

# **WORKERS COMPENSATION - CURRENT ISSUES - (SESSION WC-4)**

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Casualty Actuarial Society  
2004 Seminar on Ratemaking  
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# WC Premium Growth Leads Other Lines

## Net Written Premium by Line

Line of Business	2002	2003	2004p	Change
Personal Auto	\$ 139.6 B	\$ 151.0 B	\$ 158.0 B	4.7%
Homeowners	\$ 40.0 B	\$ 47.7 B	\$ 51.5 B	7.9%
<b>Workers Compensation</b>	\$ 36.5 B	\$ 41.6 B	\$ 47.4 B	14.1%
Other Liability (Incl Prod Liab)	\$ 30.9 B	\$ 38.7 B	\$ 44.1 B	13.9%
Commercial Multiple Peril	\$ 25.4 B	\$ 27.4 B	\$ 28.3 B	3.5%
Commercial Auto	\$ 24.6 B	\$ 25.4 B	\$ 25.5 B	0.3%
Fire & Allied Lines (Incl EQ)	\$ 15.4 B	\$ 17.6 B	\$ 17.9 B	1.9%
All Other Lines	\$ 66.4 B	\$ 66.0 B	\$ 62.5 B	-5.3%
<b>Total All Lines</b>	<b>\$378.9 B</b>	<b>\$415.3 B</b>	<b>\$435.2 B</b>	<b>4.8%</b>

Source: Best's Aggregates & Averages, Review/Preview

(Includes state funds for: AZ, CA, ID, LA, MD, ME, MN, OR, RI, TX, and UT) <sup>2</sup>

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# Combined Ratios Improved in 2003

## Net Combined Ratios

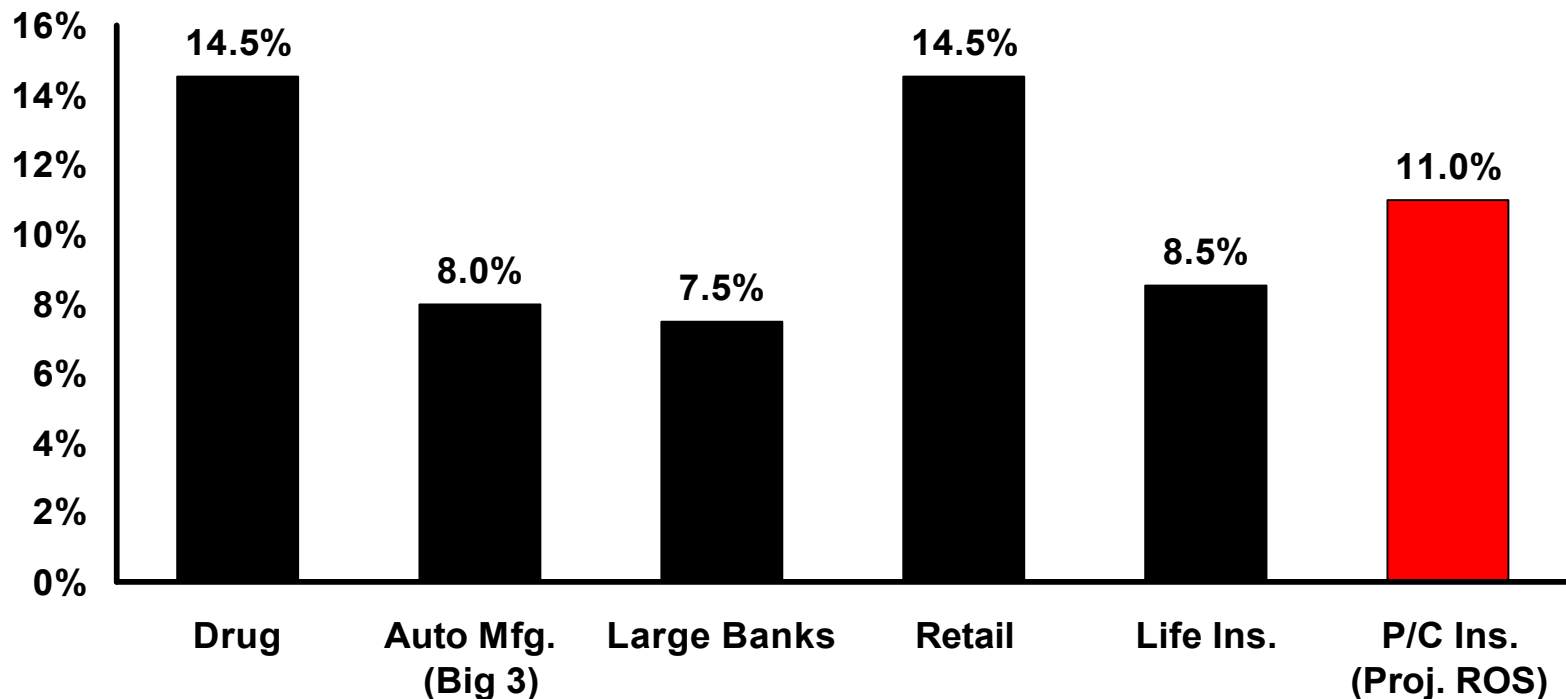
<b>Line of Business</b>	<b>2002</b>	<b>2003</b>	<b>2004p</b>
Personal Auto	104%	98%	93%
Homeowners	109%	98%	101%
Workers Compensation	112%	108%	107%
Other Liability (Incl Prod Liab)	137%	116%	111%
Commercial Multiple Peril	105%	100%	99%
Commercial Auto	103%	95%	93%
Fire & Allied Lines (Incl EQ)	89%	79%	85%
All Other	105%	95%	86%
Reinsurance Co's	126%	111%	105%
<b>Total All Lines</b>	<b>107%</b>	<b>100%</b>	<b>98%</b>

Source: Best's Aggregates & Averages, Review/Preview

(Includes state funds for: AZ, CA, ID, LA, MD, ME, MN, OR, RI, TX, and UT) <sup>3</sup>

# Return on Equity for Total P&C Appears In Line With Other Industries

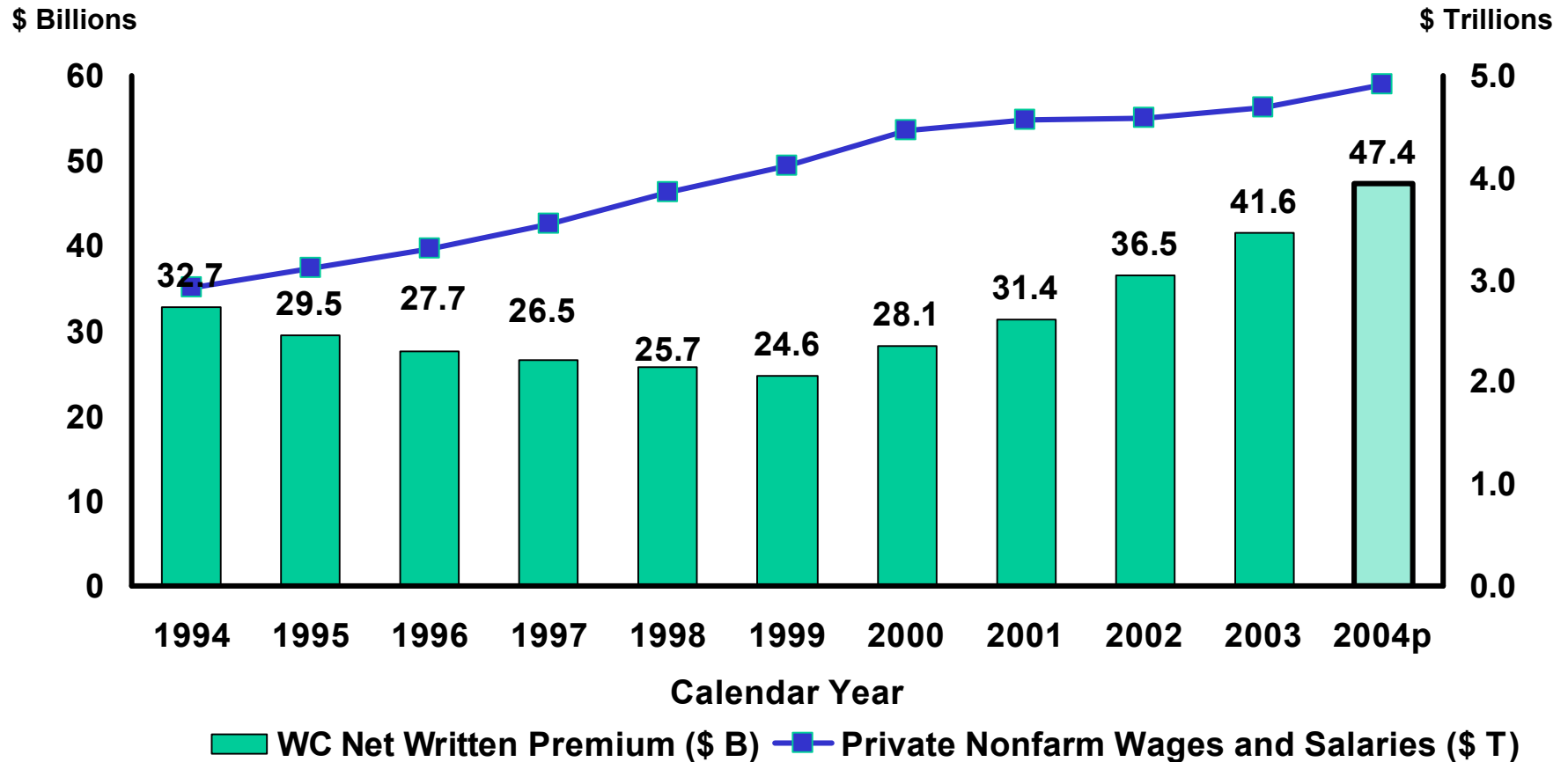
Estimated 2004 After-Tax ROE for Public Companies



Source: Value-Line, latest estimates as of January 21, 2005. P/C projected 2004 ROS from Best's Review/Preview.

