Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

MSP C 06/2002 – "California's Workers Compensation Market — Is It Getting Any Better?" June, 2002

California's Workers Compensation Market

Is It Getting Any Better?

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In our last newsletter, I touched on the insurance industry in general, and what you could expect on your next renewal. Because workers compensation is such a large part of many of our clients' insurance programs, I felt it was appropriate to deal specifically with that issue in this newsletter.

History

Workers compensation is a mandatory coverage required of all employers. It was established in California in 1914. From then until 1995, minimum rates were established by the Workers Compensation Insurance Rating Bureau (WCIRB). An insurance company could not charge a lower rate than what was specified by the WCIRB.

In the early 1990's, California's workers compensation system was in crisis. Premiums continued to go up dramatically each year. In an attempt to address the problem, the minimum rate law was abolished, and "open" rating was allowed. In other words, insurance companies were free to charge whatever rate they felt was appropriate.

For the next five years, intense competition for increased market share resulted in substantially decreased pricing. Numerous insurance companies entered the California market place. In some cases, rates plunged by as much as 50% or more. Not surprisingly, underwriting results deteriorated rapidly. The combined ratio (loss costs plus insurance company expenses divided by premium) in California increased from 84% in 1993 to over 174% in 1999.

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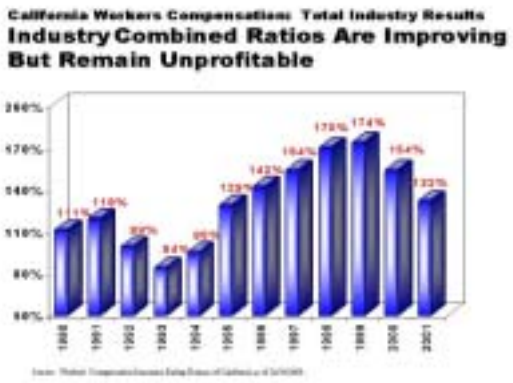

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To compound the problem, it became clear that the workers compensation insurance industry was under-reserved by billions of dollars. This means that the insurance companies have set reserves that are lower than what they will ultimately pay for claims, which means that the industry is actually in more trouble than the combined ratios imply. In July of 2001, Standard and Poor's estimated that the U. S. workers compensation industry was under-reserved by $20 billion, while California alone was under-reserved by $7.1 billion.

In 2000, rates started to increase, but unfortunately for some companies, it was too little, too late. A number of California specialty carriers ceased underwriting altogether, while some large national insurance companies decided to leave the market.

Superior National Insurance Group, which in 1998 had been California's largest private sector workers compensation writr, was seized by the California Department of Insurance (CDI) in March of 2000. The CDI cited the company's hazardous financial condition and severe under-reserving of claims. Superior National was not alone.

In the second quarter of 2001, the HIH Insurance Group of companies and Sable Insurance Company were also taken over by the CDI. Last year, Santa Monica-based Fremont General Corporation, the nation's second largest private workers compensation provider, was taken under the effective supervision of the CDI because of its fragile financial condition. Like Superior National and the others, Fremont's problems are in large part caused

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5 Ways to Control Your Workers Compensation Costs

Ultimately, the only way to control your workers compensation premiums is to control the underlying costs. The five items shown below can help keep your workers compensation costs under control.

1. Timely First Reporting of Claims

The timely first reporting of claims not only allows the employee to receive benefits soon after his/her accident, but also authorizes the adjuster to start the investigation. Mailing in first reports to your insurer loses valuable time. You should report all claims either electronically or by facsimile. The first 72 hours following an accident will set the tone for the claim, and greatly influence the reserves on the file.

2. Immediate Medical Control

Recognize that in California, employees have the opportunity to pre-designate their medical provider. Regardless, very few do. It is important that the employer set up a relationship with an industrial-minded medical treatment facility that knows how to handle work-related injuries and work with insurance companies.

3. Return to Work Program

Return to work programs work. They will lower your overall total cost of risk in most cases.

4. Employee Treatment

If employees feel that they are being treated fairly, they are much less likely to litigate a workers compensation case. Stay in touch with your injured employees, either by phone, mail or electronically. Make them understand that you care.

5. Safety Program

A solid safety program is critical in order to reduce claims. This is not just a written set of policies and procedures that sit on the shelf gathering dust, but a well-written, usable program that is functional in reducing claims.

There is no way you can avoid workers compensation claims. There are, however, ways to control the costs.*

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by charging rates that were inadequate to cover its losses and other underwriting costs. (Recently Fremont was acquired by Employers Insurance Company of Nevada, and is now operating in California as Fremont Employers Insurance Company.)

