



Florida Workers Compensation Joint Underwriting Association, Inc.

P.O. Box 48957, Sarasota, FL 34230-5957
• Tel (941) 378-7400 • Fax (941) 378-7405 • www.fwcjua.com

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MANAGEMENT'S DISCUSSION AND ANALYSIS – 2016

1. OBJECTIVE & BACKGROUND

This discussion provides an assessment by management of the current financial position, results of operations, cash flow and liquidity, and changes in financial position for the Florida Workers' Compensation Joint Underwriting Association, Inc. (FWCJUA). Information presented in this discussion supplements the financial statements, schedules and exhibits in the 2016 Annual Statement.

The FWCJUA is a single-line insurer underwriting workers' compensation and employer's liability coverage in Florida with Net Premiums Earned of \$27,412,424 for the year ended December 31, 2016.

In December 1993, the FWCJUA was formed as a Florida Corporation Not for Profit for the purpose of organizing, operating, and administering a workers' compensation joint underwriting plan, pursuant to section 627.311(5), Florida Statutes, as amended by Chapter 93-415, Laws of Florida, and as that section may be amended from time to time, and for such purposes as may be incidental thereto. On January 1, 1994, the FWCJUA began providing workers' compensation and employer's liability insurance to applicants who are required by law to maintain workers' compensation and employer's liability insurance and who are in good faith entitled to, but who are unable to, purchase such insurance through the voluntary market, and to collect premiums and assessments from its policyholders in order to satisfy the obligations of the Corporation. Further, the operation of the FWCJUA is subject to the supervision of a 9-member Board of Governors appointed by the Financial Services Commission and comprised of two representatives of the twenty largest domestic insurers, two representatives of the twenty largest foreign insurers, one representative of the state's largest property and casualty agents' association, the consumer advocate appointed under section 627.0613, Florida Statutes, and three other persons appointed by the Financial Services Commission.

2. FINANCIAL POSITION

The FWCJUA's statutory financial position at December 31 was as follows:

	2016	2015
ASSETS		
Bonds	\$111,132,066	\$100,994,078
Cash & Short Term Investments	8,105,250	8,093,139
Premium Receivable	11,091,027	6,025,279
Other Assets	970,082	1,565,253
Total Assets	\$131,298,425	\$116,677,749
LIABILITIES		
Unpaid Losses & DCC Expense	\$26,016,945	\$21,238,328
Retroactive Reinsurance	(1,165,279)	(1,220,135)
Unpaid A&O Expense	2,300,000	1,900,000
Unearned Premium	16,102,614	12,847,095
Accrued Commissions & Servicing Carrier Fee	2,220,969	1,448,508
Other Liabilities	6,034,216	5,177,223
Total Liabilities	\$51,509,465	\$41,391,019
SURPLUS	\$79,788,960	\$75,286,730

Assets:

Total Assets increased by 13% from \$116,677,749 in 2015 to \$131,298,425 in 2016, a \$14,620,676 change.

This was primarily the result of Cash and Invested Assets increasing by \$10,150,099 from \$109,087,217 in 2015 to \$119,237,316 in 2016. This was due to a combination of positive cash flow from operations and investment income of approximately \$10.7 million and a reduction in book value of securities due to amortization of premium and discounts paid for securities of \$0.7 million.

Cash and short-term investments remained relatively consistent during 2016 close to targeted balances. Investment maturities and positive operating cash flow generated from operations were reinvested and invested timely. The FWCJUA bond portfolio is comprised of a combination of Government and Agency bonds, corporate bonds, taxable municipal bonds, mortgage backed securities and Certificates of Deposit (all of which are either investment grade or better at time of purchase, or FDIC insured deposits in the case of Certificates of Deposit) with a maximum duration of fifteen years.

Premium Receivable Balances increased from \$6,025,279 in 2015 to \$11,091,027 in 2016. This increase is largely the result of increased premium writings in 2016 versus 2015. The FWCJUA does not anticipate any changes in collection activity with respect to the December 31, 2016 premium receivable balances other than those recognized as non-admitted assets.

Non-Admitted Assets changed from \$765,036 in 2015 to \$570,011 in 2016, a decrease of \$195,025. This 25% change in Non-Admitted Assets is primarily the result of a decrease in the greater than 90-day past due premium receivable.

Liabilities:

Loss and Loss Adjustment Expense (LAE) Reserves are stated at the company's estimate of the ultimate cost of settling all unpaid incurred claims, net of ceded reinsurance. Loss and LAE Reserves are not discounted for the time value of money.