# Workers Compensation Premium Volume Continues to Grow

## Workers Compensation Net Written Premium

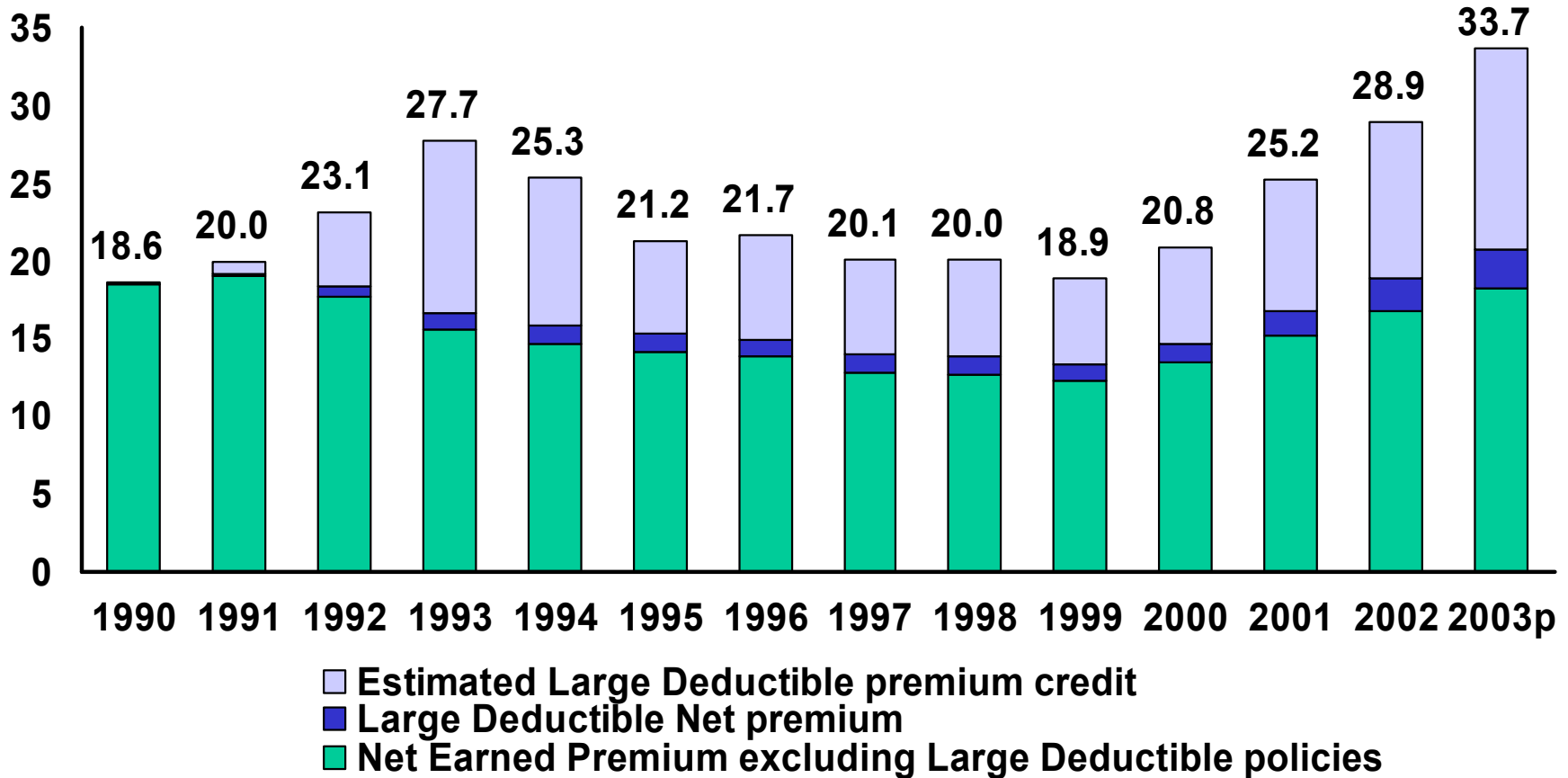


Source: Best's Aggregates & Averages, Review/Preview; Economy.com

# Large Deductible Growth Continues

## Calendar Year WC Earned Premiums & Premium Equivalents NCCI States

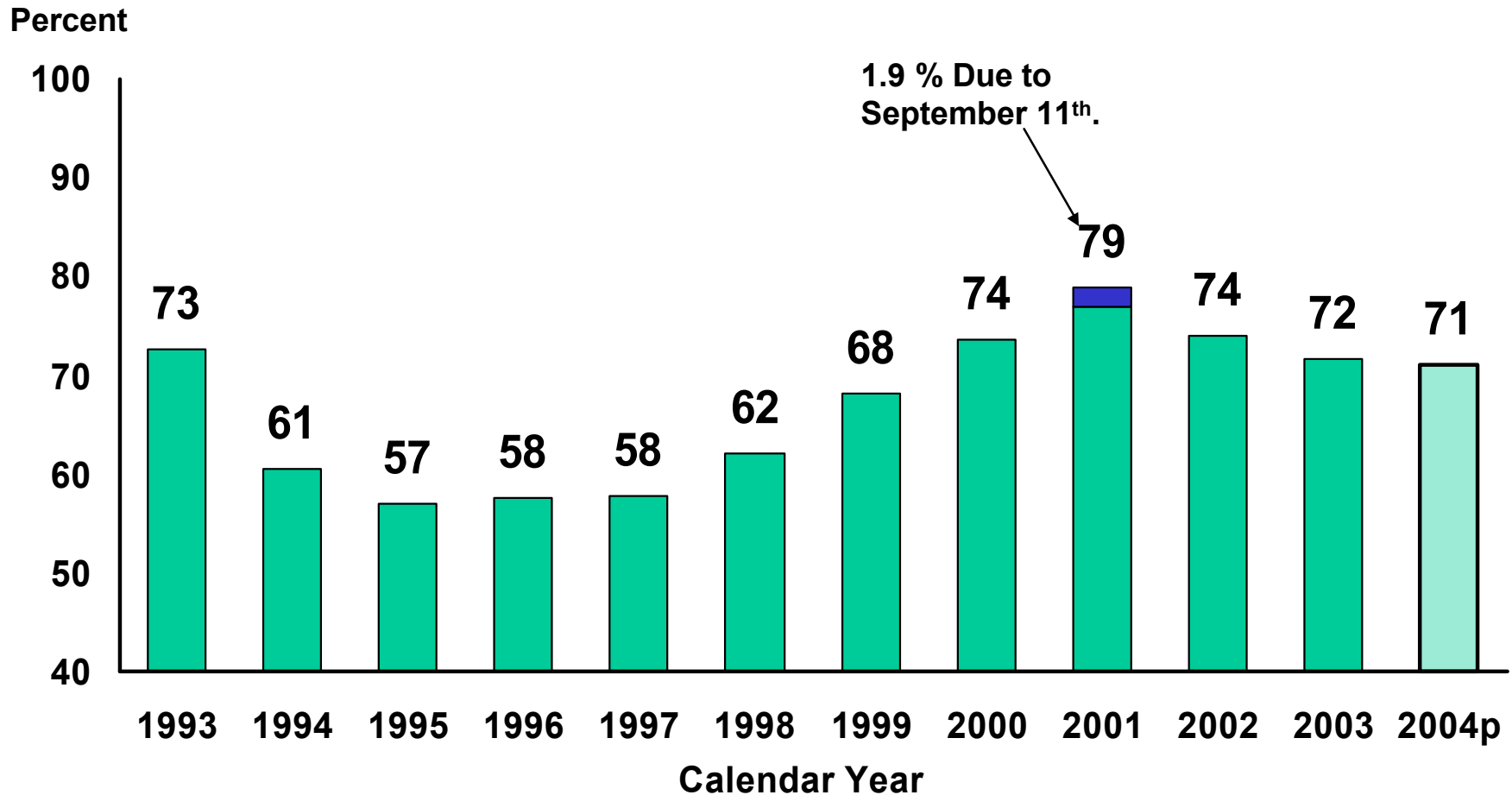
\$ Billions



Source: NCCI Large Deductible study

# Calendar Year WC Loss Ratio Showing Slight Improvement

## Workers Compensation Net Loss Ratios



Source: Best's Aggregates & Averages, Review/Preview; 9-11 est. from NCCI

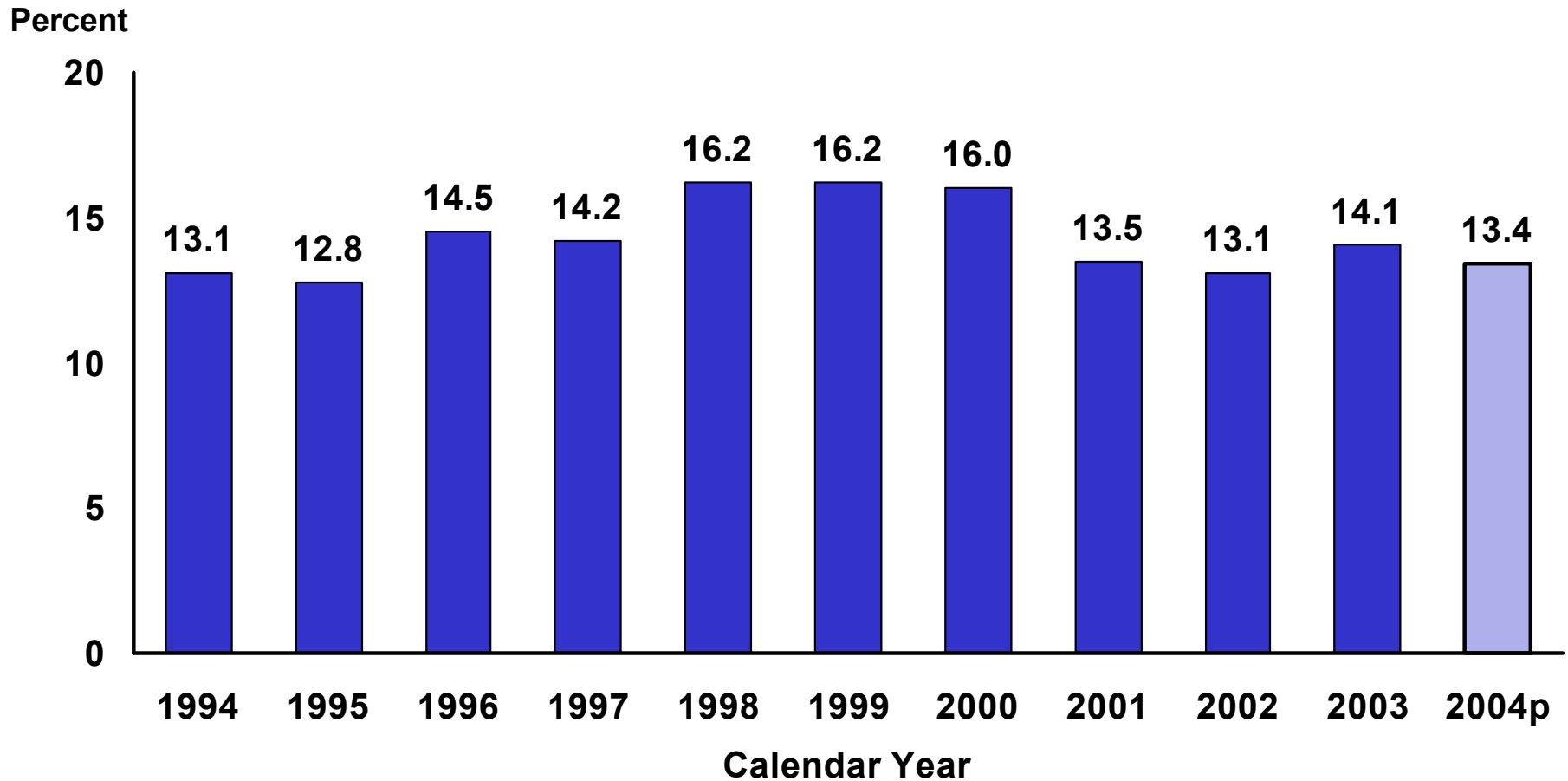
# WC Loss Ratios - Impact of Large Deductible Policies

