

Report on the Cotton Merchants and Warehouses Study

Excerpt from the WCIRB Classification and Rating Committee Minutes
May 7, 2019

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Cotton Merchants and Warehouses Study

0400(1), Cotton Merchants – including cotton compressing
0400(2), Warehouses – cotton – including cotton compressing
**0401, Cotton Gin Operation – during both active and dormant seasons – including installation
or repair of equipment; yard employees; seed or fuel haulers**

Executive Summary

Objective

Employers assigned to Classifications 0400(1), *Cotton Merchants – including cotton compressing*, and 0400(2), *Warehouses – cotton – including cotton compressing*, do not develop sufficient data to produce a statistically credible advisory pure premium rate and, as a result, loss experience from year-to-year is volatile. Consistent with the WCIRB's practice of reviewing classifications with low statistical credibility, the WCIRB studied these classifications to determine whether to eliminate these classifications and reassign their constituents to one or more existing classifications.

Findings

Based on its review, the WCIRB determined:

1. The aggregate payroll and loss data reported under Classifications 0400(1), *Cotton Merchants – including cotton compressing*, and 0400(2), *Warehouses – cotton – including cotton compressing*, is not sufficient to generate a statistically credible pure premium rate and as a result there are wide fluctuations in loss to payroll ratios for these classifications from year-to-year. There are only five policyholders with current coverage that have data reported in Classification 0400. The annual payroll reported for the employers assigned to Classification 0400 is very modest (approximately 2 million) and is not expected to grow.
2. There is not a clear line of demarcation between Classifications 0400(1) and 0400(2) and the activities currently performed by employers described by Classifications 0400(1) and 0400(2) are nearly identical. Both classifications apply to the storage of cotton until it is either sold directly by the same employer or otherwise made ready for shipment. Additionally, cotton compressing, originally a key activity contemplated by Classifications 0400(1) and 0400(2), is no longer performed by employers assigned to these classifications.
3. The operations currently contemplated under Classifications 0400(1) and 0400(2) are typically performed in connection with cotton ginning operations that are assigned to Classification 0401, *Cotton Gin Operation*. Payroll for about 25 employers was reported in Classification 0401 for the 2019 relativity period.
4. The Selected (Unlimited) Loss to Payroll Ratio for Classifications 0400 and 0401 combined is 236% higher than that for Classification 0400, and 16% lower than that for Classification 0401. Although the average loss to payroll ratio for Classification 0400 is significantly less than that for Classification 0401, given the very low statistical credibility for Classification 0400, it is not clear if those differences are meaningful.

Recommendations

Based on these findings, the WCIRB recommends:

1. Consolidating Classifications 0400(1) and 0400(2) into a single classification and amending the classification phraseology to indicate that this classification applies to cotton warehousing and cotton merchants.

2. Combining Classification 0400 with Classification 0401 for ratemaking purposes and limiting the advisory pure premium rate for constituents of Classification 0400 to 25% each year until the rate better aligns with that of Classification 0401, at which time consideration can be given to eliminating Classification 0400 and reassigning all constituents of that classification to Classification 0401.

Introduction

The WCIRB regularly reviews classifications that do not develop sufficient data to produce statistically credible advisory pure premium rates. Classifications 0400(1), *Cotton Merchants – including cotton compressing*, and 0400(2), *Warehouses – cotton – including cotton compressing*, have very low statistical credibility (0.17 for indemnity and 0.14 for medical). In light of the low statistical credibility, the WCIRB studied Classifications 0400(1) and 0400(2) to determine whether to eliminate these classifications and assign their constituents to one or more existing classifications. The WCIRB also reviewed the operations and experience of Classification 0401, *Cotton Gin Operation*, to assess whether it should be combined with Classification 0400.