Activity with respect to Unpaid Losses and LAE for the last two years is displayed below:

LOSS AND LAE RESERVE SUMMARY	2016	2015
Unpaid Losses and LAE at Beginning of Year	\$23,138,326	\$23,958,762
Losses and LAE Incurred In Current Year		
For current year Losses and LAE	\$18,167,021	\$14,258,560
For prior year Losses and LAE Expense	(434,062)	(5,142,618)
YTD Incurred Loss & LAE	\$17,732,959	\$9,115,942
YTD Losses and LAE Paid		
For current year Losses and LAE	\$6,329,973	\$4,960,375
For prior year Losses and LAE	6,224,367	4,796,003
YTD Paid Losses and LAE	\$12,554,340	\$9,936,378
UNPAID LOSSES AND LAE AT END OF YEAR	\$28,316,945	\$23,138,326

As indicated above, Loss and LAE Reserves increased by 22% or \$5,178,619 from 2015 to 2016. Although prior accident year ultimate incurred loss and LAE estimates have been reduced by \$434,062 during 2016, the amount of this favorable development was mitigated by the adverse impact of revising estimates to include approximately \$900,000 in additional liabilities anticipated as a result of recent Florida Supreme Court rulings relative to attorney fees and certain injured worker benefits. However, current accident year incurred losses have increased \$3.9 million, or 27% over the prior accident year due to increased net earned premium, which increased 12% for the same period and a higher anticipated loss ratio for the current

accident year. The higher loss ratio is due in part to those findings of the Florida Supreme Court. Paid losses and LAE for the current accident year are higher than the prior year, an expected result due to reasons similar to incurred losses for the current accident year.

Further, the risk factors of the policies that the FWCJUA writes expose the reserve estimates to significant variability. The major risk factors have been identified as unanticipated trend, changes in payment patterns and changes in laws, judicial interpretations, the residual market function with a short history and a constantly changing mix of risks, and other economic and social factors affecting workers' compensation costs.

The FWCJUA's Statement of Actuarial Opinion for the Year-Ended December 31, 2016, as prepared by Milliman Inc. opines that carried reserves meet the requirements of the insurance laws of Florida; are consistent with the reserves computed in accordance with the Standards of Practice issued by the Actuarial Standards Board; and make a reasonable provision for all unpaid loss and loss expense obligations of the FWCJUA.

The FWCJUA has purchased excess of loss reinsurance throughout its history. Such reinsurance reduces the amount for which the FWCJUA records its liability for unpaid losses and LAE. In earlier years, the FWCJUA's retention on such reinsurance was \$250,000-\$500,000 per claim and in more recent years has been \$1 million. In 2015, the FWCJUA had a 50% participation in the \$1 million excess \$1 million layer and in 2016 a 27.5% participation with a \$350,000 annual aggregate deductible in the \$1 million excess \$1 million layer. As of December 31, 2016, \$58,343 was recoverable from reinsurers on paid losses and loss adjustment expenses and \$13,083,560 recoverable on unpaid losses and loss adjustment expenses (\$4,920,439 on case reserves, \$8,163,121 on IBNR reserves). As of the end of the prior year, \$52,466 was recoverable on paid losses and \$11,700,589 recoverable on unpaid losses.

Unearned Premium increased by 25.3% or \$3,255,519 from \$12,847,095 in 2015 to \$16,102,614 in 2016. The FWCJUA experienced a 32% increase in premium written in 2016 over 2015 which is the primary reason for the increase in the unearned premium liability.

Accrued Commissions/Servicing Carrier Fees increased by 53.3% or \$772,461 from \$1,448,508 in 2015 to \$2,220,969 in 2016. This increase is attributable mainly to a higher premium written for the later part of 2016 versus 2015. Servicing Carrier Fees are based on a percent of premium written including a reduction for accrued uncollectable premium and are paid monthly based on premium collected.

Other Liabilities have increased \$856,993 comparing 2016 and 2015 balances; \$5,177,223 in 2015 to \$6,034,216 in 2016. The largest component of Other Liabilities is a liability carried by the FWCJUA for excess funds received from the State of Florida to fund the deficit of a particular rating plan, Subplan D. These funds are used to fund any cash flow deficit incurred by Subplan D policies. As of December 31, 2016, the remaining balance of this fund was \$3.79 million, relatively unchanged from the prior year end. The increase in other liabilities from 2015 to 2016 is predominantly due to the increase in service carrier settlement due for December of \$628,215 and an increase in reinsurance premium payable of \$163,213.