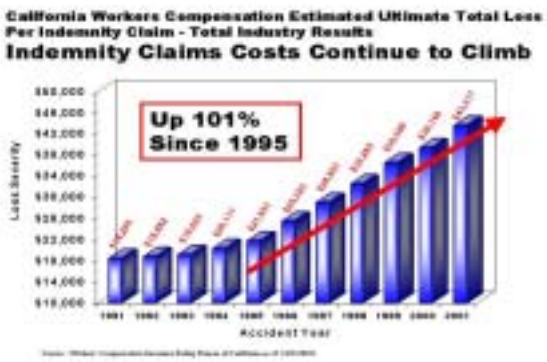
Along with the insolvencies came rating downgrades on a handful of companies. The State Compensation Insurance Fund of California was not exempt. Standard and Poor's downgraded the State Fund from A to BB+, and subsequently lowered its counter-party credit and financial strength ratings from BBB+ to BB+.

Best's Insurance Rating Guide also dropped the State Fund's rating from an A- to a B+, and on May 1st down to B-! Rather than being considered a B-rated carrier, the State Fund elected to withdraw from Best's rating system, so in actuality Best's now shows the State Fund as NR-4 (Not Rated by company request). The State Fund's financial size category remains XIII (capital surplus and conditional reserves of $1.25 billion to $1.5 billion).

During the last several years, there have been only a handful of private market insurance companies willing to compete with the State Fund. In that time frame, the State Fund's market share has increased significantly, from 22% to almost 50%.

There is concern that the State Fund's market share is getting too big. In the last two years, however, prices have started to rise, in some cases significantly.

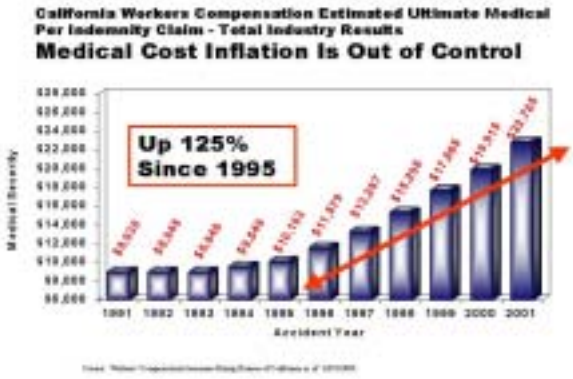
The State Fund recently announced a 19% increase in workers compensation rates that will go into effect on July 1st of this year. This is in addition to the 22% price crease that took effect on January 1st. In fact, some of the early quotations



we've received from the State Fund are actually up nearly 70%. The hope is that, with increased pricing, more private carriers will be attracted back to the California market to compete with the State Fund.

As mentioned, prices are on the rise. Since 1999, California's Insurance Commissioner has approved pure premium advisory rate increases totaling 39%. An additional 10.1% increase was recommended by the WCIRB effective July 1, 2002. Although these are advisory only, most insurance companies are taking rate increases of at least this much.

These increases, however, may not be enough. The average total loss per indemnity claim (one in which time was lost from work) jumped from $21,551 in 1995 to $43,317 in 2001, an increase of 101%. During that same time frame, medical costs for those same claims increased by 125%.



In addition, on February 15th, California Governor Gray Davis signed a workers compensation-related bill (AB-749) that provides for maximum benefits paid to employees for work-related injuries to be increased incrementally over a four-year period from the current $490 per week to $840 per week in 2005.

The bill becomes effective on January 1, 2003, and is estimated to ultimately cost the industry $3.5 billion annually. This will increase benefit costs by 22.8%. The money to cover these increases will have to come from somewhere. An interim rate increase of approximately 10% is projected to be effective on January 1, 2003 on all in-force workers compensation policies.

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So What Will Happen?

From the insurance company's perspective, with the rates significantly higher than they were several years ago, there is certainly improvement, but there is still a long way to go. California workers compensation is still not profitable. Prices will continue to rise. It is hoped, though, that the increased pricing will attract additional insurance companies to compete with the State Fund for workers compensation business in California. Regardless, we expect to see average premium increases in 2002 and again in 2003 of 20% to 30%.

What Can You Do?

You would be well served to prepare your renewal submissions as early as possible (we usually start 90 to 120 days in advance). The submissions need to be complete and concise to allow the underwriter to quickly digest the type of risk being reviewed. A comprehensive description of operations, any specific related entities, and complete loss runs are mandatory. Your broker should be able to assist you in making your firm as attractive as possible to the insurance marketplace.

The most important thing you can do is to adequately manage your risk. By focusing on educating your employees, beefing up your loss prevention efforts, and aligning yourself with a knowledgeable insurance broker capable of placing you with a proactive insurance company, you can effectively manage your risk and your costs. This is critical. Ultimately, in workers compensation, you will end up paying for your losses. The only way to control your cost is to control your losses.✳

Disclaimer: *This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.*

TWIN Award Winner:
Sue Marberry

The Tribute to Women in Industry (TWIN) Award is an annual award program that recognizes and honors outstanding women in the San Diego business community who have made a difference in their companies and in the community.

Sue Marberry, Office/Accounting Manager of Cavignac & Associates, is one of 101 women honored this year by the TWIN Award program, which has recognized more than 1,700 exceptional San Diego business women over the last 23 years.

The TWIN Award program also raises money for local YWCA programs, which focus on assisting women and children in crisis situations.✳