A. There are several reasons for concern. Exhibit SCCA-2a, a Test Audit Quarterly
15 Report, dated July 14, 2003, was submitted to the Department of Insurance from
16 NCCI, and received from the Department in response to the Consumer
17 Advocate's discovery requests. In the summary of that report, NCCI states that
18 for the six quarters ending June 30, 2003, 54.33% of the audited rates charged by
19 South Carolina insurers were in error. This is twice the error rate in any other
20 state. The net premium difference was four times as much as in any other state.

21 Data provided by insurers responsible for those errors are used in determining the
22 loss costs in this proceeding and may also be fraught with errors. To make

1 matters worse, the report states that **the error ratio in South Carolina is**
2 **trending upward** from these already extraordinarily high error rates. (see
3 attachment included at the end of Exhibit SCCA-2a, labeled *South Carolina Test*
4 *Audit Results – October, 2003*, page 1). These errors occurred during times
5 coincident with the experience in the filing; experience that produces an increase
6 that, according to the NCCI's Annual Statistical Bulletin, is greater than that
7 approved for any state's voluntary market in more than a decade.

8 My concerns have been echoed by the Staff of the South Carolina Department of
9 Insurance. Exhibit SCCA-3 contains a copy of a letter from Mr. Dean Kruger of
10 the Department of Insurance to Cathy Booth of NCCI, dated November 13, 2003.

11 In the letter, Mr. Kruger states:

12 I have reviewed materials related to actuarial standards of practice and
13 have listed the ones that stand out in my mind. The issue is the
14 determination that the data used by NCCI in South Carolina is faulty. It
15 does not meet any minimum standards that I am aware of. As far as the
16 actuaries at NCCI, (sic) they must have good data in order to work and
17 NCCI data is filled with errors.

18
19 My thought (sic) at this time are that the data presently in the NCCI
20 databanks is filled with errors and should not be used. It may be
21 appropriate for NCCI to cease all rate filing activity and classification
22 analysis based upon this fact and begin a program to ensure data meets
23 minimum quality standards before it is used in analysis (sic).

24
25 Despite the Department's concerns, errors in South Carolina have remained high.

26 According to information in Exhibits SCCA-2a and SCCA-2b, error rates in

27 South Carolina, by quarter, have been as follows:

	<u>2002</u>	<u>2003</u>	<u>2004</u>	
1				
2	1 st quarter	53.77	52.87	30.68
3	2 nd quarter	56.36	55.06	46.36
4	3 rd quarter	48.57	55.43	38.10
5	4 th quarter	59.14	45.88	44.05

6

7 Q. Are there other data concerns beside the South Carolina error rates?

8 A. Yes. According to Appendix A-IV-A of the NCCI filing, data from several
9 insurance companies has been excluded from the filing calculations. The data
10 from the following companies are excluded from various portions of the filing:

- 11 AIU Insurance Company (AIG)
- 12 Accident Insurance Company
- 13 Lumbermens Mutual Casualty Company
- 14 Virginia Surety Company, Inc.
- 15 Nationwide Mutual Insurance Company
- 16 Insurance Company of New York
- 17 Argonaut Insurance Company

18

19 One of these companies, AIU Insurance Company (AIG), is the largest workers'
20 compensation insurer in the State. One must question the filed calculations when
21 data from the largest insurer (over 14% of the 2004 market) are excluded.

1 In response to the Consumer Advocate, NCCI stated (Exhibit SCCA-4, page 9):

2 To date, the South Carolina financial data AIG has submitted has
3 not met NCCI's data quality standards for inclusion in a filing.
4

5
6 The problems associated with the missing AIG data do not appear to be limited to
7 South Carolina. According to an article in the Insurance Journal, an electronic
8 insurance news source (Exhibit SCCA- 5), the Florida Office of Insurance
9 Regulation (the Florida Insurance Department), "has issued a consent order
10 requiring 10 American International Group Companies (AIG) to transmit the
11 financial data required by statute, to pay administrative fines and costs of more
12 than half a million dollars and to fully comply with workers' compensation
13 reporting requirements". According to the Insurance Journal, the companies
14 reportedly failed to transmit information required by statute and requested by the
15 workers' compensation rating organization, the National Council on
16 Compensation Insurance, Inc.

17 The American International Group is the parent company of AIG. The Florida
18 Department has levied a substantial fine to AIG due to its failure to provide
19 statutorily required workers' compensation statistical data to the NCCI.
20

21 Q. Are there other concerns with the data in the filing?

22 A. Yes. It involves reimbursements received by insurers from the Second Injury
23 Fund.

1 Q. What is the Second Injury Fund?

2 A. The Second Injury Fund functions within the South Carolina Workers'
3 Compensation system to protect employers from the higher cost of insurance that
4 can occur when an injury combines with a prior disability to result in substantially
5 increased medical or disability costs than the accident alone would have
6 produced.

7
8 Q. Will you please describe your concerns relative to the Second Injury Fund?

9 A. When the Second Injury Fund reimburses an insurer, that insurer's incurred
10 claims should be reduced by the amount of the reimbursement. The failure to do
11 so will result in an overstatement of losses, an overstatement of the indicated loss
12 costs, and an unjustified windfall to that insurer at the expense of all South
13 Carolina employers. In addition, if the appropriate reductions are not initiated,
14 employers end up paying more than they should, more than the filed rates
15 purportedly allow, and more than that which is statutorily permitted.

16 The Second Injury Fund is designed to be a pass through of the costs associated
17 with providing workers' compensation insurance for disabled employees.
18 Reimbursements from the Second Injury Fund to insurers must produce
19 commensurate reductions in the insurance companies' loss data, and thereby
20 produce reductions in the loss costs from those that would be present in the
21 absence of the reimbursement. The claims are supposed to be paid for by either
22 the insurance company or the Second Injury Fund, but not both. Second Injury

1 Fund reimbursements currently amount to in excess of \$100 million annually. If
2 insurers appropriately account for the reimbursements, then a \$100 million
3 Second Injury Fund payout should result in a \$100 million decrease in the loss
4 costs derived in this proceeding. The failure of insurers to appropriately reduce
5 the incurred loss files in even a small or moderate percentage of cases will result
6 in the derivation of loss costs that are substantially overstated, and will result in
7 substantial costs to employers.

8

9 Q. Do NCCI rules require that Second Injury Fund reimbursements be credited to the
10 incurred loss data?

11 A. Yes. The NCCI Statistical Plan – Special Fund and Recoveries section item U-
12 1344 (Exhibit SCCA-6), Section 6-B requires:

13 In all cases where a claim has been determined to be eligible for
14 reimbursement to the carrier from a special fund (such as Second
15 Injury Fund, Handicapped Workers' Reserve Fund, etc.) the gross
16 incurred cost of the claim (i.e. the gross evaluation of the claim on
17 which the award was based, whether the claim is still opened or not)
18 shall be reduced by the amount of any paid or anticipated recovery
19 from such Fund and the net incurred cost of the claim shall be
20 reported on reports which would impact the current and up to two
21 prior modifications.
22

23 Since the NCCI created and maintains the statistical plan, the Consumer Advocate
24 asked NCCI how it was determined that the reductions actually take place. The
25 NCCI responded:

1 Based on the Workers Compensation Statistical Plan detail collected
2 by NCCI, it is not possible to verify whether carriers are reducing their
3 reported experience in recognition of Second Injury Fund recoveries.
4
5

6 (See Exhibit SCCA-4, page 17). It is alarming that the statistical plan mandates
7 an action that is not only not monitored, but is left to insurers that have been
8 wrong in more than half of their pricing activities. Insurers are expected, without
9 oversight, to account for the reductions despite a multi-million dollar annual
10 incentive to refrain from doing so.
11

12 Q. Does the NCCI's statistical plan cover all Second Injury Fund reimbursements?

13 A. No. There are also reimbursements related to claims older than those covered by
14 the statistical plan. Since the claim is beyond the experience rating plan period, it
15 is excluded. These reimbursements are not even required to be accounted for by
16 the NCCI, but they should also reduce the loss costs.
17

18 Q. How would you account for the Second Injury Fund reimbursements?

19 A. A statistically reliable program should be established that would follow Second
20 Injury Fund reimbursements to ensure that the employers' incurred claim files are
21 appropriately adjusted for those reimbursements.