Description of Operations

Classification 0400(1), *Cotton Merchants – including cotton compressing*, applies to cotton dealers and includes ancillary cotton compressing and fee-based cotton compressing. Although originally established to apply to cotton compressing, this classification also included cotton merchants as, traditionally, cotton compressing was performed primarily by cooperatives engaged in the storage, compressing and sale of cotton grown by the cooperative's members. The cotton was transported from growers' fields to separate gins for processing. The ginned cotton was received in bulk by the compressing firms, compressed and baled. The compressing firm would then represent the members for the sale of the cotton, thus acting as a cotton merchant.

Classification 0400(2), *Warehouses – cotton – including cotton compressing*, applies to the storage of cotton bales on a fee basis and includes incidental cotton compressing. Operations typically include receiving cotton bales from cotton gins or cotton farms and utilizing forklifts to place the cotton bales into storage. As orders are received, the bales are loaded onto trucks for shipment. Like Classification 0400(1), this classification was originally established to apply to cotton compressing but included ancillary cotton warehousing as employers assigned to this classification were primarily cooperatives engaged in the storage and sale of cotton grown by the cooperative's members.

Classification 0401, *Cotton Gin Operation*, applies to the ginning of cotton (removing cotton fibers or lint from the seeds) including drying, raking, compressing and baling the cotton. Operations typically include receiving unprocessed cotton from growers in modular form and removing the cotton from trailers or van trucks using an air suction system. The cotton is vacuumed, dried to remove any residual moisture and then conveyed through a series of ginning processes where the lint is separated from seeds and waste products, such as dirt, debris and cotton plant leaves. The seed is transferred by means of blowers into cotton seed delinting machines. (A cotton seed delinter is a machine very similar to a cotton gin, except that it cuts more closely and finely). The cleaned cotton lint is automatically fed into a compressor/baler where the cotton is compressed and wrapped with baling wire. The bales are covered with burlap, bound with strap iron and weighed to determine the amount of pure cotton. Once operations are complete, the baled cotton is covered and prepared for storage.

Cotton compressing used to be a separate activity from ginning as it required separate equipment and machinery and was typically performed in connection with storage operations. Currently, however, cotton gins commonly perform their own cotton compressing, and cotton warehouses rarely, if ever, perform cotton compressing.

Classification Analysis

Classification 0400 was established primarily for cotton compressing activities. Activities such as cotton warehousing and cotton dealing were performed in support of the primary compressing operations.

As the industry evolved and advancements were made in cotton processing machinery and equipment, employers engaged in cotton ginning started to include cotton compressing in their operations. Currently,

there are no employers engaged strictly in fee-based cotton compressing activities and the employers currently assigned to Classifications 0400(1) and 0400(2) primarily perform warehousing and merchant activities. Due to this operational shift, the core operations originally contemplated by Classification 0400 are now assigned to Classification 0401, leaving very few employers in Classification 0400.

There are no employers currently assigned to Classification 0400(1), *Cotton Merchants*, and only 5 employers with current coverage assigned to Classification 0400(2), *Warehouses – cotton*. Additionally, the activities performed by employers described by Classifications 0400(1) and 0400(2) are nearly identical. Both classifications apply to the storage of cotton until it is either sold directly by the same employer or otherwise readied for shipment.

Employers currently assigned to Classification 0401, *Cotton Gin Operation*, handle cotton in ways similar to those of employers assigned to Classification 0400. Further, in addition to cotton ginning, employers assigned to Classification 0401 engage in cotton warehousing and cotton merchant activities, as well as cotton compressing, an activity that was previously performed by separate employers assigned to Classification 0400.

The WCIRB also reviewed the operations and experience of Classification 8292, *Warehouses – general merchandise – N.O.C.*, but determined that it is not a good fit with Classification 0400 as there are far fewer similarities and overlaps in operation between 8292 and 0400. In addition, the advisory pure premium rate difference between 0400 and 8292 is more significant than the difference between 0400 and 0401.