	<b><u>First Dollar</u></b>	<b><u>Large Deductible</u></b>
<b>Loss</b>	<b>\$ 75</b>	<b>\$ 15</b>
<b>Expense</b>	<b><u>\$ 25</u></b>	<b><u>\$ 23</u></b>
<b>Premium</b>	<b>\$100</b>	<b>\$ 38</b>
<b>Loss Ratio</b>	<b>75%</b>	<b>40%</b>
<b>Expense Ratio</b>	<b>25%</b>	<b>60%</b>



# WC LAE Ratios to Premium Are Leveling Off

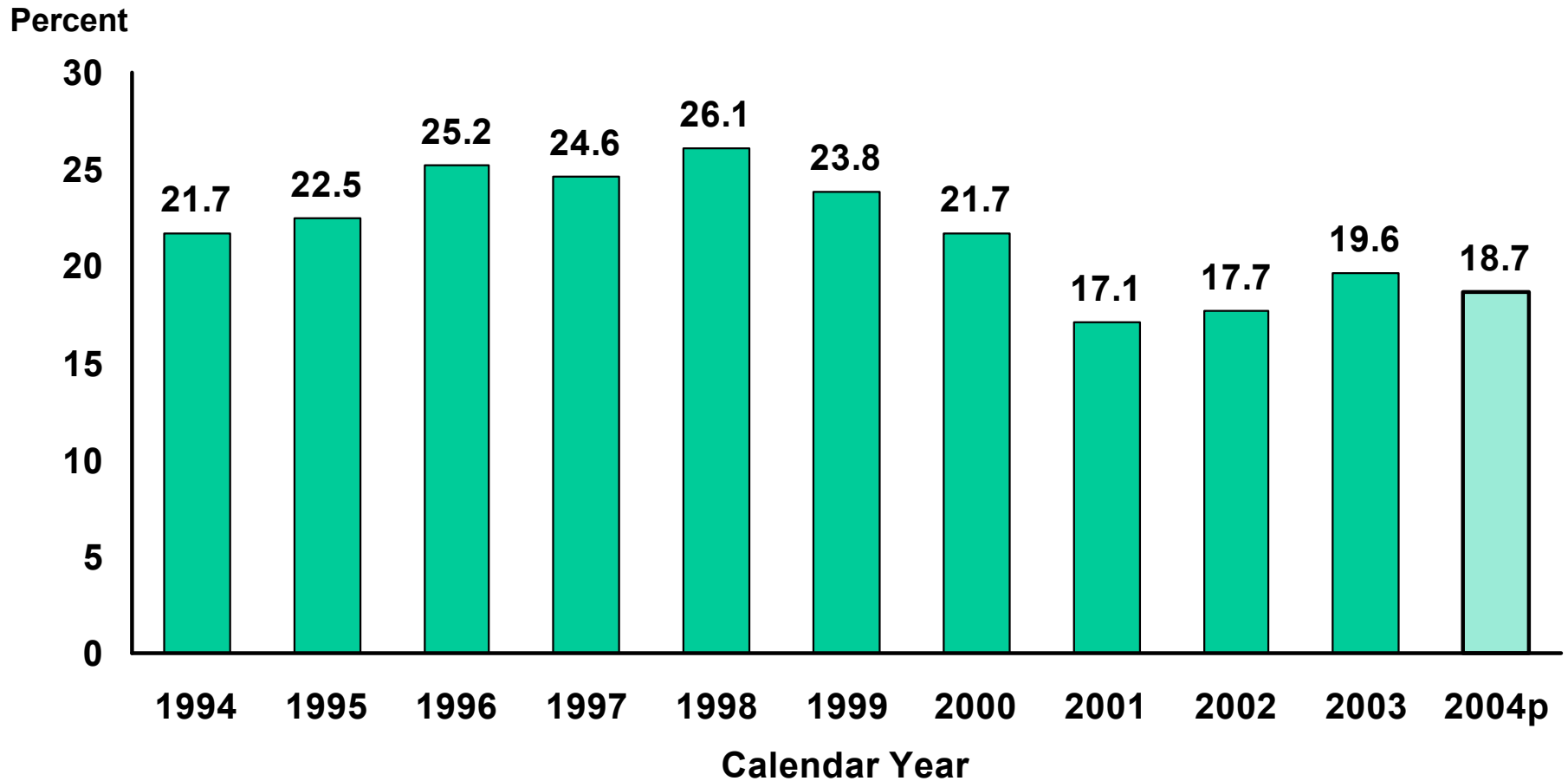
## WC Ratio of Loss Adjustment Expense to Net Earned Premiums



Source: Best's Aggregates & Averages, Review/Preview

# WC LAE To Loss Ratios Remain Relatively Unchanged

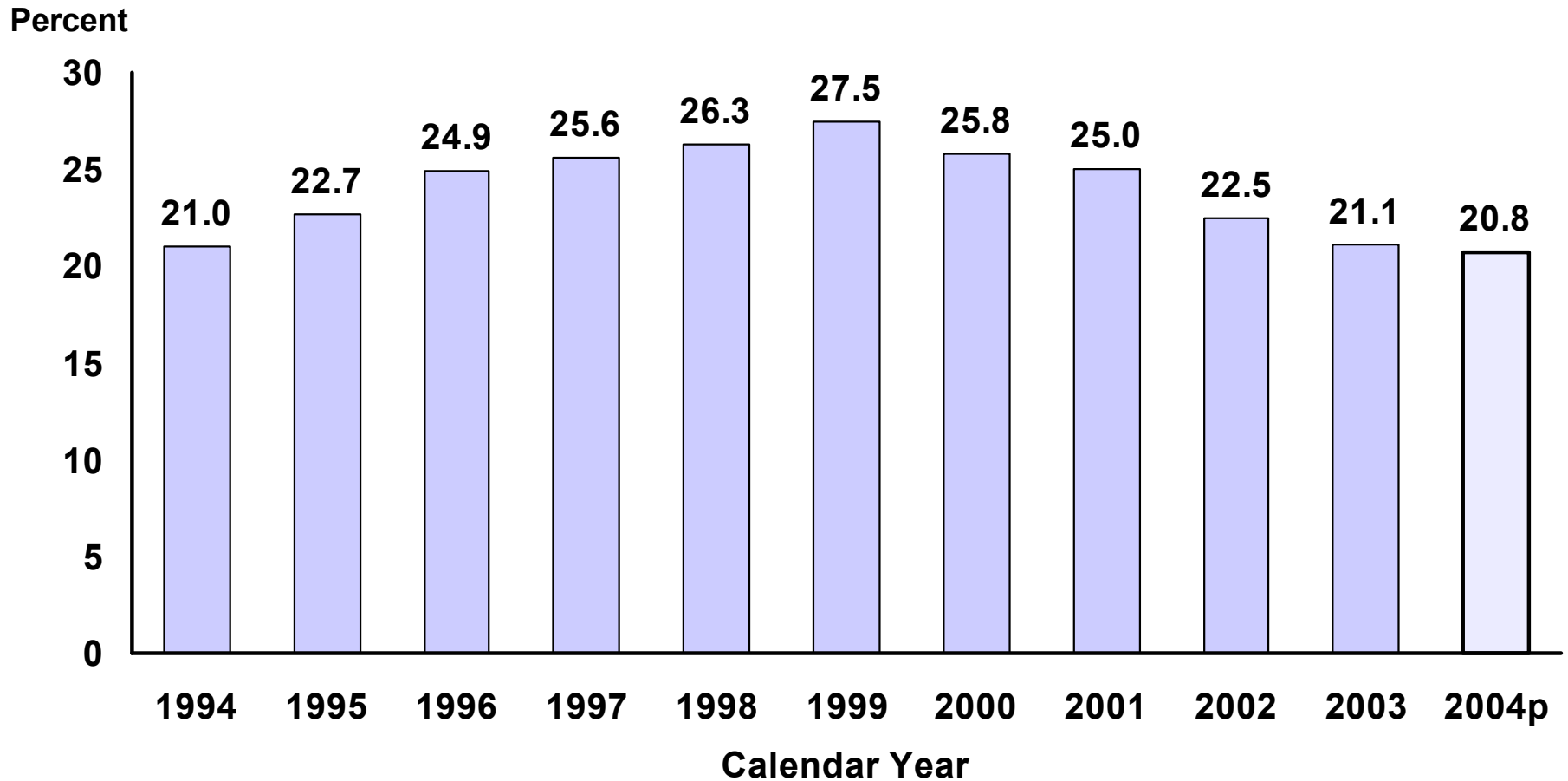
## WC Ratio of Loss Adjustment Expense to Losses



Source: Best's Aggregates & Averages, Review/Preview

# WC Expense Ratios Showed Little Movement in 2004

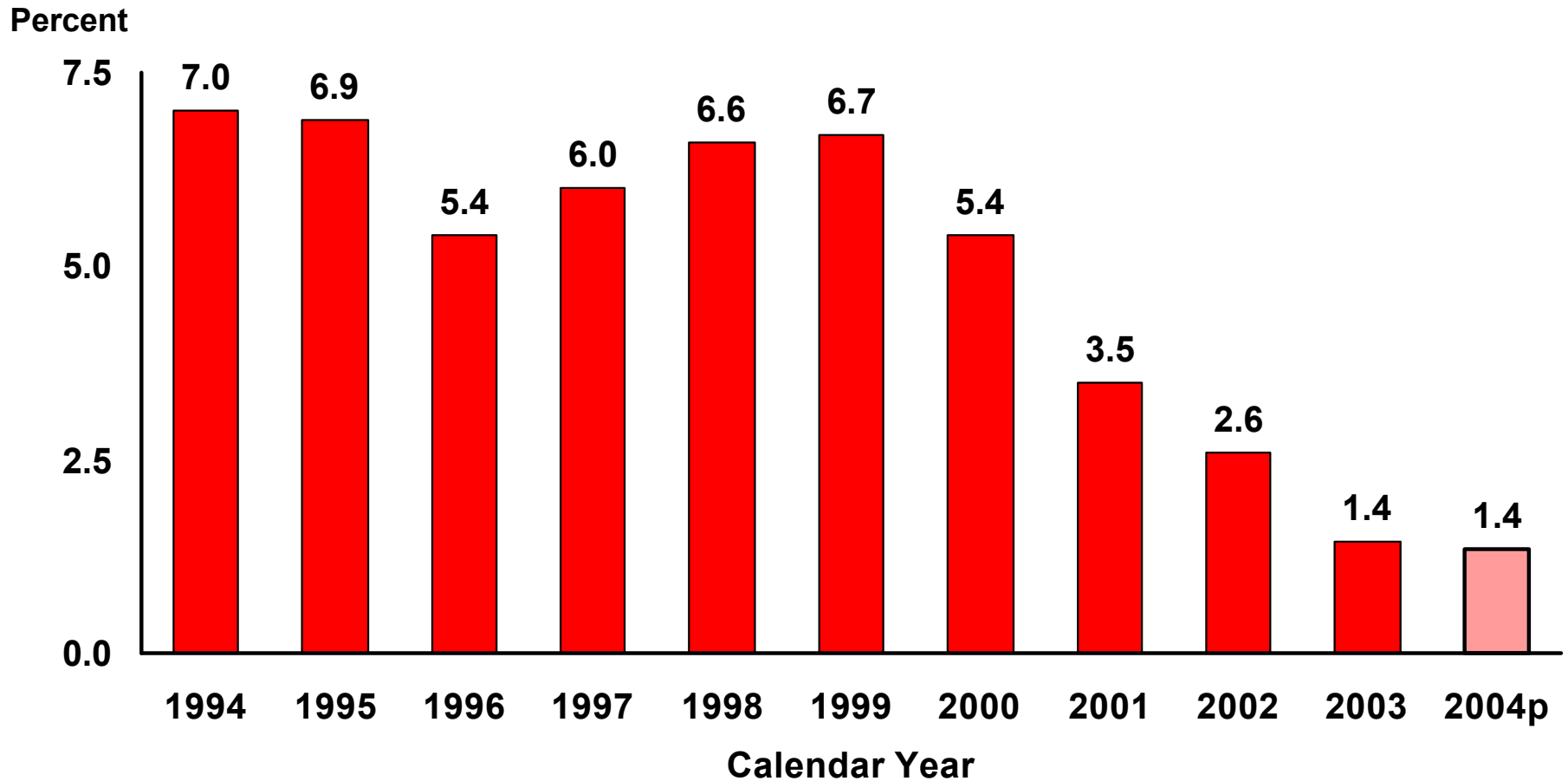
## WC Ratio of Underwriting Expenses to NWP (Excl Divs)