1 Q. Did the Consumer Advocate attempt to determine whether the Department of
2 Insurance has initiated a means of reviewing Second Injury Fund reimbursements
3 and their effect on insurers' incurred claim files?

4 A. Yes. The Consumer Advocate requested the following from the South Carolina
5 Department of Insurance in CA Interrogatory No. 2-5:

6 Provide a detailed description of the methods used by the Department of
7 Insurance in its examination process to ensure that Second Injury Fund
8 reimbursements received by insurers (voluntary and assigned risk) are
9 properly used to adjust the insurers' incurred loss data.

10

11 Exhibit SCCA-1. The Department responded as follows:

12 The Department retains the services of a consulting actuary to conduct this
13 examination. In examining the insurers, the consulting actuary routinely
14 submits written questions to the carriers seeking explanations and
15 documentation of the accounting of assets and liabilities for future Second
16 Injury Fund recoveries, and seeking a listing of past SIF recoveries.

17

18

19 Exhibit SCCA-7. To date, the Department of Insurance has not produced any
20 questions submitted to carriers by its consulting actuary or by the Department,
21 any responses from any carriers to the questions to the Department or to its
22 consulting actuary, any listings of past SIF recoveries, or any documentation from
23 its consulting actuary.

24

25 Q. Are there criteria other than Second Injury Fund recoveries that should reduce the
26 insurance companies' incurred loss data?

1 A. As with Second Injury Fund assessments, subrogation recoveries should be
2 accompanied by a corresponding reduction in the insurance company's incurred
3 claim files.

4
5 Q. What are subrogation recoveries?

6 A. When an insurance company pays a claim and then subsequently receives funds
7 associated with that claim payment from a third party who is determined to be
8 liable, the process is called subrogation. It is important that credits are provided to
9 the claim files so that the employer's experience rating modifier is not penalized
10 due to actions for which someone else has been determined to be liable.

11 In addition, the overall claim data must be adjusted, since in the absence of such
12 adjustment, the insurer could simply keep the recovered money and an unwary
13 public or regulator would be none the wiser. The result would be that insurers are
14 receiving more money than that which is considered in establishing the rates,
15 contrary to South Carolina statute requiring that rates shall not be excessive,
16 inadequate or unfairly discriminatory as well as statutory requirements that rates
17 charged must be filed with the Department of Insurance.

18

19 Q. Are the subrogation recoveries accounted for appropriately?

20 A. The Consumer Advocate requested the following from the South Carolina
21 Department of Insurance in CA Interrogatory No. 2-6:

1 Provide a detailed description of the methods used by the Department of
2 Insurance in its examination process to ensure that subrogation recoveries
3 received by insurers (voluntary and assigned risk) are properly used to
4 adjust the insurers' incurred loss data."
5

6 Exhibit SCCA-1. The Department responded as follows:
7

8 See answer to number 5 above. In examining the insurers, the consulting
9 actuary routinely submits written questions to the carriers seeking
10 explanations and documentation of the accounting for recoveries due to
11 salvage, subrogation, and refunds.
12

13 Exhibit SCCA-7. To date, the Department has not produced any questions
14 submitted to carriers by its consulting actuary or by the Department of Insurance,
15 responses from any carriers to the questions to the consulting actuary or to the
16 Department of Insurance, or any documentation from its consulting actuary.
17

18 Q. Do NCCI rules require that subrogation recoveries be credited to the incurred loss
19 data?

20 A. Yes. The NCCI Statistical Plan – Special Fund and Recoveries section item U-
21 1344 (Exhibit SCCA-6, labeled as page 05), requires:

22 Subrogation

23 In all cases where there has been recovery of loss due to subrogation, the
24 amount of loss reported shall be the net incurred loss. The net incurred loss
25 is defined as the gross incurred loss (i.e., the gross evaluation of the claim
26 on which the award was based, whether the claim is still open or not)
27 minus the amount recovered less recovery expenses. When the recovery
28 expenses exceed the amount recovered, report the gross incurred loss
29 instead of the net incurred loss.
30

31 Since the NCCI created and maintains the statistical plan, the Consumer Advocate
32 asked NCCI in CA Interrogatory No. 2-13 how it was determined that the

1 reductions actually take place. Exhibit SCCA-1. In the December 29, 2005
2 response to the Consumer Advocate, the NCCI provided the following:

3 Based on the Workers' Compensation Statistical Plan detail collected by
4 NCCI, it is not possible to verify whether carriers are reducing their
5 reported experience in recognition of subrogation recoveries.
6

7 Exhibit SCCA-8.

8

9 Q. Are there other areas of concern relative to the accuracy of the data?

10 A. There are several additional concerns pertaining to the entire South Carolina
11 workers' compensation system that directly impact this proceeding, which I will
12 describe later.

13

14 Q. What process did you use to review the NCCI voluntary loss cost filing?

15 A. My initial review found that additional information was needed for a proper
16 analysis. There are different methods that may be used in analyzing a loss cost
17 filing. The selection of a process should include an analysis of which data types,
18 which methods, and which experience periods provide the most appropriate basis
19 for analysis at the time the analysis is being performed. NCCI has access to each
20 and has selected from among them in producing the filing. As in prior hearings,
21 the Consumer Advocate requested the indications be re-calculated using methods
22 and data types that were available to NCCI but were not included in the filing.

23 Additional information was requested relating to loss development, the exclusion
24 of some insurance companies' experience, the test audit program, previously

1 approved filings, and the NCCI's Annual Statistical Bulletin. Copies of assigned
2 risk filings made during the past five years were also requested.

3

4 Q. What is loss development?

5 A. Workers' compensation insurance claims can frequently take several years
6 between the date of the accident and the final date at which time the claim is fully
7 paid. The process used by actuaries in reviewing loss costs and rate filings
8 includes a process called loss development. The loss development process
9 accounts for the fact that the currently analyzed insurance data applies to claim
10 payments that may take several years to be completely paid.

11

12 Q. Will you please continue describing the process you used in analyzing the NCCI
13 filing?

14 A. The Consumer Advocate also requested information from the Department of
15 Insurance relating to the Test Audit Program, Second Injury Fund
16 Reimbursements, subrogation recoveries and other workers' compensation
17 insurance filings received by the Department, including assigned risk and
18 voluntary loss cost multiplier filings.

19

20 Q. What do you mean by "voluntary" and "assigned risk" filings?

21 A. Voluntary workers' compensation insurance business includes those employers in
22 South Carolina that are written by insurers in accordance with their rate filings.

1 For workers' compensation insurance in South Carolina, the voluntary filings
2 include these voluntary loss costs as well as the insurance companies loss cost
3 multipliers which add additional factors relative to the insurance company's
4 individual operating expenses and an accounting for the investment income
5 earned by insurers on funds held by them for South Carolina policyholders and
6 claimants. The loss cost multiplier is the factor that is ultimately applied to the
7 approved loss costs to develop a final voluntary rate for the specific insurance
8 company.

