Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

MSP C 06/99 – "Workers Compensation: State of the Market" June, 1999

Workers Compensation: State of the Market

The workers compensation market in California has changed dramatically since open rating was implemented in 1995. In the past four years, rates have plunged. Unfortunately, they have now reached a point at which most industry experts feel they can go no lower. In fact, the pundits are predicting a turn in California's workers compensation marketplace.

Before we discuss how the market got to its present point, and what conceivably could happen in the future, let's discuss workers compensation in general and its history to date.

A look back

Prior to the beginning of the Industrial Revolution in the United States, there was little reason for the development of workers compensation statutes. Employee injuries were not considered to be a major problem by the American public.

All of this changed with the advent of the Industrial Revolution. High-speed machinery and mass production techniques combined with poor working conditions led to a startling increase in work-related injuries, disease and death. Although an injured employee could sue his employer based on the employer's failure to meet one or more of its common law obligations, it was almost impossible for an employee to win such a suit.

By the late 1800's it had become very apparent that the legal system was not adequately addressing employment-related injuries. Occupational injury and death were still increasing, and many workers and their families were being left destitute or impoverished because of their inability to collect for the negligence of their employers.

A number of employers liability statutes and judicial modifications of common law were implemented, but they were not satisfactory. An employee still had to resort to the courts to be compensated for an injury.

The first attempt to enact a workers compensation law in the United States took place in Maryland in 1902. Although most of these early laws were ruled to be unconstitutional, in 1911 Wisconsin passed a workers compensation law which was ruled to be constitutional. The first workers compensation law in California was passed shortly thereafter.

Today, all 50 states and the District of Columbia have workers compensation laws. Although each state's law is different, each has the same basic objective of providing no-fault benefits to workers injured on the job. Basically, employees are entitled to compensation for both loss of income and

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medical benefits if their injury *"arises out of and in the course of their employment."* In turn, the employee gives up the right to sue the employer for damages.

Until 1995, California was a "minimum rate law" state. This meant that regardless of who was writing the coverage in the state, the minimum rate the insurance company could charge was specified by the Workers Compensation Insurance Rating Bureau (WCIRB).

In other words, everyone had to use the same experience modification and the same minimum rates (although they could charge higher rates) and therefore charge the same minimum premium. Insurance companies competed on service and dividend programs.

All this changed dramatically in 1995, when California converted from a "minimum rate" law to an "open rating" law. In other words, insurance companies licensed to do business in California were free to charge whatever rate they felt was appropriate for a given risk.

The result: the bottom fell out of the workers compensation market. In the last four years, rates have plummeted in the neighborhood of 40% to 50%.

The Market Today

Unfortunately, the competitive market is nearing an end. According to the WCIRB, it is now estimated that workers compensation carriers as a whole in California are under-reserved by $3 billion for 1997 and 1998.

The WCIRB also reports that accident year loss ratios in California have continued deteriorating, reaching 133% on average in 1998 and 132% in 1997. That means for every $1 in premium workers compensation insurers take in, they pay out $1.33 in expenses, benefits and other considerations.

Most experts agree that there is no chance of making a profit with these ratios. (It will come as no surprise that this is higher than the country average, which is $1.21.)

One of the reasons that rates were bid so low was the use of "preferred contracts from reinsurers." With a greater transfer of risk to reinsurers, insurers were able to lower prices even farther, creating higher expense ratios and reserve expectations.

Unfortunately the market for such reinsurance deals has virtually dried up. One of the main sources of these reinsurance treaties, a pool of insurers managed by Unicover Managers, Inc., has ceased accepting new business, and pool members have "jumped ship" to avoid more losses.

All this has created a very difficult climate for workers compensation in California. We are starting to see this manifest itself in higher premiums and stricter underwriting.

What To Do Now?

So what does this mean to today's employers? What can they do? How should they prepare for this turn in the market? As is often the case, to figure out the future, all we need to do is look at the past.

The best way to control your workers compensation exposure and hence your workers compensation cost is to focus on reducing losses. Ultimately, employers will pay for the cost of their workers compensation in the form of premiums.

Shown below are the best ways we know to manage your workers compensation costs:

- Select a specialist workers compensation insurance company proficient in handling claims and providing loss control guidance.
- Select a proactive insurance broker to orchestrate your insurance program.
- Establish an effective safety program (this is an active, ongoing safety program, not a 3-ring binder on your shelf).
- Have top management commit to your safety program.
- Follow up on all outstanding claim reserves on a regular basis, but certainly prior to the time your insurance company must file the Unit Statistical Report with the Workers Compensation Insurance Rating Bureau.
- Review all claims with staff, discussing what caused the claim and what could have been done to prevent it.

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- Provide incentives to your employees to avoid losses.

If you have any questions regarding workers compensation, your specific workers compensation program or insurance in general, give us a call or visit us at www.cavignac.com. ✧

Workers Compensation Definitions

Workers Compensation – The system by which no-fault statutory benefits prescribed in state law are provided by an employer to an employee (or the employee's family) due to a job-related injury (including death) resulting from an accident or occupational disease.