Source: Best's Aggregates & Averages, Review/Preview

# WC Dividend Ratios Are Flattening

## WC Ratio of Policyholder Dividends to Net Earned Premium

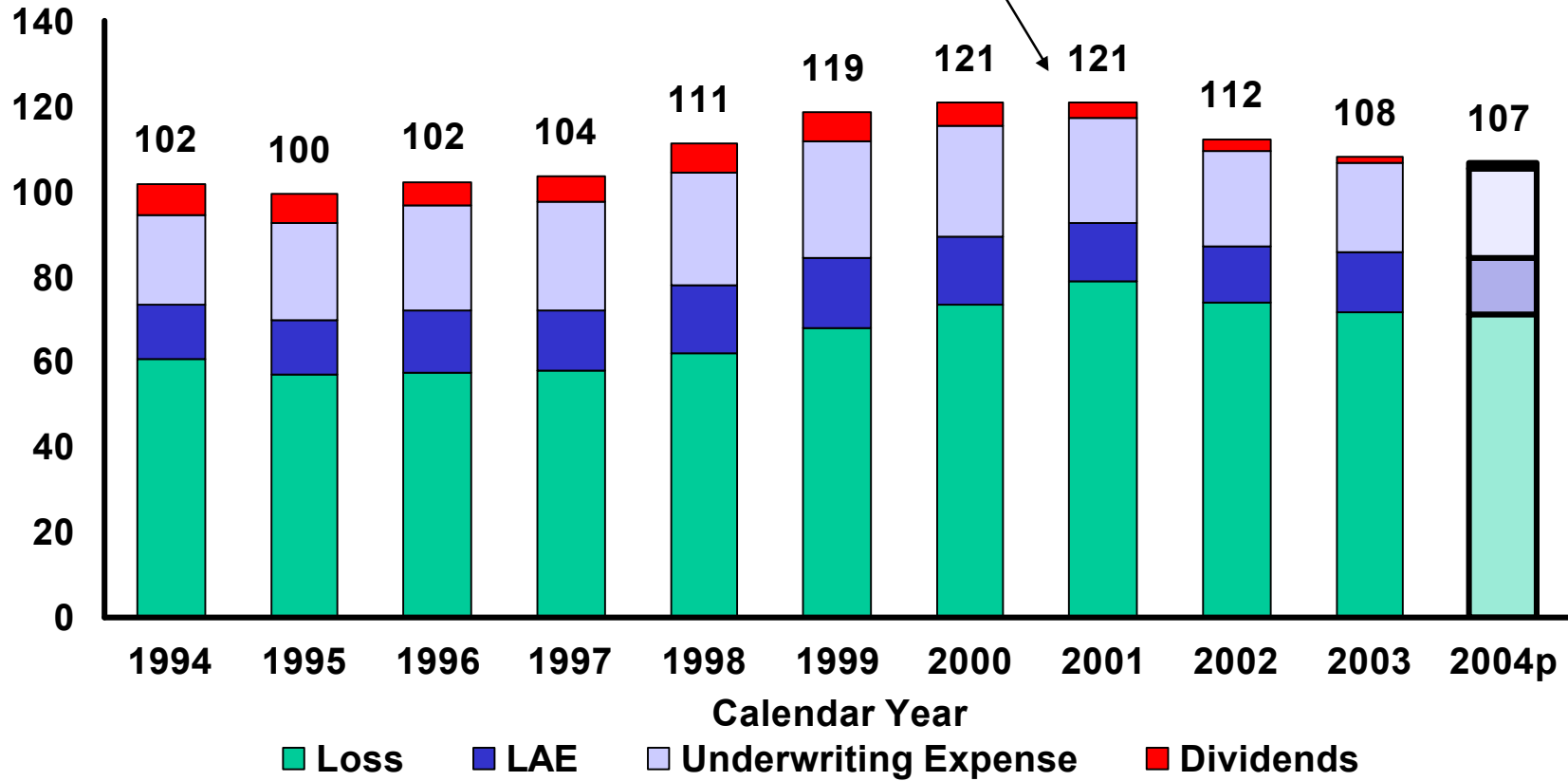


Source: Best's Aggregates & Averages, Review/Preview

# Workers Compensation Calendar Year Combined Ratio Declined in 2004

## Workers Compensation Combined Ratios

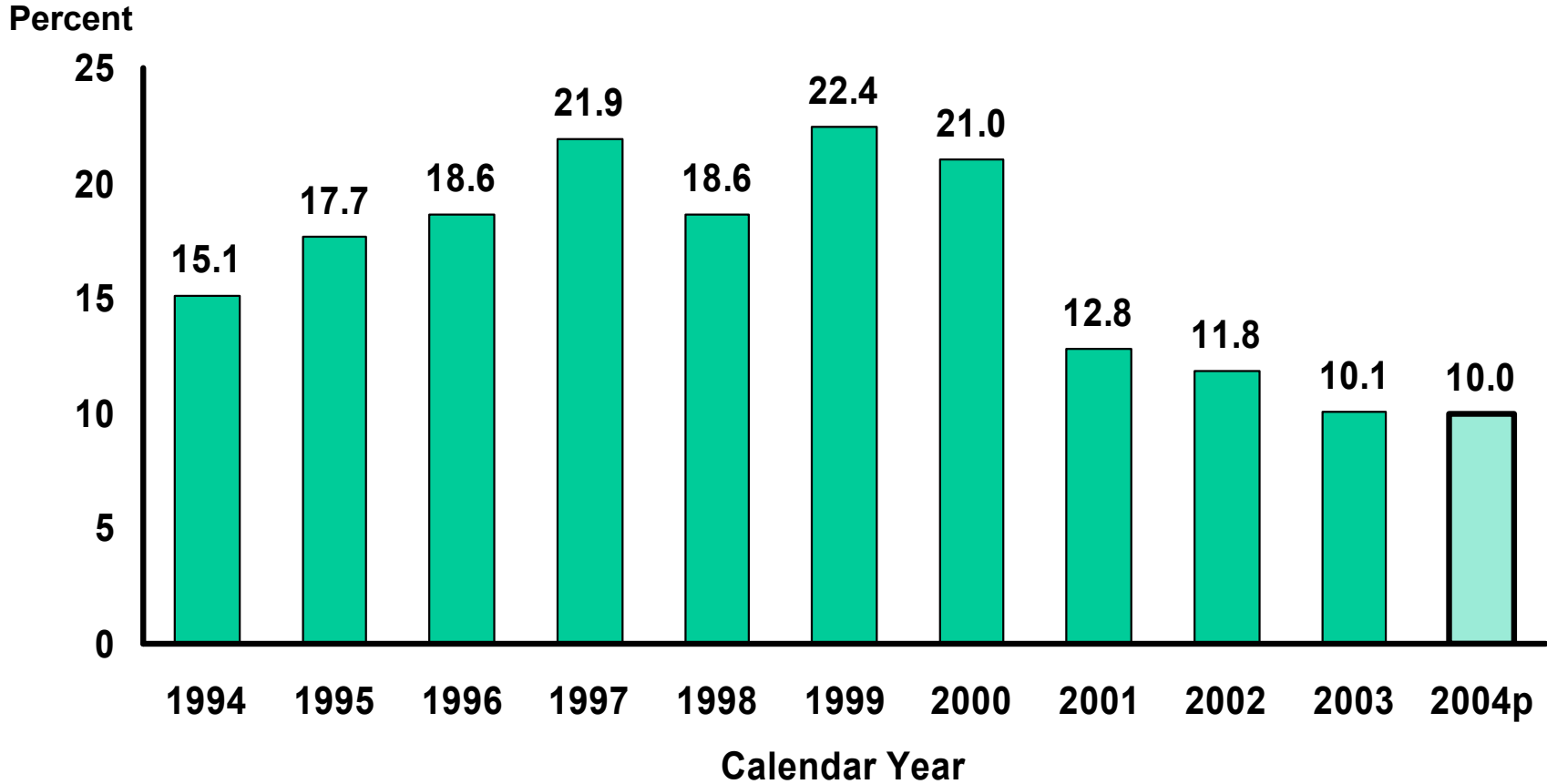
Combined Ratio



Source: Best's Aggregates & Averages, Review/Preview

# WC Investment Returns Remain Low

## WC Ratio of Investment Gain and Other Income to Premium

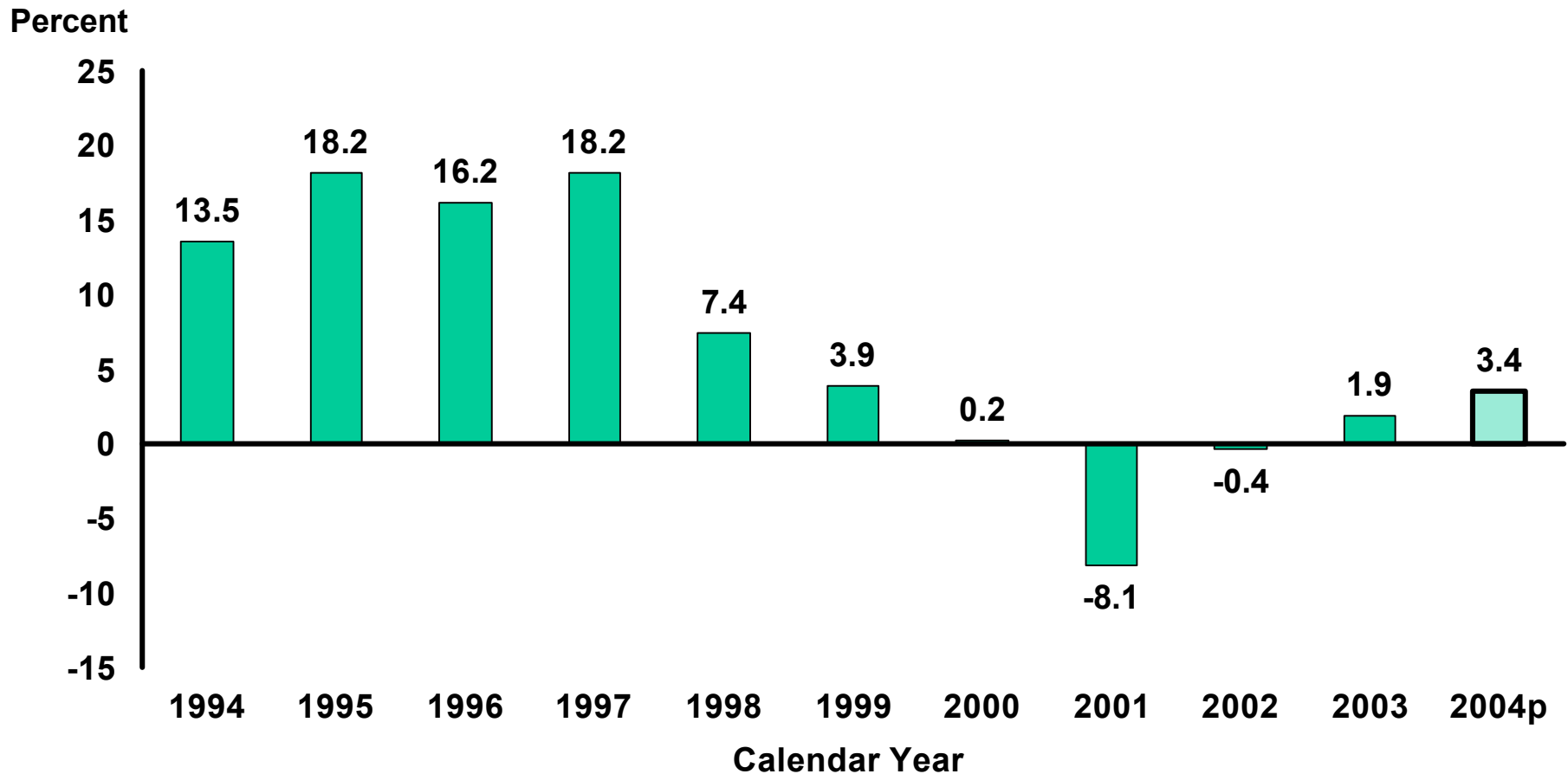


p Preliminary

Source for 1994–2003: A.M. Best Aggregates & Averages; 2004p: NCCI estimate based on data in Best's Review/Preview  
Investment gain includes investment income on insurance transactions and realized capital gains.