9 Assigned risk filings provide full rates that are applicable to employers who are
10 unable to obtain workers' compensation insurance coverage in the voluntary
11 market. The rates approved following the approval process are charged to all
12 assigned risk employers. The assigned risk rate filing incorporates the loss cost
13 multiplier that is proposed to be applicable to the approved loss costs so as to
14 arrive at the assigned risk rate.

15

16 Q. The case before this Court is a voluntary filing. Why did you ask for assigned
17 risk data?

18 A. An appropriate analysis of a voluntary filing should include the effect of changes
19 taking place in the assigned risk as well as the voluntary market. There are
20 interrelationships between voluntary and assigned risks. Calculations are included
21 in the filing (Appendix 1, Sections A, B and C.) to account for the assigned risk
22 market share. As employers are shifted between voluntary and assigned risk

1 markets, changes in assigned risk trends will often result in offsetting changes in
2 voluntary trends.

3 For example, in his Interrogatory No. 1-7 to NCCI, the Consumer Advocate
4 requested information relating to the exclusion of Lumbermens Mutual Casualty
5 Insurance Company data in the filing. Exhibit SCCA-1. NCCI responded as
6 follows:

7 The carrier mentioned above is insolvent and no longer submits data to the
8 NCCI. Presumably, other carriers currently writing workers'
9 compensation business in South Carolina, and reporting their data to
10 NCCI, are insuring those risks previously afforded coverage by the above-
11 mentioned carrier. (emphasis added)

12
13 Exhibit SCCA-8, page 11. One might also “presume” that the business left in the
14 final throes of a dying insurer may not be the most profitable business, that
15 insurers might not eagerly write an insolvent company’s last remaining business,
16 and that a portion may now be assigned risks. If this is true, the voluntary
17 experience will improve as these policies exit the voluntary market, and the
18 involuntary experience will change depending upon the experience generated as
19 the business enters the assigned risk pool.

20

21 Q. What other assigned risk information was requested from the NCCI?

22 A. In his Interrogatory No. 1-5, the Consumer Advocate asked the NCCI for the
23 current assigned risk and the proposed voluntary loss cost for each of the five
24 largest classifications in South Carolina. Exhibit SCCA-1. The response
25 indicates that for two of the five classes, the loss costs requested in this filing are

1 actually **higher** than the assigned risk rates effective only a few months ago.
2 Exhibit SCCA-4, page 8.

3 Any workers' compensation insurance system that creates voluntary loss costs
4 higher than corresponding involuntary loss costs must be viewed with more than a
5 modicum of skepticism.

6

7 Q. How did South Carolina end up in this situation?

8 A. In its response to CA Interrogatory No. 1-13, which requested assigned risk filing
9 data, the NCCI stated:

10 Effective February 15, 2005, the South Carolina Department of Insurance
11 concluded that corrective action was necessary and ordered NCCI to
12 revise the December 1, 2001 assigned Risk Rate Level.
13

14 Exhibit SCCA-4, page 20. The result of this corrective action was an increase in
15 assigned risk rates of 32.8% effective February 15, 2005. This action represented
16 a departure from the past practice in South Carolina. Prior to this, voluntary loss
17 costs and assigned risk rates have been considered together for decades. They are
18 also considered together in other states with assigned risk plans. In the past, and
19 in other states that have workers' compensation insurance assigned risk programs,
20 there are calculations in the combined voluntary and assigned risk filings to
21 derive an appropriate assigned risk differential.

1 Q. What is the assigned risk differential?

2 A. Assigned risk experience is generally less favorable than voluntary experience. In
3 order to appropriately account for the difference in experience, an actuarial
4 calculation is necessary to determine the magnitude of the difference, and to
5 provide a differential between the voluntary and assigned risk loss costs that is
6 appropriate for the specific analysis at the specific time and for the specific filing
7 under consideration. The current South Carolina assigned risk rates, however,
8 were established separately and with no actuarial loss cost analysis.

9

10 Q. Did the NCCI provide the Consumer Advocate with loss cost data from which an
11 assigned risk differential could be calculated?

12 A. No. The NCCI responded as quoted above that “the South Carolina Department
13 of Insurance . . . ordered NCCI to revise the December 1, 2001 assigned risk rate
14 level”.

15

16 Q. How was the 32.8% assigned risk rate increase implemented?

17 A. I have substantial concerns about the way the February 15, 2005 assigned risk rate
18 increase was implemented. The process used by the Department of Insurance in
19 implementing the change produces assigned risk rates that are unfairly
20 discriminatory. Although the Consumer Advocate did not take exception to the
21 overall assigned risk rate change, he was not informed that classification
22 relativities were not to be revised. This mandate caused the rates to be unfairly

1 discriminatory in violation of South Carolina statute and in violation of Actuarial
2 Standard of Practice #12. (Exhibit SCCA-9).

3 The reason for this unusual situation, and the reason why the current assigned risk
4 rates are unfairly discriminatory, may be found in the Insurance Department notes
5 that appear on the right side of page 25 of Exhibit SCCA-3:

6 This has been an open sore for going on two years now.
7 The law states that every insurer must belong to a rating bureau,
8 but it does not say NCCI.

9
10 The law states that rates must be determined for each
11 classification.

12
13 The law states that there should be a uniform system of establish
14 (sic) rates.

15
16 The law says that DOI has authority to determine classifications.
17 The pages up to 33 indicate that all of this is broken. The system is
18 not fair and is not being enforced. That is why I do not allow
19 classification changes.

20
21 My future actions can involve the actuarial society or other
22 actions.
23

24 (Emphasis added). It is unclear how maintaining outdated class relativities
25 responds to any of the Department's concerns. In fact, the Department's
26 disallowance of classification relativity changes is not equitable, is in direct
27 violation of Actuarial Standard of Practice #12 relating to risk classifications
28 (Exhibit SCCA-9), and is in direct violation of South Carolina statutes since the
29 resulting rates are unfairly discriminatory by definition.

1 Q. What is Actuarial Standard of Practice #12?

2 A. Actuarial Standard of Practice #12, entitled Concerning Risk Classifications,
3 reads in part as follows:

4

5 Section 5. Analysis of Issues and Recommended Practices

6

7 Consistent with the *Risk Classification Statement of Principles*, there are
8 three primary purposes of risk classification:

9

- 10 1. to be fair,
11 2. to permit economic incentives to operate and thereby encourage
12 widespread availability of coverage, and
13 3. to protect the soundness of the financial security system.

14

15 In order to achieve these purposes, certain basic principles should be
16 present in any sound risk classification system:

17

- 18 1. The system should reflect cost and experience differences on the
19 basis of relevant risk characteristics.
20 2. The system should be applied objectively and consistently.
21 3. The system should be practical, cost-effective, and responsive to
22 change.
23 4. The system should minimize antiselection.

24

25 Both the design and the use of risk classification systems require the
26 actuary to exercise professional judgment as well as to use statistical tools.

27

28 5.1 Methods to Demonstrate Cost Differences – A risk classification
29 system is equitable if material differences in costs for risk
30 characteristics are appropriately reflected in the rate.
31 Classification subsidies result when the price paid by an individual
32 or class of individuals fails to reflect differences in costs among
the risk classes.