Outreach

In addition to reviewing the operations, history and statistical data related to the classification of employers in the cotton industry, WCIRB staff discussed the state of the cotton industry in California with a member insurer's underwriting team who specialize in the cotton and agricultural industries. Staff was advised that the cotton industry in California is in decline (from a historic high of 400,000 acres to 175,000 acres where it has remained for the last 7 years) primarily due to environmental factors such as water supply, but also as a result of international competition and automation, which has further reduced cotton industry payroll. The lost acreage has been permanently repurposed for other crops, such as almonds, and it is unlikely that it will be converted back to cotton growing acreage. There is continued demand for California cotton due to its particularly high quality. Therefore, the classifications under review are expected to continue generating payroll but credibility factors are not expected to increase.

Statistical Analysis

Table 1 shows the Classification Relativity Data at the policy year 2019 level for Classification 0400.

Table 1
Classification 0400
Relativity Data at Policy Year 2019 Level

Year	Payroll	Losses	Adj. Loss to P/R Ratio
2011	3,662,766	7,039	0.192
2012	3,020,930	8,529	0.282
2013	2,025,981	0	0.000
2014	2,049,943	38,526	1.879
2015	2,049,303	530	0.026
Total:	12,808,923	54,624	

Adjusted Loss to Payroll Ratio: 0.426
 Selected (Unlimited) Loss to Payroll Ratio: 1.700
 Selected Loss-to-Payroll Ratio Limited to 25% Change: 2.310

Credibility Factors

Indemnity	Medical
0.17	0.14

Table 1 indicates that Classification 0400 does not develop sufficient payroll and loss data to generate a statistically credible advisory pure premium rate as the payroll for each year is very low and loss to payroll ratios fluctuate from year-to-year.

Table 2 shows the classification relativity data at the policy year 2019 level for Classification 0401.

Table 2
Classification 0401
Relativity Data at Policy Year 2019 Level

Year	Payroll	Losses	Adj. Loss to P/R Ratio
2011	12,301,962	629,421	5.116
2012	13,629,478	924,466	6.783
2013	11,525,201	274,926	2.385
2014	10,063,563	561,335	5.578
2015	8,401,346	539,299	6.419
Total:	55,921,551	2,929,447	

Adjusted Loss to Payroll Ratio: 5.238
 Selected (Unlimited) Loss to Payroll Ratio: 6.822

Credibility Factors

Indemnity	Medical
0.44	0.45

As indicated in Table 2, while significantly more payroll is reported in Classification 0401 than in Classification 0400, Classification 0401 has only modest statistical credibility. Additionally, the Adjusted Loss to Payroll Ratio and the Selected (Unlimited) Loss to Payroll Ratio for Classification 0401 are significantly higher than those for Classification 0400. However, given the very low statistical credibility of Classification 0400 experience, WCIRB staff does not believe these differences are meaningful.

Table 3 shows the combined experience of Classifications 0400 and 0401 at the policy year 2019 level.

**Table 3
Classifications 0400 and 0401 Combined
Relativity Data at Policy Year 2019 Level**

Year	Payroll	Losses	Adj. Loss to P/R Ratio
2011	16,080,361	633,969	3.943
2012	16,639,258	927,962	5.577
2013	13,474,311	272,704	2.024
2014	12,080,959	598,485	4.954
2015	10,449,032	537,936	5.148
Total:	68,723,922	2,971,056	

Adjusted Loss to Payroll Ratio: 4.323
Selected (Unlimited) Loss to Payroll Ratio: 5.706

Credibility Factors

Indemnity	Medical
0.45	0.45

Impact Analysis

Table 4 shows the potential impact on affected policyholders currently assigned to Classification 0400 if Classification 0400 is combined with Classification 0401. The Selected (Unlimited) Loss to Payroll Ratio for Classifications 0400 and 0401 combined is 236% higher than that for Classification 0400.

Table 4: Classification 0400 vs. Classification 0400 and 0401 Combined Comparison of Selected (Unlimited) Loss to Payroll Ratios at Policy Year 2019 Level

Classification 0400	Classifications 0400 and 0401 Combined	Difference
1.700	5.706	+4.006 (+235.65%)

Table 5 shows the potential impact on affected policyholders currently assigned to Classification 0401 if Classification 0400 is combined with Classification 0401 prior to the impact of the WCIRB's standard 25% limitation on year-to-year classification relativity changes. The Selected (Unlimited) Loss to Payroll Ratio for Classifications 0400 and 0401 combined is 16% lower than that for Classification 0401.