Surplus:

The FWCJUA is not subject to the minimum surplus requirements or the deposit requirements required by sections 624.408 and 624.411, Florida Statutes. Capital requirements of the FWCJUA are to be met either by retaining any excess of income over expenses, by assessments against its policyholders or by the Florida Office of Insurance Regulation ("OIR") levying a "below-the-line" assessment to employers in the voluntary market. The FWCJUA may retain as surplus any excess of income over expenses in any given year and use that surplus to defray any deficits from subsequent years prior to assessing policyholders or levying a "below-the-line" assessment to employers in the voluntary market.

In addition, \$6.1 million of the Surplus is restricted surplus as a result of a Loss Portfolio Transfer transaction for accident years 1994 – 1999.

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At year-end 2016 and 2015, Surplus for the FWCJUA was \$79,788,960 and \$75,286,730 respectively, representing a \$4,502,230, or 5.9%, increase. This increase is predominantly attributable to net income from operations.

Given the FWCJUA is in a surplus position of \$79,788,960 as of year-end December 31, 2016, it is not statutorily required pursuant to section 627.311(5)(g), Florida Statutes, to submit a deficit elimination plan to the OIR. However, with respect to a particular group of policyholders, Subplan D, recognizing a deficit, the FWCJUA will update its plan to eliminate this individual rating plan deficit and submit said updated plan to the OIR.

3. RESULTS OF OPERATIONS

The FWCJUA's operating results for 2016 and 2015 and key financial ratios are presented in the following table:

	2016	2015
Premiums Written - Gross	\$33,296,206	\$25,240,884
Premiums Written – Net	30,667,944	22,857,407
Decrease (increase) in Unearned Premium	(3,255,519)	1,693,200
Earned Premium - Net	27,412,424	24,550,607
Net Losses and loss adjustment expenses (LAE) Incurred	17,732,957	9,115,944
Underwriting Expenses (incl. agents balances charged off/recovered)	7,502,878	6,710,870
Underwriting Gain	2,176,589	8,723,793
Net Investment Income	2,147,394	1,794,323
Other Income	(16,778)	(171,176)
Net Income Before Policyholder Dividends	4,307,207	10,346,940
Dividends to Policyholders	0	(7,752)
Net Income / (Loss)	4,307,207	10,354,692
Loss & LAE Ratio	64.7%	47.8%
Expense Ratio	24.5%	27.7%
Combined Ratio (before return of premium policyholder dividends)	89.2%	75.5%
Investment Income Ratio	7.8%	4.8%
Operating Ratio (before return of premium policyholder dividends)	81.4%	70.7%

Gross Written Premium increased by 32% or \$8,055,322 from \$25,240,884 in 2015 to \$33,296,206 in 2016. The FWCJUA remains a relatively small component of the overall market at approximately 1.3% up slightly from 1.0% at the end of the prior year.

The Net Income of \$4,307,207 for 2016 was a decrease of \$6,039,733 from the prior year Net Income of \$10,346,940. This difference is mostly attributable to a decrease in the amount of favorable loss development recognized in the current period on prior accident years and a slightly higher loss ratio for the current accident year.

	2016	2015	Difference
Net Income	\$ 4,307,207	\$10,346,940	\$(6,039,733)
Prior Accident Year Favorable Loss/LAE Development	434,062	5,142,618	(4,708,556)
Adjusted Net Income	\$ 3,873,145	\$ 5,204,322	\$(1,331,177)

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The balance of Underwriting Expense remains relatively proportionately consistent with premium decline from 2015 and 2016.

Net Investment Income increased 19.7% or \$353,071 from \$1,794,323 in 2015 to \$2,147,394 in 2016. The increase in investment income in 2016 is primarily attributable to increased investable assets as well as a slight increase in the yield on the investment portfolio.

The 2009 Policy year underwriting results, which were considered in 2016 for potential dividends, were not favorable enough to warrant a dividend declaration, and thus no dividends were declared or paid in 2016.

4. CASH FLOW AND LIQUIDITY

Cash Flow:

Primary sources of Cash include cash flow from operations and cash provided from the sale or maturity of invested assets. Primary uses of Net Cash Flows include the payment of losses and loss adjustment expenses, operating expenses in the normal course of business and policyholder return of premium dividends.