33 Exhibit SCCA-9.

1 Q. Why do you believe the currently approved assigned risk rates are unfairly
2 discriminatory?

3 A. In order to meet the requirement that rates are not unfairly discriminatory, rate
4 differentials among classifications should be supported by data that indicates
5 commensurate differences in the expected costs associated with providing
6 insurance to those classifications. The Insurance Department's disallowance of
7 classification relativity changes resulted in classification differentials that were
8 not supported by expected differences in the cost of providing insurance. The
9 NCCI was not permitted to adjust the classification relativities in accordance with
10 the underlying experience. Therefore, the current assigned risk rates are unfairly
11 discriminatory.

12
13 Q. How are employers affected by unfairly discriminatory rates?

14 A. The current disparities brought about by the Department's mandate dramatically
15 effects both voluntary and assigned risk rates. It also causes the current rates to
16 be out of sync with the rates that would be charged if the classification relativities
17 were adjusted in accordance with the experience, or as required by Actuarial
18 Standard of Practice #12 (if the classification system was equitable).

19 Insurance company actuaries analyze the loss cost experience by classification, so
20 they can alert their underwriting and marketing departments that some
21 employment classifications are under-priced and some are over-priced. With that
22 knowledge, insurance companies will tend not to write those risks they consider

1 to be under-priced. The employer, in this case, may wind up in the assigned risk
2 pool because of an inequitable classification system, not because they have had
3 any workers' compensation insurance claims.

4 On the other side of this scenario are those employers whose rates are deemed by
5 the insurance industry to be excessive. That means the approved rate is greater
6 than it would have been if the underlying classification system was equitable.
7 These employers are happily written in the voluntary market because the
8 insurance company is permitted to charge a rate that is higher than it would have
9 been if the classification system was equitable. It is interesting to note that each
10 of the two employers described above ends up paying more than they would have
11 if the classification system was equitable; one because the approved rate is
12 excessive and one because the assigned risk rate is higher than the voluntary rate.

13

14 Q. Was there information provided to determine the amount of business being
15 shifted between the voluntary and assigned risk markets?

16 A. In the Insurance Department's response to the Consumer Advocate's discovery
17 requests, there is a chart labeled *South Carolina Plan Policy Counts* and a Table
18 labeled *Plan Policy Counts*. Exhibit SCCA-3. The Chart is identified as covering
19 the period from Jan-00 to Nov-01, but appears to apply to January 2003 to
20 November 2004. Although the dates on the chart are different from the dates on
21 the table, the underlying data appear to be applicable to the same time period.

1 A footnote reads: “The Plan Assignment figures above represent the number of
2 policies in the Virginia residual market as of the month stated.” I have assumed
3 the data apply to South Carolina, and that the Virginia footnote is in error, and
4 that the data is from 2003 to 2004, and that the chart labels are in error. However,
5 the chart and the table both appear to indicate that there were no assigned risk
6 policies in South Carolina prior to May of 2003.

7 The data appear to indicate (given the cited inconsistencies, errors, and necessary
8 assumptions and adjustments) that between June 2003 and June 2004, assigned
9 risk policy counts increased by 25.21%, and this has affected both the voluntary
10 and assigned risk loss costs trends. The assigned risk market share increase in
11 South Carolina was also included in an NCCI presentation to the South Carolina
12 Workers’ Compensation Insurance Advisory Board. Exhibit SCCA-10, page 45.
13 The South Carolina assigned risk market volume was \$3.3 million in 2000.
14 According to the same document, the assigned risk market volume had grown to
15 \$55.1 million in 2004. This is a 1,600% increase in the volume in a period of four
16 years. This does not appear to support the contention that non-regulation is good
17 for consumers.

1 Q. How did you determine that the current system in South Carolina is in violation of
2 statute?

3 A. South Carolina Code Section 38-73-490 reads as follows:

4 To secure fair, reasonable, adequate, and nondiscriminatory rates for
5 workers' compensation insurance the director or his designee shall
6 approve the rate for each classification under which workers'
7 compensation insurance is written, which rate and classification must be
8 the same for all insurers. The director or his designee shall, in approving
9 the rates, make use of the experience data which may be available and any
10 other helpful information that may be obtainable. A proceeding under this
11 section is considered a proceeding to fix or alter rates for consumer
12 services in relation to the duties of the Division of Consumer Advocacy.
13
14

15 The current South Carolina workers' compensation system is in violation of
16 Section 38-73-490 in the following ways:

17 1. Current assigned risk rates are not fair.

18 According to Actuarial Standard of Practice #12 (referenced earlier in this
19 testimony, "A risk classification system is equitable if material differences
20 in costs for risk characteristics are appropriately reflected in the rate."

21 The Department's disallowance of classification differential changes
22 precludes the development of risk classification differentials that are based
23 upon material differences in risk characteristics, and therefore, the
24 assigned risk rates are not equitable.

25 2. Current assigned risk rates are not reasonable.

26 The Department's disallowance of classification differential changes is
27 not supported by actuarial data, and can not be determined to be
28 reasonable since the resulting differentials are based upon criteria that

1 were applicable to the rates that were in effect in 1999; and were not based
2 on relevant criteria for a 2005 analysis.

3 3. Current assigned risk rates are excessive for some classes.

4 The Department's disallowance of classification differential changes
5 produces rates for some classifications that are higher than the rates that
6 would have been derived using recent classification data.

7 4. Current assigned risk rates are inadequate for some classes.

8 The Department's disallowance of classification differential changes
9 produces rates for some classifications that are lower than the rates that
10 would have been derived using recent classification data.

11 5. Current assigned risk rates are unfairly discriminatory.

12 The Department's disallowance of classification differential changes
13 produces rates that are inconsistent with the expected differences in the
14 costs associated with providing workers' compensation insurance in South
15 Carolina.

16 6. Current assigned risk rates are not based on experience data.

1 Q. Who is affected by the current situation?

2 A. Studies by the Oregon Department of Consumer and Business Services indicate
3 that in 1998, South Carolina had the lowest average workers' compensation rates
4 in the nation (lowest rates of all 50 states and the District of Columbia). By 2004,
5 our comparative cost moved from its 51st position to 39th, a slippage of 12 places
6 in six short years. This economic downward slide, however, does not yet include
7 the 2004 increase of 11.4% or the 32.8% assigned risk rate increase that became
8 effective in February 2005. Exhibit SCCA-11.

9 Even with no change in these voluntary loss costs, our position will slide several
10 more places over the next few years. An additional voluntary loss cost increase of
11 32.9% would place South Carolina at or near 22nd place, and our costs will have
12 moved from being well below North Carolina, Georgia, Mississippi, Tennessee,
13 Virginia and dozens of other states to being above them in less than a decade.
14 The negative effects are and will continue to be appreciable as South Carolina
15 tries to attract and keep employers, as businesses struggle to stay afloat, and as
16 unemployment rates and the cost of goods and services increase. It is imperative
17 to our future economic well being that the current dysfunctional workers'
18 compensation system in South Carolina be corrected, and that future decisions
19 regarding workers' compensation insurance in South Carolina be initiated only
20 after an appropriate review of all relevant and available material.

ACTUARIAL ANALYSIS

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Q. Are you able to provide your recommendation for the indicated change in the South Carolina workers' compensation voluntary loss costs at this time?

A. As stated earlier in this testimony, there are grave concerns regarding the accuracy of the data used in the filing as well as the South Carolina workers' compensation system. I am, however, concerned that corrective action is necessary to solve the underlying problems and inconsistencies in the system as expeditiously as is practical in order to maintain a viable workers' compensation marketplace in the State. Therefore, the methods used to produce an indicated change are provided as a step toward fixing those problems.

Q. When describing your initial review of the voluntary loss cost filing, what did you mean by different methods and data types?