# WC Results in 2003 Improved Over 2002

## WC Pretax Operating Gain/Loss Ratio



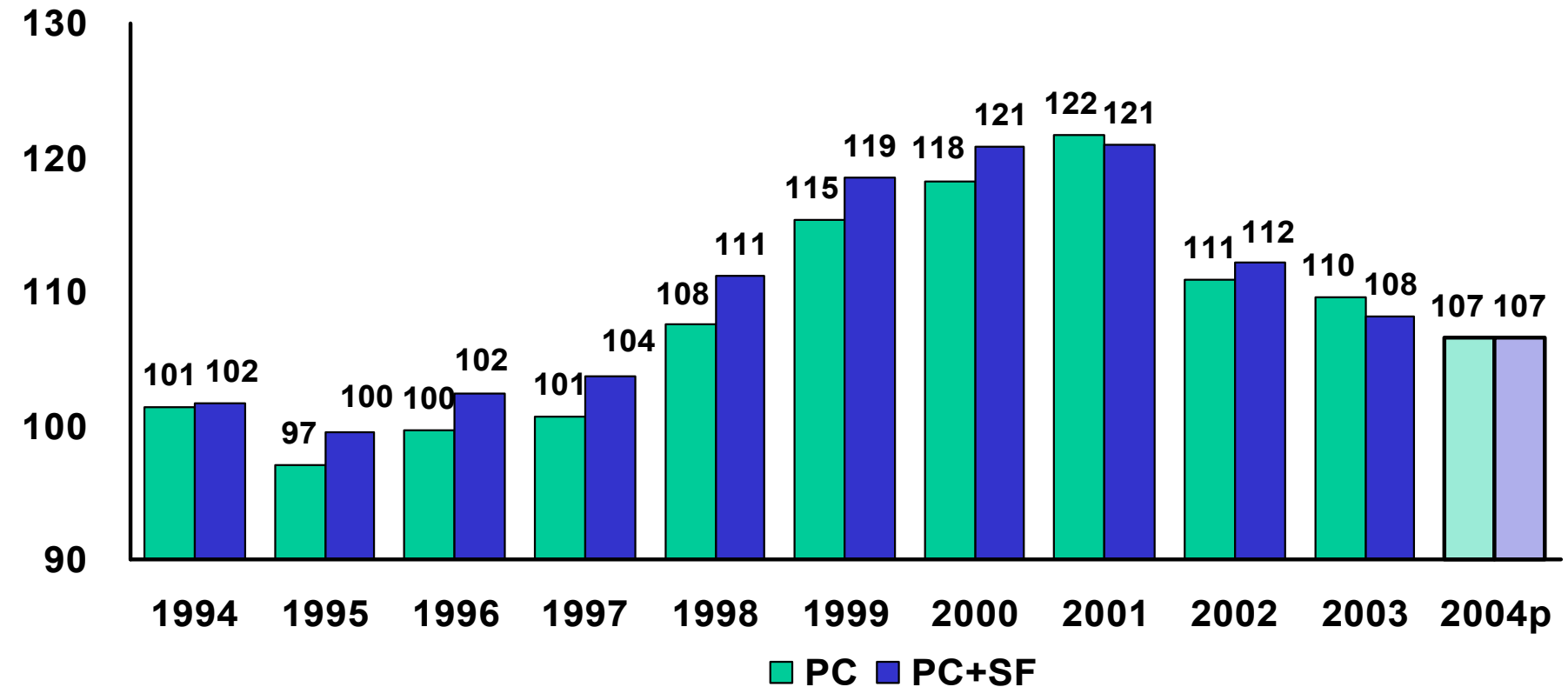
p Preliminary

Source for 1994–2003: A.M. Best Aggregates & Averages; 2004p: NCCI estimate based on data in Best's Review/Preview  
Investment gain includes investment income on insurance transactions and realized capital gains.

# WC Calendar Year Combined Ratios

## Private Carriers Compared to Private Carriers + A.M. Best State Funds

Combined Ratio



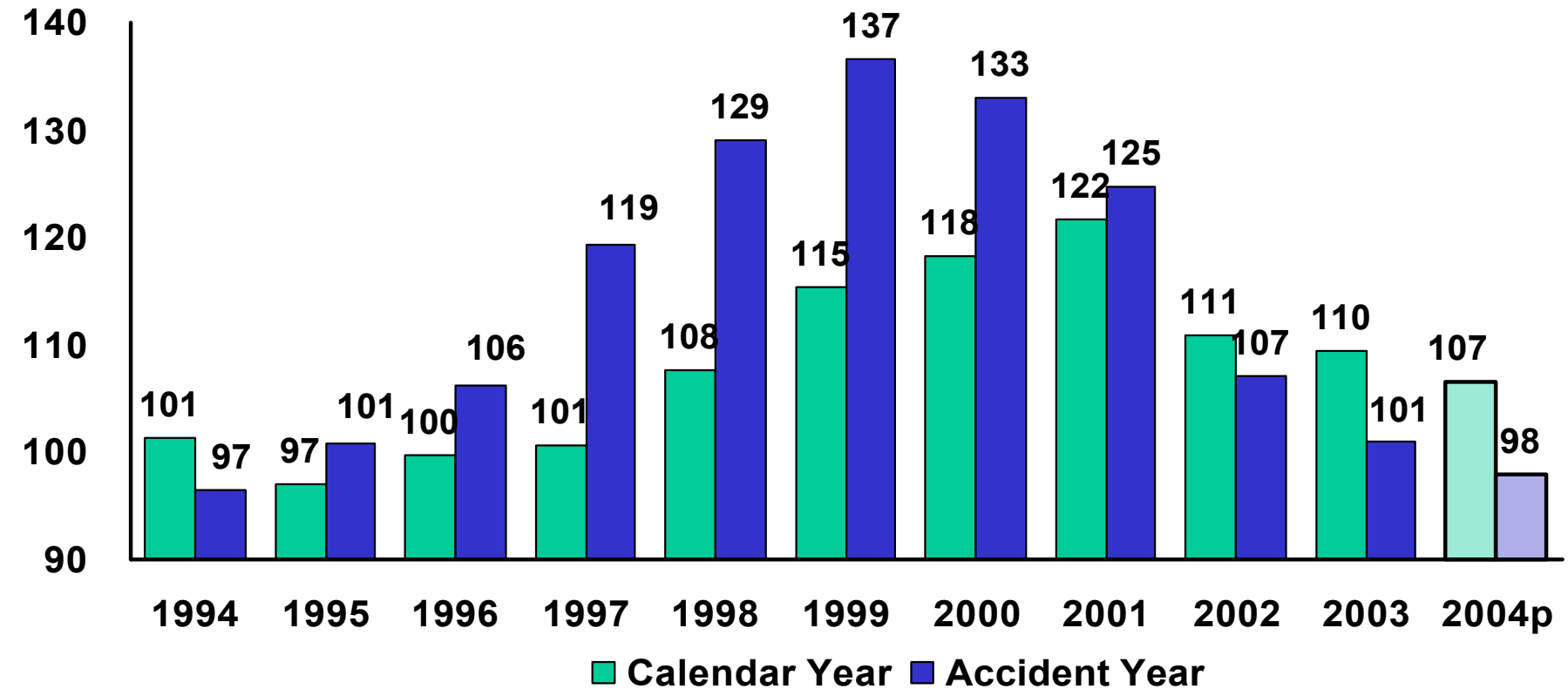
p Preliminary (State Funds include: AZ, CA, ID, LA, MD, ME, MN, OR, RI, TX, and UT)  
CY 1994-2003 & PC+SF 2004p: Best's Aggregates & Averages, Review/Preview;  
PC CY 2004p: NCCI estimate  
Includes dividends to policyholders.