Table 5: Classification 0400 vs. Classification 0400 and 0401 Combined Comparison of Selected (Unlimited) Loss to Payroll Ratios at Policy Year 2019 Level

Classification 0401	Classifications 0400 and 0401 Combined	Difference
6.822	5.706	-1.106 (-16.36%)

Findings

Based on its review, the WCIRB determined:

1. The aggregate payroll and loss data reported under Classifications 0400(1), *Cotton Merchants – including cotton compressing*, and 0400(2), *Warehouses – cotton – including cotton compressing*, is not sufficient to generate a statistically credible pure premium rate and as a result there are wide fluctuations in loss to payroll ratios for these classifications from year-to-year. There are only five policyholders with current coverage that have data reported in Classification 0400. The annual payroll reported for the employers assigned to Classification 0400 is very modest (approximately 2 million) and is not expected to grow.
2. There is not a clear line of demarcation between Classifications 0400(1) and 0400(2) and the activities currently performed by employers described by Classifications 0400(1) and 0400(2) are nearly identical. Both classifications apply to the storage of cotton until it is either sold directly by the same employer or otherwise made ready for shipment. Additionally, cotton compressing, originally a key activity contemplated by Classifications 0400(1) and 0400(2), is no longer performed by employers assigned to these classifications.
3. The operations currently contemplated under Classifications 0400(1) and 0400(2) are typically performed in connection with cotton ginning operations that are assigned to Classification 0401, *Cotton Gin Operation*. Payroll for about 25 employers was reported in Classification 0401 for the 2019 relativity period.
4. The Selected (Unlimited) Loss to Payroll Ratio for Classifications 0400 and 0401 combined is 236% higher than that for Classification 0400, and 16% lower than that for Classification 0401. Although the average loss to payroll ratio for Classification 0400 is significantly less than that for Classification 0401, given the very low statistical credibility for Classification 0400, it is not clear if those differences are meaningful.

Recommendations

Based on these findings, the WCIRB recommends:

1. Consolidating Classifications 0400(1) and 0400(2) into a single classification and amending the classification phraseology to indicate that this classification applies to cotton warehousing and cotton merchants.
2. Combining Classification 0400 with Classification 0401 for ratemaking purposes and limiting the advisory pure premium rate for constituents of Classification 0400 to 25% each year until the rate better aligns with that of Classification 0401, at which time consideration can be given to eliminating Classification 0400 and reassigning all constituents of that classification to Classification 0401.

Appendix I

Classification History

The following is a timeline of the significant changes to the scope and application of the relevant classifications:

1916: Classification 0400, *Cotton Compressing*, was established.

1917: Classification 0400 phraseology was modified to include incidental warehousing and prohibit the division of payroll with Classification 0401, *Cotton Gin Operation*.

1930: A new cotton classification was established, 8295, containing two phraseologies: *Cotton Storage – baled cotton – including warehouse or yard; Drivers, Chauffeurs and Helpers*, and *Cotton Merchants – including warehouse or yard; Drivers, Chauffeurs and Helpers*.

1947: Classification 8295 was eliminated and its constituents were reassigned to Classification 8292, *Warehouses – general merchandise – N.O.C.*, provided the employer did not engage in any cotton compressing. Employers engaged in cotton compressing were assigned to Classification 0400.

1992: WCIRB staff studied Classifications 0400 and 0401, primarily due to the low credibility of Classification 0400. This study resulted in cotton merchants and warehouses being reassigned from Classification 8292 to Classifications 0400(1) and 0400(2), respectively, based on similarity in operations, irrespective of compressing operations.