A. The filing uses policy year data which separates data by the year the policy was written. This requires a longer time for initial claim data to become available than accident year data where claims are sorted by the year of the accident. Initial accident year data is available sooner, allowing the use of more recent initial claim experience if it is appropriate to do so.

Another difference is in the type of historical claim data used. The NCCI uses both paid and paid-plus-case loss data. Paid data is based almost solely on claim

1 payments, while paid-plus-case data is based on the paid claims plus the reserve
2 estimates established by insurers.

3 Still another difference is the time period of the historical data used. The filing
4 uses policy years 2002 and 2003. The data requested by the Consumer Advocate
5 from NCCI also uses accident years 2003 and 2004.

6

7 Q. What specific data types did the Consumer Advocate ask NCCI to provide?

8 A. The NCCI was asked to provide experience on both a “paid” and “paid-plus-case”
9 basis for the two most recent policy years and the two most recent accident years
10 using 8-year exponential trend calculations. The Consumer Advocate has
11 historically requested this information from the NCCI in South Carolina. I have
12 traditionally requested this information from the NCCI in South Carolina as well
13 as in other states in which I have provided an analysis of an NCCI loss cost or
14 rate filing.

15

16 Q. Which types are most appropriate to use in this proceeding?

17 A. On Page 62 of “State of the Line – Analysis of Workers’ Compensation Results”,
18 (Exhibit SCCA-12) NCCI states the industry is “making progress on reserve
19 deficiency”. Page 33 indicates workers’ compensation reserves were
20 strengthened by \$9 billion between 2001 and 2004. Paid-plus-case data is
21 directly influenced by insurance industry reserve practices. Changes in reserves
22 directly impact the paid-plus-case data and cause significant changes in the

1 underlying development of workers' compensation insurance claims and in the
2 loss cost trends over time. When reserves are so substantially strengthened
3 during the period used in the filing calculations, the paid-plus-case data and the
4 resulting indicated loss costs are distorted. Changes in reserve strengthening
5 would have a minimal impact on paid loss data. Therefore, paid experience is
6 preferable in this case.

7
8 Q. Will you describe the indicated changes provided by the NCCI in response to the
9 Consumer Advocate?

10 A. The paid indications provided by the NCCI indicate the following:

- 11 (1) The indicated change provided by the NCCI using paid data varies
12 from +10.1 to +31.1%.
13
14 (2) In every case, the most recent experience indication is substantially
15 more favorable than the corresponding earlier indication.
16
17 (a) Policy year 2003 indications are more favorable than policy
18 year 2002 indications.
19
20 (b) Accident year 2004 indications are more favorable than
21 accident year 2003 indications.
22
23 (c) The experience of the most recent accident years is more
24 favorable than the most recent policy years.
25
26 (3) Each paid loss indication is substantially lower than the increase
27 requested in the filing.
28
29 (4) The average of the most recent policy and accident year credibility
30 weighted (with NCCI "countrywide") paid loss calculations
31 produces an indicated change of +10.6% (average of +10.1% and
32 +11.1%).

- 1 (5) The average of the most recent policy year and accident year South
2 Carolina only paid loss calculations produces an indicated change
3 of +12.25% (average of +12.1% and +12.4%).
4
- 5 (6) The South Carolina only experience indications are less favorable
6 than the weighted South Carolina and countrywide experience
7 indication.
8

9

10 Q. Is it unusual that the South Carolina data produce a higher increase than the South
11 Carolina data weighted with countrywide data?

12 A. Previously, South Carolina only trend data have been more favorable than those
13 which included countrywide experience.

14

15 Q. Were individual loss ratios provided to you by the NCCI?

16 A. In Exhibit 1-D of Exhibit SCCA-4, the NCCI provides the loss ratios used in the
17 trend calculations. As requested, the calculations are based on 8-year exponential
18 trends. This means that the trend is developed in consideration of the percentage
19 change in the loss ratio over the 8-year period being analyzed. At this time,
20 however, these trends may be hiding recent improvements.

21

22 Q. How did you determine that the trends may be hiding recent improvements?

23 A. Table S-1 presents the trend factors based directly on South Carolina historical
24 trends since the year 2000.

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TABLE S-1
ANNUAL W.C. LOSS COST TRENDS

Paid South Carolina Data

	indemnity	medical
8 year exponential trend	+1.2%	+3.8%
Since the year 2000	-6.1%	+0.7%

In each case, the trend factor calculated from the year 2000 forward is substantially more favorable than the 8-year exponential factor provided in response to the Consumer Advocates request to produce them.

Table S-2 presents the indications if the exponential trend, the trend since the year 2000, and the average of the two were used to calculate the indications. The underlying calculations may be found at the end of this testimony in Appendix 1, Parts 1 through 4.

Table S-2
South Carolina Indicated Voluntary Loss Cost Experience Change

		Various Trend Calculation Methods			
		(1)	(2)	(3)	(4)
		NCCI	8 yr exp	average	since 2000
a)	policy year 2002	+38.6%	+31.2%	+18.6%	+7.2%
b)	policy year 2003	+26.2%	+12.1%	+4.2%	-3.3%
c)	accident year 2003	n/a	+21.3%	+11.5%	+2.5%
d)	accident year 2004	n/a	+12.5%	+8.5%	+2.3%
	average	+32.4%	+19.3%	+10.7%	+2.2%

1 The indicated experience change based on the South Carolina trends since the
2 year 2000 ranges from a **decrease** of 3.3% to an increase of 7.2%.

3

4 Q. Why is it of interest that the most recent indication is substantially more favorable
5 than the earlier indication and that the indication using recent South Carolina
6 trends is so much more favorable than the methods used by NCCI in the filing?

7 A. It is illogical that trends would be improving so rapidly if experience was
8 deteriorating at such a pace that an increase of 32.9% is needed from loss costs
9 that were approved only a year ago, especially in light of NCCI's filed increase of
10 +17.6% in 2004 and their agreement that an increase of +11.4% was appropriate
11 such a short period of time ago.

12

13 Q. What factors did you consider in arriving at your indicated change for South
14 Carolina voluntary workers' compensation loss costs in this proceeding?

15 A. My indicated change is based on the following criteria:

16 (1) The method produces a fair estimate of insurance industry needs, taking
17 into account the tremendous amount of data reporting errors.

18

19 (2) The indicated change is fair to employer-policyholders.

20

21 (3) The change is based on paid loss data which is least affected by reserving
22 practices and is least subject to insurer mistakes.

23

24 (4) The indicated change is close to neither the high nor the low end in the
25 range of paid loss indications.

26

27 (5) The filed indications are not considered due to the factors described.

1 (6) The indicated change is calculated from recent data to account for the
2 extremely favorable trends in South Carolina since the year 2000, as
3 shown in the data we have been provided.
4

5 Q. What is your recommendation for South Carolina voluntary workers'
6 compensation loss costs in this proceeding?

7 A. In light of the numerous errors, inconsistencies, and other factors described in this
8 testimony, it is not definitively possible to arrive at an indicated change that can
9 be actuarially demonstrated not to be excessive, inadequate or unfairly
10 discriminatory. I am, however, acutely aware of the troubled state of the workers'
11 compensation insurance market in South Carolina today. Recommending no
12 increase in rates at this point could make things even worse. Therefore, to avoid
13 any further deterioration in the market, I will make a recommendation based on
14 the data which I have been able to review.

15 Based on my review, the filed increase of 32.9% is excessive. My recommended
16 change is calculated from an equal weight of the most recent policy year and
17 accident year of South Carolina paid loss indications based upon 8-year
18 exponential trends.