# Combined Ratio in AY 2004 Continued to Improve

## WC Calendar Year vs. Ultimate Accident Year Countrywide—Net—Private Carriers

Combined Ratio



p Preliminary

CY 1994-2003: Best's Aggregates & Averages; AY 1994-2003: NCCI; CY & AY 2004p: NCCI estimates

Accident year data is evaluated as of 12/31/2003 and developed to ultimate.

Includes dividends to policyholders.

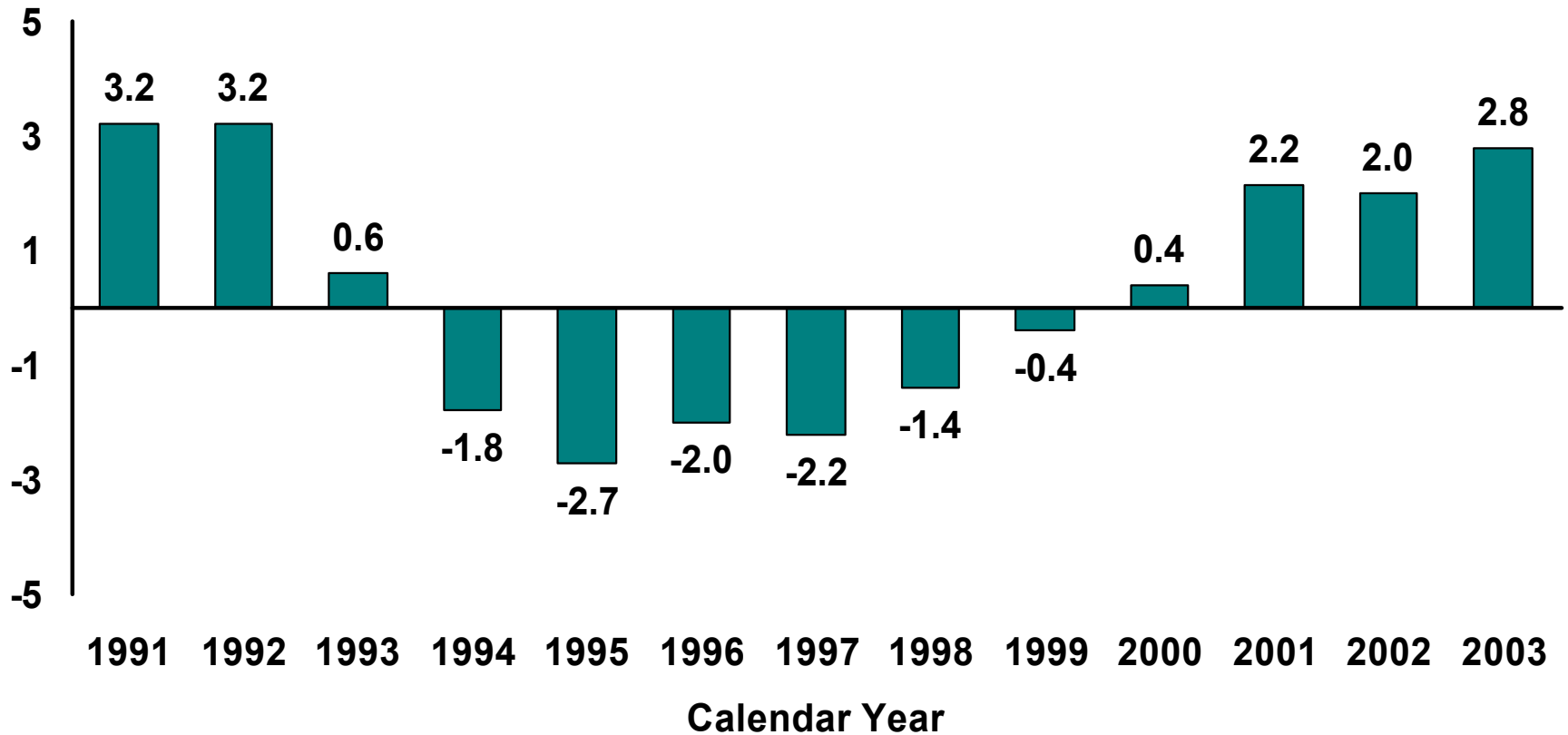
# **What Have Been The Key Factors Impacting Workers Compensation Results?**

- **Reserve Levels**
- **Pricing**
- **Loss Severity Trends (especially Medical)**
- **Frequency Trends**
- **Investments**

# Workers Compensation Reserve Strengthening Continues

## Dollar Amount of Reserve Adjustments on Prior AYs Countrywide—Net—Private Carriers

\$ Billions

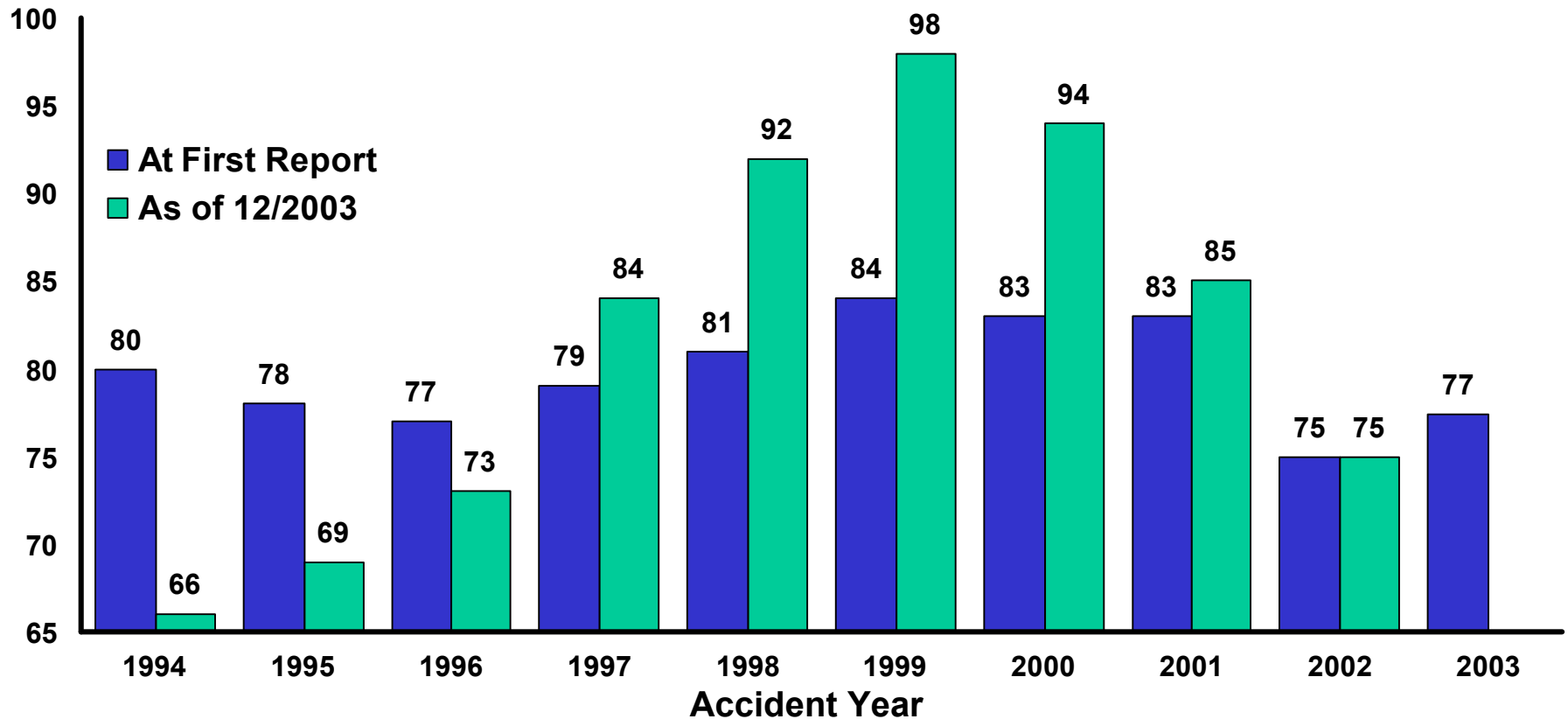


Loss and LAE reserves.

# Workers Compensation Accident Year Loss & LAE Ratios Developed Upward

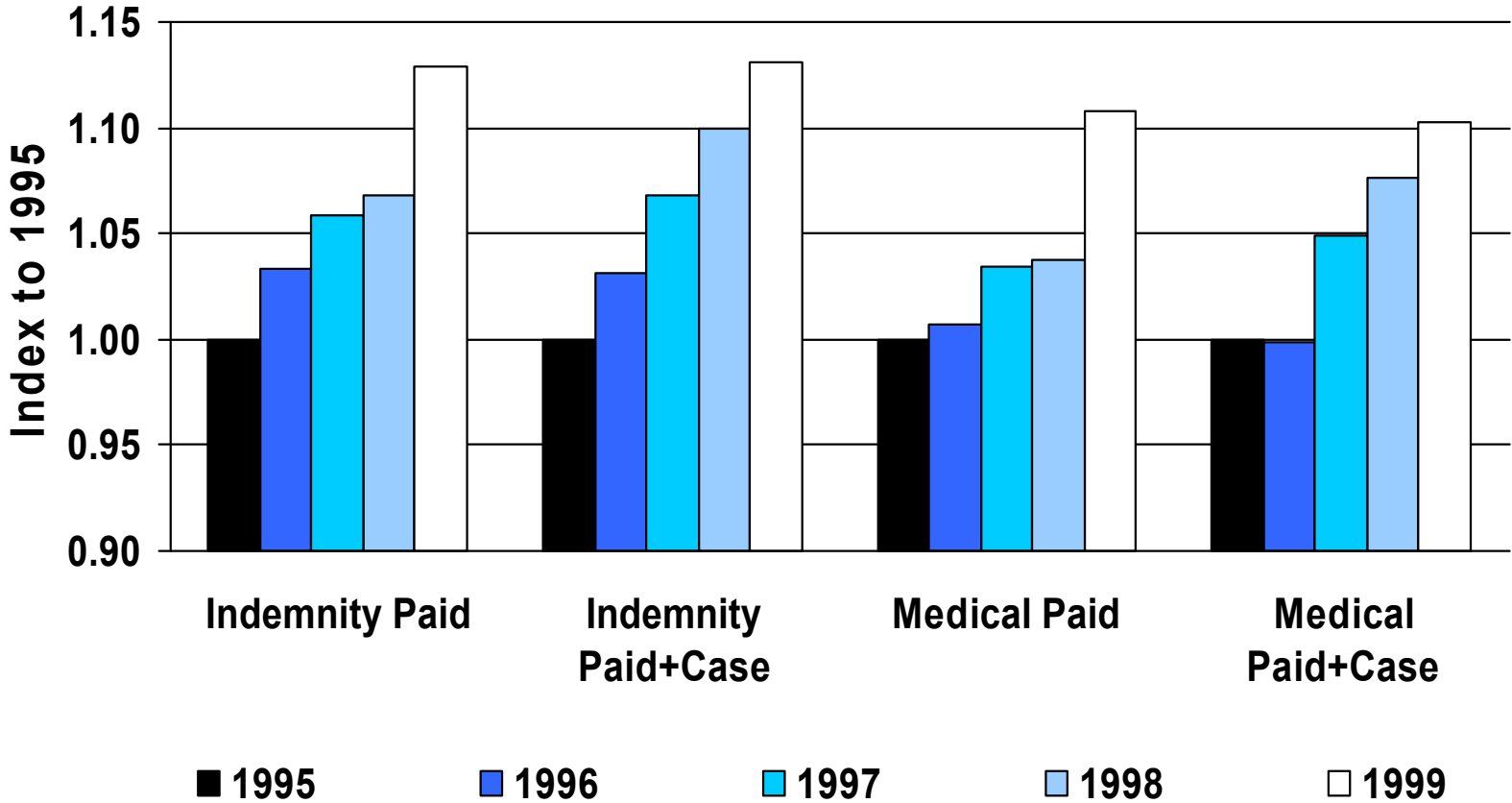
## Accident Year Loss Ratios Including LAE Countrywide—Net—Private Carriers

Percent



Reported Loss and LAE reserves from Schedule P.