Recommendation

Eliminate Classification 0400(1), *Cotton Merchants*, and consolidate it with Classification 0400, *Warehouses – cotton – including cotton compressing*, into a single classification.

PROPOSED

~~COTTON MERCHANTS – including cotton compressing~~

0400(1)

~~This classification applies to dealers of cotton and includes incidental cotton compressing. This classification also applies to cotton compressing that is performed for other concerns on a fee basis.~~

~~This classification does not apply to cotton gin operations; all operations, including the sale and distribution of cotton in connection with cotton gin operations, shall be classified as 0401, *Cotton Gin Operation*.~~

~~The contract storage of baled cotton, including cotton compressing, shall be classified as 0400(2), *Warehouses – cotton*.~~

~~Cotton batting manufacturing shall be classified as 2211(1), *Cotton Batting, Wadding or Waste Mfg.*~~

~~The cultivation and harvesting of cotton shall be separately classified as 0044, *Cotton Farms*.~~

* * * * *

Recommendation

Amend Classification 0400(2), *Warehouses – cotton*, to include cotton dealers or merchants.

PROPOSED

WAREHOUSES – cotton – including cotton compressing

0400(2)

This classification applies to the storage of cotton for other concerns on a fee basis and includes incidental cotton compressing. This classification also applies to cotton dealers or merchants.

This classification does not apply to cotton gin operations; all operations, including the storage, compressing, sale and distribution of cotton in connection with cotton gin operations shall be classified as 0401, *Cotton Gin Operation*.

~~The purchase and sale of cotton, including cotton compressing, shall be classified as 0400(1), *Cotton Merchants*.~~

Cotton batting manufacturing shall be classified as 2211(1), *Cotton Batting, Wadding or Waste Mfg.*

The cultivation and harvesting of cotton shall be separately classified as 0044, *Cotton Farms*.

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Recommendation

Amend Classification 0401, *Cotton Gin Operation*, to clarify how related operations should be classified.

PROPOSED

COTTON GIN OPERATION – during both active and dormant seasons – including installation or repair of equipment; yard employees; seed or fuel haulers **0401**

This classification applies to the ginning (removing cotton fibers from their seeds) of cotton, including drying, raking, compressing and baling of cotton, when performed for other concerns on a fee basis ~~and/or~~ when performed in connection with the purchase and sale of cotton.

The contract storage of baled cotton or purchase and sale of cotton, including cotton compressing, with when no ginning operations are performed, shall be classified as 0400(4), ~~Cotton Merchants Warehouses – cotton.~~

~~The contract storage of baled cotton, including cotton compressing, shall be classified as 0400(2), Warehouses – cotton.~~

Cotton batting manufacturing shall be classified as 2211(1), *Cotton Batting, Wadding or Waste Mfg.*

The cultivation and harvesting of cotton shall be separately classified as 0044, *Cotton Farms*.

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Recommendation

Amend Classification 0044, *Cotton Farms*, which is part of the *Farms* Industry Group, to clarify how related operations should be classified.

PROPOSED

FARMS

COTTON FARMS **0044**

This classification applies to all acreage devoted to the cultivation and harvesting of cotton.

Cotton gin operations, including cotton compressing, shall be separately classified as 0401, *Cotton Gin Operation*.

The contract storage of baled cotton or the purchase and sale of cotton, including cotton compressing, when no ginning operations are performed, shall be classified as 0400(4), ~~Cotton Merchants Warehouses – cotton.~~

~~The contract storage of baled cotton, including cotton compressing, shall be classified as 0400(2), Warehouses – cotton.~~

Providing machinery and operating crews to conduct mechanized farming or harvesting operations for separate concerns on a fee basis shall be classified as 0050, *Farm Machinery Operation*.

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Recommendation

Amend Section VIII, *Abbreviated Classifications – Numeric Listing*, for consistency with other proposed changes.

PROPOSED

Section VIII – Abbreviated Classifications – Numeric Listing

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- 0400(1) Cotton Merchants
- 0400(2) Warehouses–cotton–incl cotton compressing

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