19 Paid Loss Experience Indications:

20 Policy year 2003 experience indication = +12.1%

21 Accident year 2004 experience indication = +12.4%

22 INDICATED EXPERIENCE CHANGE = +12.25%

1 To the above, a factor is included in the filing to account for a change in loss
2 adjustment expenses that the Consumer Advocate does not dispute, and is
3 estimated to be an increase of 4/10 of 1%.

4 Therefore, my recommended change for loss costs in this proceeding is +12.7%
5 (1.1225 x 1.004 = 1.127).

6 Loss costs applicable to “F” classes (governed by federal laws) should be reduced
7 by 5.0%. NCCI indicated “F” class change using paid loss data (Exhibit SCCA-4,
8 page 3).

9 Additionally, I believe it is imperative that measures be taken immediately to
10 improve the quality of data provided to NCCI, so that the next review of loss
11 costs will allow for a proper and full actuarial analysis.

ASSIGNED RISK

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Q. Historically, how were assigned risk rates established in South Carolina?

A. Historically, assigned risk rates were established in conjunction with the voluntary loss costs. The indicated loss cost change was historically calculated from the data for voluntary and assigned risk business. Through the analysis of actuarial loss cost data, an assigned risk differential was calculated to account for the difference in the underlying experience from the assigned risk to the voluntary business.

For example, during the 2001 hearing, the NCCI testified that it had performed the actuarial loss cost analysis on the underlying data at that time in South Carolina, and that it had determined through that analysis that the then current assigned risk differential of forty percent was appropriate. The Consumer Advocate had no objection, based on the underlying South Carolina experience at that time.

Once the assigned risk differential is determined, then the final assigned risk rates are calculated by applying a factor to the approved loss costs to account for both the differential (loss experience) and the expenses associated with the assigned risk pool (loss cost multiplier).

The final assigned risk rate, appropriately developed in this manner, is calculated using a rate of return on equity analysis, to arrive at rates that are not excessive, inadequate or unfairly discriminatory.

1 Q. Who was the plan administrator during the experience period of the data used in
2 the filing (2002 and 2003)?

3 A. It appears as though the NCCI was the plan administrator up until April 30, 2000.
4 It also appears as though the NCCI was also plan administrator after May 1,
5 2003. (Exhibit SCCA-8, response 4).
6

7 Q. Who was the plan administrator during the period when the NCCI was not?

8 A. The Consumer Advocate has been unable to clearly determine who performed the
9 functions of the plan administrator. According to testimony of Mr. Dean Kruger
10 of the Department of Insurance as recorded in the transcript of the 2001 South
11 Carolina workers' compensation voluntary and assigned risk filing 00-ALJ-09-
12 0687-CC (Exhibit SCCA-13 page 112):

13 Under this approach we adopted in May of '99, we have two servicing
14 carriers, we still have NCCI's plan administrator (sic). It was done under a
15 bid process run by the Department.
16

17 Q. Was the Consumer Advocate able to obtain the data necessary to perform an
18 actuarial analysis on the assigned risk data?

19 A. When the South Carolina workers' compensation assigned risk plan
20 administration was revised, the responsibility for collecting assigned risk
21 ratemaking data was apparently eliminated from the NCCI's duties.
22 Unfortunately, the process neglected to assign the data collection duties to any
23 other entity. Hence, at this time, there are no actuarial loss cost data for South
24 Carolina assigned risk business for the policy years and accident years necessary

1 to properly determine loss costs that are not excessive, inadequate or unfairly
2 discriminatory in compliance with South Carolina statute.

3

4 Q. Did the Consumer Advocate attempt to obtain this information?

5 A. Yes. The Consumer Advocate requested the information from the NCCI, the
6 Department of Insurance and from Companion through discovery requests in this
7 case. (Exhibit SCCA-1).

8

9 Q. Was the information provided?

10 A. No. (See Exhibits SCCA-7, SCCA-8 and SCCA-14).

11

12 Q. Why is that important in these proceedings?

13 A. This is of great importance due to the substantial growth in the assigned risk
14 market since the last actuarial analysis in 2001. As described earlier, the assigned
15 risk market in South Carolina grew by 1,600 % over the period from 2000 to
16 2004. According to the NCCI, 73% of assigned risk policies are under \$2,500 in
17 annual premium. (Exhibit -10, page 47). Much of the increase in assigned risk
18 business is due to an increase in the percentage of smaller policies in the assigned
19 risk pool. The increased assigned risk market share appears to include an
20 increased number of policies; not necessarily only an increase in policies with
21 adverse experience, but also an increase in policies that are smaller than those
22 desired by the insurance industry, even if they did not have bad experience.

1 Therefore, the differential that had been agreed to by all parties in the 2001 loss
2 cost and rate hearing is no longer valid, and must be recalculated using recent
3 actuarial experience. Since no entity was responsible for maintaining South
4 Carolina workers' compensation insurance assigned risk actuarial loss cost data, a
5 proper actuarial analysis cannot be performed at this time.

6

7 Q. Are you aware of the Corrective Action Order issued by the Department of
8 Insurance in October of 2005?

9 A. Yes.

10

11 Q. Was the process used by the Department of Insurance in its corrective action
12 order in October of 2005 appropriate to determine assigned risk rates that are not
13 excessive, inadequate or unfairly discriminatory?

14 A. No. According to the Insurance Department's response to the Consumer
15 Advocate, dated January 9, 2006, the Department does not incorporate a target
16 rate of return analysis in its statutory duty to ensure that assigned risk rates are not
17 excessive or inadequate. (Exhibit SCCA-7).

18 According to the Insurance Department:

19 The National Council on Compensation Insurance functions as plan
20 administrator for the South Carolina assigned risk plan. As plan
21 administrator, NCCI handles the competitive bid process for the selection
22 of servicing carriers, subject to the approval of the South Carolina
23 Department of Insurance.

24

1 Also included in the Department's response is the following:

2 The target return on equity is irrelevant to the servicing carrier selection
3 process or the assigned risk plan.
4

5 Q. Do you agree that a target rate of return analysis is irrelevant?

6 A. No. I do not believe approval can be appropriately afforded without a rate of
7 return analysis. It appears as though the industry is permitted to charge excessive
8 assigned risk rates if the plan administrator (the majority of whose Board of
9 Directors, according to the NCCI web site, is composed of insurance industry
10 executives) says that it's okay to do so. The potential additional cost to South
11 Carolina employers from the failure to determine that assigned risk rates are not
12 excessive, inadequate or unfairly discriminatory, is extremely high.

13

14 Q. How was this process handled when you were the Deputy Director at the
15 Department of Insurance?

16 A. During my twelve year tenure with the South Carolina Department of Insurance,
17 each and every assigned risk filing was analyzed using a target rate of return on
18 equity analysis to determine that approved assigned risk rates in South Carolina
19 were not excessive, inadequate or unfairly discriminatory. The Consumer
20 Advocate intervened in each of those proceedings, and information requested
21 through interrogatories was exchanged in an expeditious process. This was a
22 major reason why South Carolina had the lowest rates in the nation. South

1 Carolina employers ended up paying hundreds of millions of dollars less than
2 they would have paid in the absence of these rate of return analyses.

3

4 Q. What are your recommendations regarding the assigned risk rates that should be
5 approved in this proceeding?

6 A. Since there has been no entity responsible for producing assigned risk actuarial
7 loss cost statistics for the experience period, it is not possible to properly produce
8 an actuarial calculation of the assigned risk differential to derive assigned risk
9 indicated loss costs at this time. The South Carolina Department of Insurance
10 should initiate direction to an appropriate entity to provide the actuarial loss cost
11 statistics necessary for an appropriate actuarial analysis. Until such information is
12 available, an appropriate actuarial analysis cannot be performed, and an actuary is
13 unable to produce recommended assigned risk rates that can be demonstrated to
14 meet the South Carolina statutory requirement that the final rate not be excessive,
15 inadequate or unfairly discriminatory.