Employers Liability – This coverage is provided by Part 2 of the basic workers compensation policy, and pays on behalf of the insured (employer) all sums that the insured shall become legally obligated to pay as damages because of bodily injury by accident or disease sustained by any employee of the insured arising out of and in the course of his/her employment by the insured.

Longshore and Harbor Workers Compensation Act (USL&H) – A federal law that provides no-fault workers compensation benefits to employees other than masters or crew members of a vessel injured in maritime employment – generally, in loading, unloading, repairing or building a vessel. Employers can obtain coverage under a standard workers compensation policy by purchasing a Longshore and Harbor Workers Compensation Act coverage endorsement.

Experience Rating – As respects workers compensation, the method in which the actual loss experience of the insured is compared to the loss experience that is normally expected by other risks in the insured's rating class. The resulting experience modification factor is then applied to the premium of the insured.

Experience Modification – The actual process by which the factor developed through experience rating is applied to the premium of the insured.

Other States Coverage – Workers compensation and employers liability insurance coverage for an insured's employees traveling through or temporarily working in states other than the insured's home state, as specifically listed in Item 3.C of the information page of the policy. The endorsement expands the policy so that an injured employee can receive compensation benefits as prescribed by the other states listed on the endorsement. However, coverage only applies to states so listed, and coverage ***cannot*** be extended in this manner to monopolistic fund states.

Voluntary Compensation Endorsement – Enables an employer to extend the benefits provided by the workers compensation act to employees who may not be entitled to benefits under the terms of the act, such as executive officers, partners, sole proprietors, farm workers, domestic employees, or employees traveling overseas. If such an employee is injured in the course of employment, she/he may elect to accept the scale of benefits provided by the designated workers compensation law or pursue common law remedies.

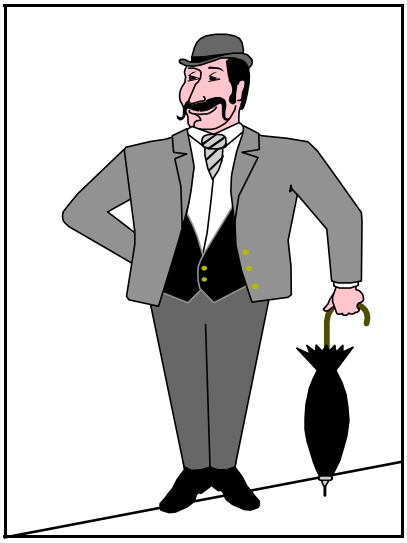
Open Rating – A pricing regulation approach associated with workers compensation premium costs in which state regulators allow insurers to issue policies using rates other than those established by the managing rating bureau. Types of variances include the use of rate deviations and the promulgation of rates by the insurers. ✧

Loss Prevention and High Wire Walking

by Frank G. Cavignac

A recent ***New Yorker Magazine*** article told about a man called Philippe Petit who is arguably the greatest high wire walker of the 20th century.

Consider just a few of his achievements: he has walked a wire strung between the towers of Notre Dame Cathedral in Paris; he has walked, upward, 2,000 feet from the Place du Trocadero at the foot of the Eiffel Tower to the second stage landing of the Tower. This summer he will attempt to cross a 1,200 foot portion of the Grand Canyon, 1,600 feet above the valley floor. He uses no nets.



In preparation for his canyon walk Petit has photographed and mapped every bit of the terrain involved in his crossing. He has given names to certain areas to help him identify the forty-six anchor points for the twenty-three cavalletti, or guy wires, that are needed to stabilize the cable.

The combination of length and height and the exposed nature of this site, which offers no protection from the wind, makes this the most demanding and, of course, the most dangerous of his walks, but danger is not an element that figures in Petit's calculations. As he often says, he takes no risks.

What he means is that he prepares so thoroughly for each walk, learning everything there is to learn about the site (weather, wind patterns, history, geological features, etc.), rigging his own cable and cavalletti according to ultra-conservative safety factors, and trusting his own phenomenal power of concentration to rule out any misstep — that the danger, although real and present, is subject to his control.

He also said in the ***New Yorker Magazine*** article that he knows his limits and that if he thinks that he is a hero and invincible, then he will pay for it with his life.

In business the perils of unknown risk which can injure or severely damage a business or professional enterprise are always lurking in the background waiting to victimize the unwary.

But as Petit works to diminish his chance of loss (which can result in death) by practicing loss prevention at its very highest plateau, so can the prudent business and professional practitioner reduce the risk of injurious loss by identifying potential loss problems, taking steps to eliminate them, transferring them or insuring them.

Being in business may not offer the exotic degree of thrill and danger involved in Petit's line of work, but pitfalls exist and the successful business enterprise will benefit from loss prevention — as does Philippe Petit. ✧