# WC Changing Development Patterns 1<sup>st</sup> to 5<sup>th</sup> Development



Accident Year Development. First is at 12 months.  
Source: NCCI's Loss Development Exhibits.

# How Are Final WC Premiums Determined?

## ADVISORY ORGANIZATION

**Advisory Loss Costs**

**Assigned Risk Rates**

**Experience Rating Values**

**Experience Mods**

**Rating Plans and  
Classifications**

## INSURANCE COMPANY

**Final Rate Determination:**

- **Expense Multiplier**
- **Loss Cost Deviations**

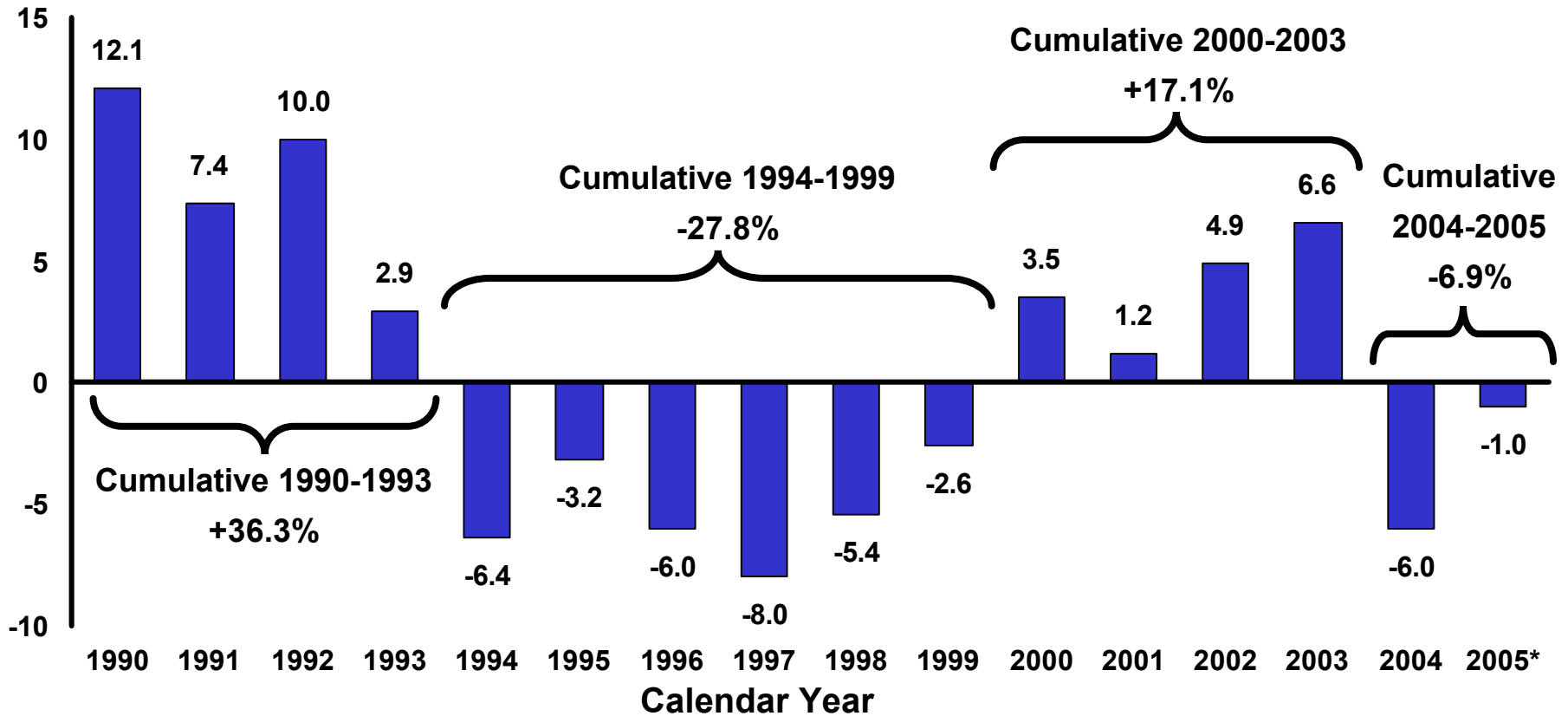
**Individual Risk Modifications:**

- **Schedule Rating**
- **Retrospective Rating**

# Average Approved Bureau Rate/Loss Cost Still Decreasing

## History of Average WC Bureau Rate/Loss Cost Level Changes

Percent

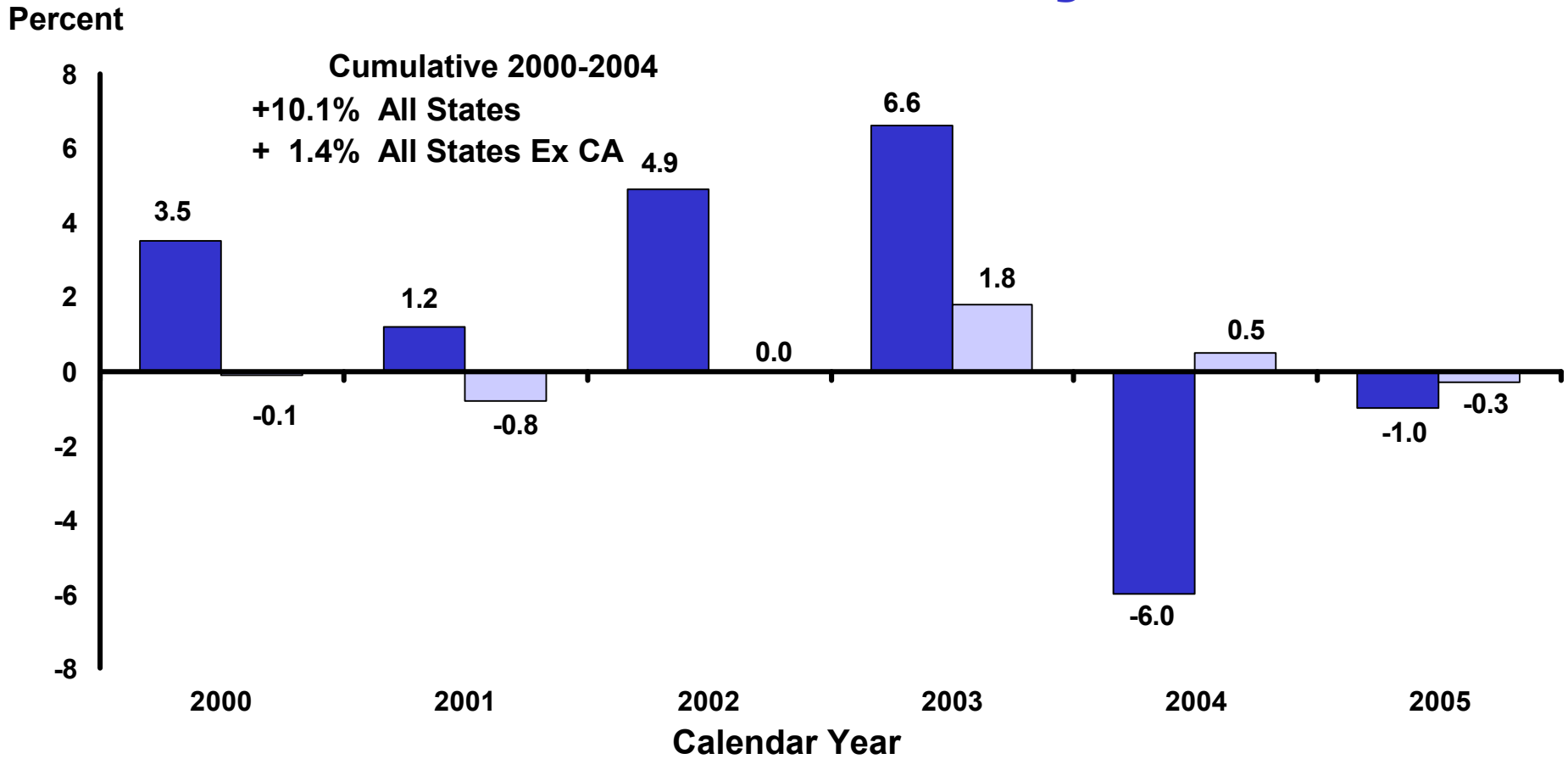


\* States approved through 03/01/2005

Countrywide approved changes in advisory rates, loss costs and assigned risk rates as filed by the applicable rating organization