16

17 Q. Did the Department of Insurance have the appropriate data when it issued its
18 Corrective Action order on October 10, 2005?

19 A. No. In its response to the CA Interrogatory No. 2-2, the Department of Insurance
20 states the following:

21 . . . the Department did not “use” any calculations in its corrective action
22 order of October 10, 2005. The Department issued the corrective action
23 order dated October 10, 2005 based on the its (sic) conclusion that (1) the
24 current assigned risk loss cost differential is reasonable.

25

26 Exhibit SCCA-7, page 5.

1 This response is quite confusing since there is no “current assigned risk loss cost
2 differential” and there was no “current assigned risk loss cost differential” in
3 existence when the Department’s corrective action order was issued. The
4 assigned risk loss cost differential was eliminated by the Department of Insurance
5 in its directive to implement the February 15, 2005 assigned risk rate increase,
6 and to disallow classification relativity changes at that time.

7 The Department also states in Exhibit SCCA-7:

8 Further, under the Workers’ Compensation Insurance Plan, the servicing
9 carriers report their experience on business written under the Plan to
10 NCCI, not to the Department.
11
12

13 The Department does not explain how it determined an appropriate assigned risk
14 rate without being provided the most basic information to determine how much
15 South Carolina policyholders are being charged for insurance company expenses.
16

17 Q. What is your recommendation regarding the assigned risk rate that should be
18 implemented following this proceeding?

19 A. In virtually all cases in which I have been involved, in South Carolina as well as
20 in other jurisdictions, I have provided an actuarial analysis of the appropriate
21 underlying data, and have provided a recommended loss cost multiplier, assigned
22 risk differential and corresponding assigned risk rate level. As I stated earlier,
23 however, the underlying data necessary to produce an actuarially acceptable
24 assigned risk rate level are not available in South Carolina at this time.
25

1 Q. Does this conclude your testimony?

2 A. Yes, for now. I reserve the right to supplement my testimony if I receive further
3 or updated information.

APPENDIX 1**Recalculation of indicated changes****Part 1 - paid loss data for policy year 2002**

		NCCI		
		8 yr exp.	since 2000	average
	Indemnity trend factor	1.012	0.939	0.976
9	adjusted ind cost ratio exc trend	0.623	0.623	0.623
10	factor to reflect indemnity trend	1.047	0.784	0.908
11	factor to adj to unlimited basis	1.022	1.022	1.022
12	factor for change in ind pmts	1.009	1.009	1.009
13	adjusted ind cost ratio	0.672	0.503	0.584
	medical trend factor	1.038	1.007	1.023
18	adjusted med cost ratio exc trend	0.541	0.541	0.541
19	factor to reflect medical trend	1.155	1.027	1.090
20	factor to adj to unlimited basis	1.022	1.022	1.022
21	factor for change in med pmts	1.000	1.000	1.000
22	adjusted med cost ratio	0.639	0.568	0.603
23	total ind + med cost ratio	1.311	1.072	1.186

APPENDIX 1**Recalculation of indicated changes****Part 2 - paid loss data for policy year 2003**

		NCCI		
		8 yr exp.	since 2000	average
	Indemnity trend factor	1.012	0.939	0.976
9	adjusted ind cost ratio exc trend	0.514	0.514	0.514
10	factor to reflect indemnity trend	1.035	0.835	0.931
11	factor to adj to unlimited basis	1.022	1.022	1.022
12	factor for change in ind pmts	1.009	1.009	1.009
13	adjusted ind cost ratio	0.549	0.442	0.494
	medical trend factor	1.038	1.007	1.023
18	adjusted med cost ratio exc trend	0.503	0.503	0.503
19	factor to reflect medical trend	1.113	1.020	1.066
20	factor to adj to unlimited basis	1.022	1.022	1.022
21	factor for change in med pmts	1.000	1.000	1.000
22	adjusted med cost ratio	0.572	0.524	0.548
23	total ind + med cost ratio	1.121	0.967	1.042

APPENDIX 1**Recalculation of indicated changes****Part 3 - paid loss data for accident year 2003**

		NCCI		
		8 yr exp.	since 2000	average
	Indemnity trend factor	1.012	0.939	0.976
9	adjusted ind cost ratio exc trend	0.558	0.558	0.558
10	factor to reflect indemnity trend	1.040	0.814	0.922
11	factor to adj to unlimited basis	1.022	1.022	1.022
12	factor for change in ind pmts	1.009	1.009	1.009
13	adjusted ind cost ratio	0.598	0.468	0.531
	medical trend factor	1.038	1.007	1.023
18	adjusted med cost ratio exc trend	0.532	0.532	0.532
19	factor to reflect medical trend	1.130	1.023	1.075
20	factor to adj to unlimited basis	1.022	1.022	1.022
21	factor for change in med pmts	1.000	1.000	1.000
22	adjusted med cost ratio	0.614	0.556	0.585
23	total ind + med cost ratio	1.212	1.025	1.115

APPENDIX**Recalculation of indicated changes****Part 4 – paid loss data for accident year 2004**

		NCCI		
		8 yr exp.	Since 2000	average
	Indemnity trend factor	1.012	0.939	0.976
9	adjusted ind cost ratio exc trend	0.526	0.526	0.526
10	factor to reflect indemnity trend	1.027	0.867	0.945
11	factor to adj to unlimited basis	1.022	1.022	1.022
12	factor for change in ind pmts	1.009	1.009	1.009
13	adjusted ind cost ratio	0.557	0.470	0.513
	medical trend factor	1.038	1.007	1.023
18	adjusted med cost ratio exc trend	0.510	0.532	0.532
19	factor to reflect medical trend	1.088	1.016	1.052
20	factor to adj to unlimited basis	1.022	1.022	1.022
21	factor for change in med pmts	1.000	1.000	1.000
22	adjusted med cost ratio	0.567	0.552	0.572
23	total ind + med cost ratio	1.125	1.023	1.085

APPENDIX 2

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EXPERIENCE AND BACKGROUND

(6/86 to present) Sole Proprietor: Martin M. Simons, Public Actuarial Consultant

Clients:

1. Hawaii Insurance Division (1986-present)
 - a. Actuarial consulting
 - b. Review of property and casualty insurance rates
 - c. Economic analyses and rate of return calculations
 - d. Department staff training
 - e. Development of review process for hurricane models
 - f. Review hurricane models used for producing loss costs
 - g. Provide expertise to Governor and Legislature
 - h. Development and analysis of legislation
 - i. Self Insurance actuarial analyses
 - j. Assist financial examiners
 - k. Expert testimony at public hearings
 - l. Market conduct examiner

2. Florida Commission on Hurricane Loss Projection Methodology (1997-present)
 - a. Actuarial analysis of hurricane models
 - b. Lead Actuary – FCHLPM Professional Team
 - c. On site review of hurricane models
 - d. Participation at all commission and committee meetings
3. Oklahoma Attorney General (1987-present)
 - a. Workers' Compensation rates and Loss Costs
 - b. Economic analyses and rate of return calculations
 - c. Analysis of State Workers' Compensation Fund
 - d. Expert testimony at public hearings
4. Florida State University (2004-2005)
 - a. Sinkhole Insurance Study
 - b. Data analysis and aggregation
 - c. Loss cost and trend production
5. South Carolina Department of Consumer Affairs (1997 - present)
 - a. Property/casualty insurance rate filing analyses
 - b. Workers' Compensation analyses
 - c. Economic analyses and rate of return calculations
 - d. Public utility hearings - insurance related expertise
 - e. Expert testimony at public hearings and Legislature