The FWCJUA's Cash Flow for 2016 as compared to 2015 is summarized as follows:

	2016	2015
OPERATIONS		
Cash from Underwriting	\$8,074,526	\$7,705,894
Investment Income Received	2,816,778	2,454,376
Other – Net	(225,589)	(470,585)
Dividends Paid to Policyholders	0	(13,163)
Cash Provided by Operations	\$10,665,715	\$9,676,522
INVESTMENT ACTIVITIES		
Proceeds from Sale or Maturity of Invested Assets	\$16,677,565	\$21,054,617
Cost of Invested Assets Acquired	(27,558,388)	(34,081,484)
Cash Provided by (Used in) Investment Activities	(\$10,880,823)	(\$13,026,867)
FINANCING ACTIVITIES		
Increase (Decrease) in Borrowed Money	\$0	\$0
Other – Net	227,221	(32,647)
Cash Provided by (Used in) Financing Activities	\$227,221	(\$32,647)
NET INCREASE (DECREASE) IN CASH & SHORT TERM INVESTMENTS	\$12,113	(\$3,382,991)

Liquidity:

The FWCJUA generally invests in assets whose maturities approximate the actuarial expected payout pattern of the related losses and LAE and invests surplus for a slightly longer duration. The effective duration of the invested portfolio was 3.9 years and 3.8 years as of the end of 2016 and 2015, respectively.

The FWCJUA's Cash and Cash Equivalents at year-end 2016 were \$8,105,250 as compared to year-end 2015 of \$8,093,139. The FWCJUA engages a professional investment advisory firm to assist the company in the development and deployment of a specific investment strategy. The Cash and Cash equivalent balances at both 2016 and 2015 year ends are more than adequate to cover the near term cash needs of the FWCJUA.

In regard to both the ability to generate adequate amounts of cash to meet current needs and solvency requirements normally quantified by risk based analysis, the FWCJUA has the statutory authority to assess

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its policyholders in Tier 3 and increase rates in all three rating tiers if it is unable to pay its obligations. For Tier 1 and Tier 2, the FWCJUA could request OIR to levy a “below-the-line” assessment against premiums charged to insureds for workers’ compensation insurance. Currently, the FWCJUA has sufficient liquidity resources available to meet its balance sheet liabilities as they become due. However, any change in our projections or operating results could cause this situation to change.

5. RESIDUAL MARKET PERFORMANCE

As the FWCJUA was designed to depopulate the Florida workers' compensation residual market and invigorate the competitive or voluntary market, it is appropriate to compare the FWCJUA's results to that of its predecessor, the Florida Workers' Compensation Insurance Plan (FWCIP).

COMPARABLE DATA (\$ in thousands)	2016 FWCJUA RESULTS	2015 FWCJUA RESULTS	2014 FWCJUA RESULTS	2013 FWCJUA RESULTS	2012 FWCJUA RESULTS	2011 FWCJUA RESULTS	1993 FWCIP RESULTS
Written Premium (Calendar Year)	\$33,296	\$25,241	\$32,924	\$29,659	\$17,126	\$9,585	\$328,160
Residual Market Share (Calendar Year)	1.3%	1.0%	1.3%	1.2%	0.8%	0.5%	12.7%
Net Underwriting Gain (Loss) (Calendar Year)	\$2,177	\$8,724	\$7,106	\$2,938	\$1,737	(\$1,702)	(\$238,082)
Policyholder Return of Premium Dividends	\$0	\$(7)	\$3,931	\$7,775	\$12,178	\$5,193	\$0
Net Operating Gain (Loss) (Calendar Year)	\$4,307	\$10,355	\$4,337	(\$3,648)	(\$10,702)	(\$4,935)	(\$131,860)
Surplus	\$79,789	\$75,287	\$65,071	\$60,672	\$64,764	\$75,254	N/A
Policies Issued Effective that Year	2,570	2,429	2,330	1,831	1,263	931	48,430

Since the inception of the FWCJUA, there continues to be substantial evidence that the voluntary market can absorb the vast majority of the workers' compensation business in Florida. Even though premium written in the residual market in Florida has been on the rise in the past few years, it is still an immaterial component of the overall market. The FWCJUA has gained financial stability and as such has been returning some of its past profitability to policyholders through return of premium dividends.

Further, the Florida Office of Insurance Regulation, in its 2016 Workers' Compensation Annual Report issued in January 2017, stated that although the FWCJUA has seen its premium increase in recent years, it is still a very small portion of the market. At its 2016 Florida State Advisory Forum, NCCI presented analysis of residual market size for 26 states based on calendar year 2015 data. The NCCI analysis showed Florida had the smallest residual market as a percent of premium for the 26 states except for Idaho. This degree of private market activity indicates that coverage should be generally available in the voluntary market. This is a considerable improvement since 1993.

A contributing factor to the availability of affordable, competitive voluntary market workers' compensation insurance coverage in Florida has been the existence of a viable residual market mechanism.

Respectfully submitted,

Florida Workers' Compensation Joint Underwriting Association, Inc.



David L. Webber
Treasurer & Controller

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