6. California Earthquake Authority (2004 – present)
 - a. Member - Actuarial Modeling Assumptions Working Group
 - b. Member - Financial Alternatives Working Group
7. Georgia Subsequent Injury Trust Fund (2004 – 2005)
 - a. Liability and Runoff Analysis
 - b. Actuarial consulting
8. Hawaii Hurricane Relief Fund (1993 - 2002)
 - a. Involvement from prior to Fund start-up to planned termination
 - b. Member of Technical Advisory Committee
9. Independent Insurance Agents & Brokers of Greater Charleston S.C.
 - a. Consultation regarding creation of a public hurricane Insurer
10. South Carolina Uninsured Employers Fund (1990 - present)
 - a. Financial and reserve analyses
 - b. Technical and actuarial assistance
11. South Carolina Second Injury Fund (1995 – present)
 - a. Liability analysis
 - b. Legislative testimony
 - c. Technical and actuarial assistance
12. SC Medical Malpractice Patients' Compensation Fund (1986-1999)
 - a. Rates, reserves and funding level analyses

13. American Academy of Actuaries (current - pro bono)
 - a. Member of AAA Extreme Events Committee
 - b. Member of Actuarial Standard of Practice #38 Task Force
 - c. Member of Actuarial Standards Board Review Committee

14. Other Clients (1986-present)
 - a. ABC News NIGHTLINE
 - b. New Mexico Insurance Department
 - c. Colorado Workers' Compensation Education Association
 - d. Hawaii Department of Commerce and Consumer Affairs
 - e. Illinois Insurance Department
 - f. North Dakota Insurance Department
 - g. Minnesota Insurance Department
 - h. Arkansas Insurance Department
 - i. Self Insured Employers' Association of SC
 - j. Hawaii Department of Labor
 - k. Georgia Insurance Department
 - l. Delaware Insurance Department
 - m. Louisiana Association of Business & Industry
 - n. Manitoba Personal Injury Protection Plan Review Commission

- o. Dodge, Fazio, Anderson & Jones
- p. Reimbursement Consultants, Inc.
- q. Schiff, Harden & Waite – State Farm Mutual Automobile Ins. Co.

National Association of Insurance Commissioners (1985 – 1997)

- a. Exercised South Carolina voting rights at plenary sessions
- b. Chair: Property/Casualty Advisory Org. Loss Cost Working Group
- c. Chair: Workers' Comp. Advisory Org. Loss Cost Working Group
- d. NAIC Liaison with Advisory Organizations
- e. Chair: Profitability Report Working Group
- f. Chair: Insurance Expense Exhibit Working Group
- g. Chair/Member: Catastrophe Insurance Working Group
- h. Member: Liability Closed Claim Study Working Group
- i. Member: Personal Lines (C) Committee
- j. Member: Commercial Lines (D) Committee
- k. Member: Statistical Task Force
- l. Advisor to NAIC Executive Committee
- m. Member: Data Quality Working Group
- n. Chair: Commercial GL and Hold Harmless Agreement Work Groups
- o. Member: Consumer Information Working Group

Employment History:

South Carolina Department of Insurance (1985-1997)

Deputy Director - Actuarial Services & Chief Actuary

1. Management of Property and Casualty Insurance Division
2. Management of Life, Accident and Health Division
3. Management of State Rating and Statistical Division
4. Approval of property and casualty forms, rates and rules
5. Economic and rate of return analyses
6. Expert testimony
7. Analysis of property and casualty financial exhibits
8. Expertise to Governor, Legislature, and Insurance Director
9. Service on Applications Committee for new insurers

(Prior to June 1985) :

Unigard Insurance Group (1968 to 1984)

- a. Branch Manager – Fresno California (1983 - 1984)
- b. Marketing Services Manager (1978-1983)
- c. Manager of Corporate Control and Analysis Dept. (1975 - 1978)
- d. Assistant/Associate Actuary (1968-1975)
- e. Elected President of Unigard Employees Fed. Credit Union (1975-1980)

State Farm Fire and Casualty Insurance Co. (1966-1967)

Professional Designations:

1. Member: American Academy of Actuaries (MAAA)
2. Associate: Casualty Actuarial Society (ACAS)
3. Fellow: Conference of Consulting Actuaries (FCA)

Author:

1. Simons, Martin M., *Analysis of Liabilities and Estimate of Future Liabilities and Assessments of the South Carolina Second Injury Fund as of June 30, 2005, Calculated as of November 29, 2005*, South Carolina Second Injury Fund, January, 2006
2. Simons, Martin M., *Analysis of Liabilities of the Georgia Subsequent Injury Trust Fund*, in response to HB 1579, of the 2004 Georgia legislative session, 2005.
3. Simons, Martin M. et al, *Insurance Study of Sinkholes*, Florida State University, submitted to the Florida Legislature, April 2005
4. Cohn, Richard A., Goldberg, Steve, and Simons, Martin M., *Report of The Financial Alternatives Work Group to the California Earthquake Authority*, January 6, 2005.
5. Schmidt, J. P., and Simons, Martin M., *Catastrophe Modeling, the Regulator's Perspective*, Risk Management Magazine, August 2004.
6. Watson, Charles C., Johnson, Mark E. and Simons, Martin M., *Insurance Rate Filings and Hurricane Loss Estimation Models*, Journal of Insurance Regulation, NAIC, April 2004.

7. Simons, Martin M., *Analysis of Liabilities of the South Carolina Second Injury Fund As of June 30 2002, Calculated as of March 5, 2003*, South Carolina Second Injury Fund, 2003.
8. Simons, Martin M., *The Property & Casualty Insurance Environment in Hawaii, An Overview*, Prepared for the Hawaii Insurance Division, February 2003.
9. Simons, Martin M., *Actuarial Analysis of the Utilization and Rate Impacts of Reinstating Naturopathy Among the Personal Injury Protection Benefits in Motor Vehicle Insurance*. Pursuant to HCR 131, 2002, REQ. and adopted by the Legislature of the State of Hawaii, December 2002.
10. Simons, Martin M., *Inside the Black Box*, Best's Review, August, 2002
11. Simons, Martin M., et al, *Report to the Hawaii Legislature on the Feasibility of a Wind Resistive Device Grant Program*, December 13, 2001
12. Simons, Martin M., *Taking the Next Step in Hurricane Modeling*, Best's Review, May, 1997
13. Simons, Martin M., *In Defense of Rate Regulators*, Best's Review, Property and Casualty Edition, June 1992
14. Klein, Robert W., Eley, David F. and Simons, Martin M., *NAIC Report on Profitability - By Line By State*, The Interpreter, Insurance Accounting & Systems Association, December 1991

15. Simons, Martin M., *Rate Regulation Revisited* - Best's Review, Property and Casualty Edition, July 1989
16. Simons, Martin M., *Federal Oversight – The Wrong Answer*, Best's Review, Property and Casualty Edition, November 1988
17. Simons, Martin M., *Managing for Consistency*, Best's Review, Property and Casualty Edition, January 1987
18. Simons, Martin M., *Looking Inside the Statistics*, Best's Review, Property and Casualty Edition, May 1986

Education and miscellaneous:

1. Bachelor of Arts degree in Mathematics
From Washburn University - Topeka Kansas
2. Served in United States Air Force (1959-1963)
Honorable Discharge