# Average Approved Bureau Rate/Loss

## All States vs All States Excluding California



\* States approved through 03/01/2004

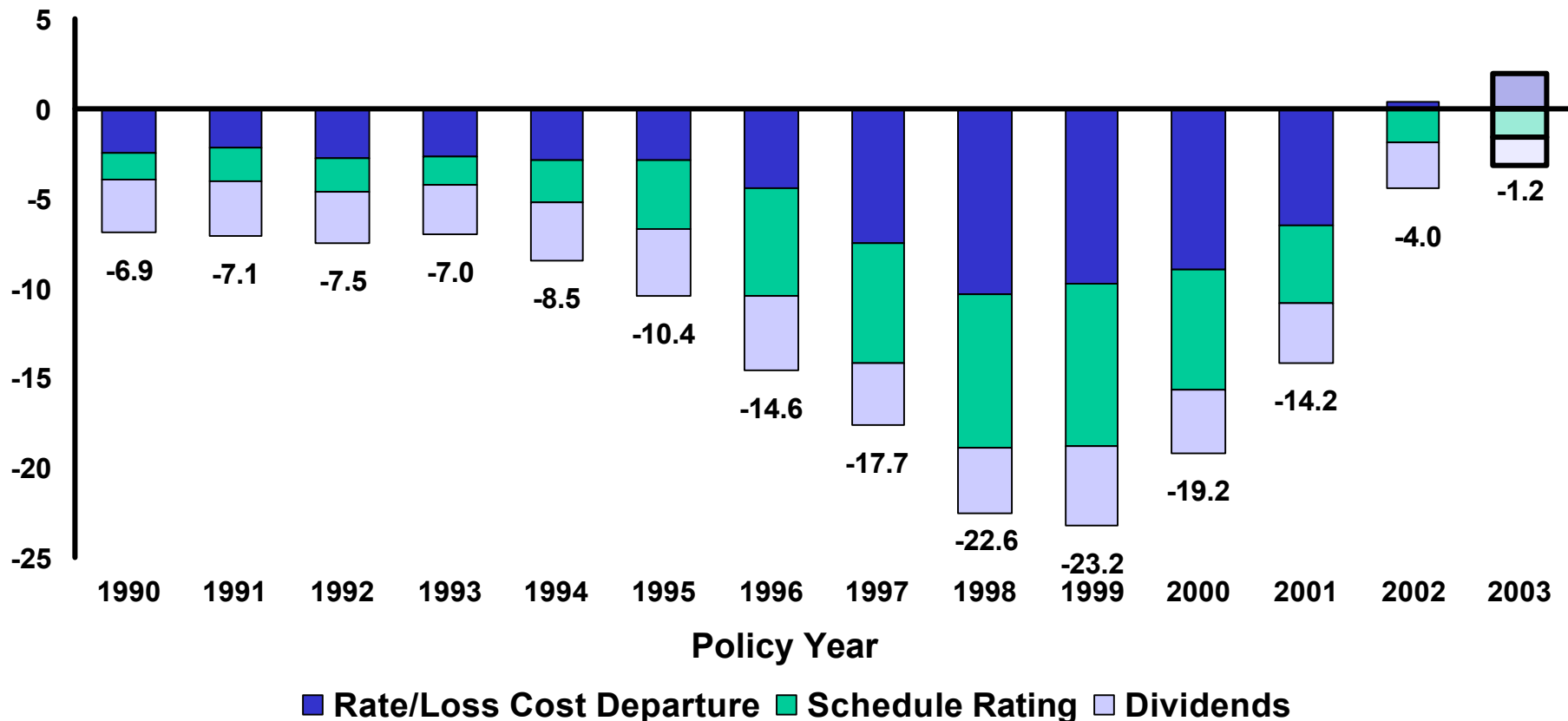
Countrywide approved changes in advisory rates, loss costs and assigned risk rates as filed by the applicable rating organization



# Impact of Discounting on WC Premium

## NCCI States—Private Carriers

Percent



Based on data through 12/31/2003 for the states where NCCI provides ratemaking services  
 NCCI benchmark level includes no provision for profit and contingency  
 Dividend ratios are based on calendar year statistics

# What are Some Primary Components and Factors of WC Premiums?

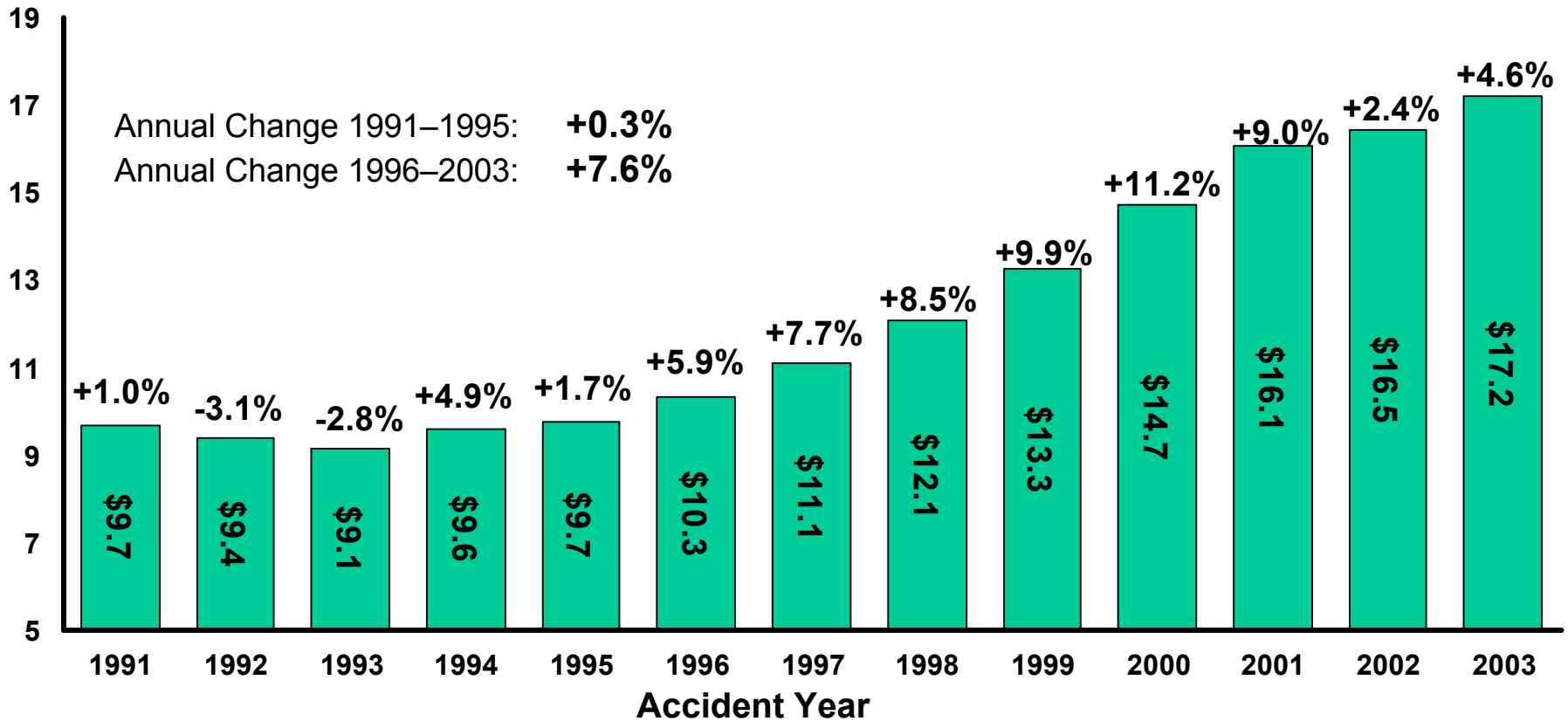
**Loss Cost = f (customer, company, and/or industry losses, inflation, interest rate, medical technology, economy, etc.)**

**+ Risk Charge**  
**+ Expenses**  
**+ Tax**  
**Premium**

# The Rate of Change in Workers Compensation Indemnity Claim Costs Is Moderating

Indemnity Claim Cost (000s)

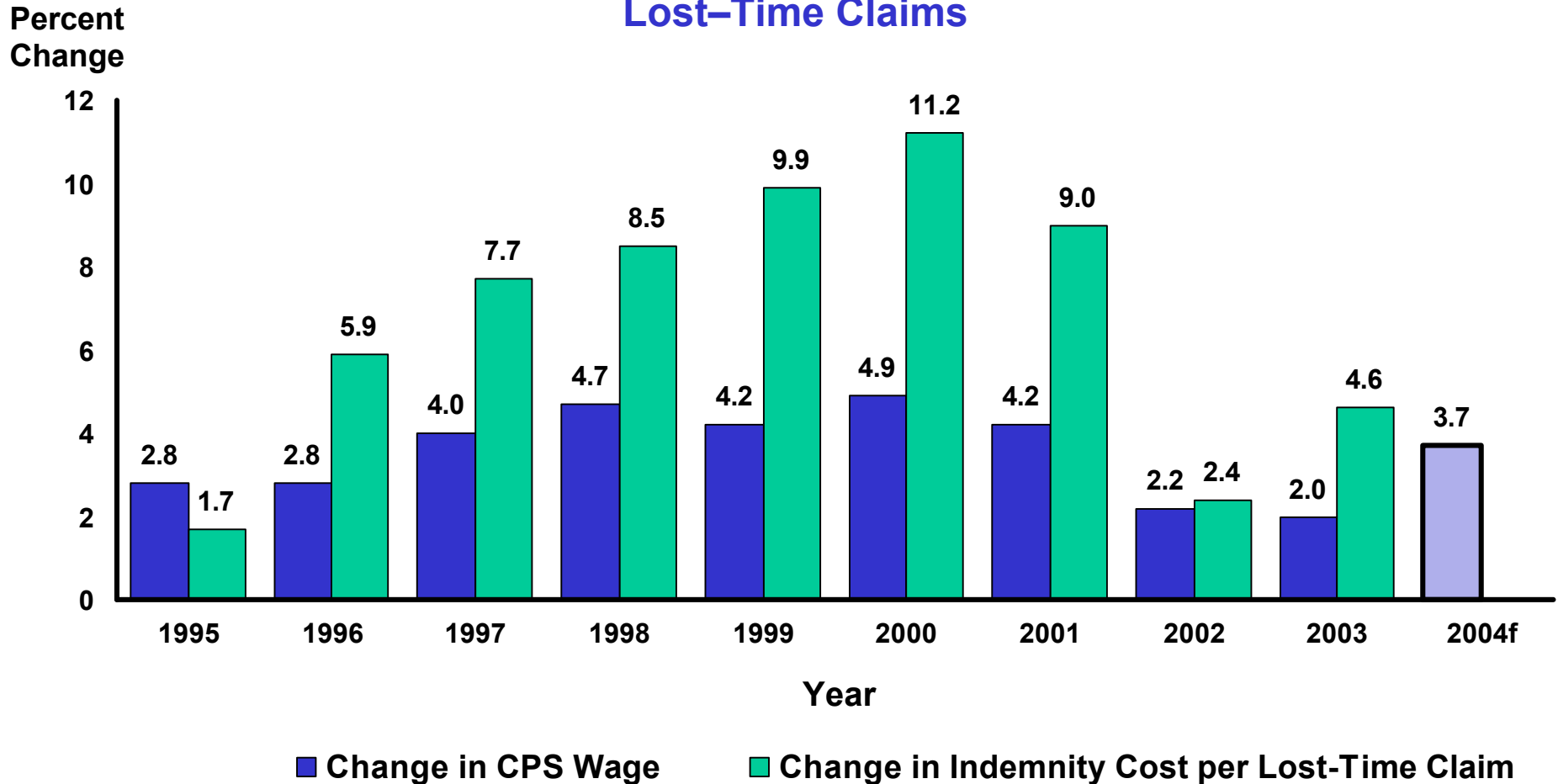
Lost-Time Claims



Based on data through 12/31/2003, developed to ultimate  
Based on the states where NCCI provides ratemaking services  
Excludes the effects of deductible policies

# Workers Compensation Indemnity Severity Is Outpacing Wage Inflation

## Lost-Time Claims



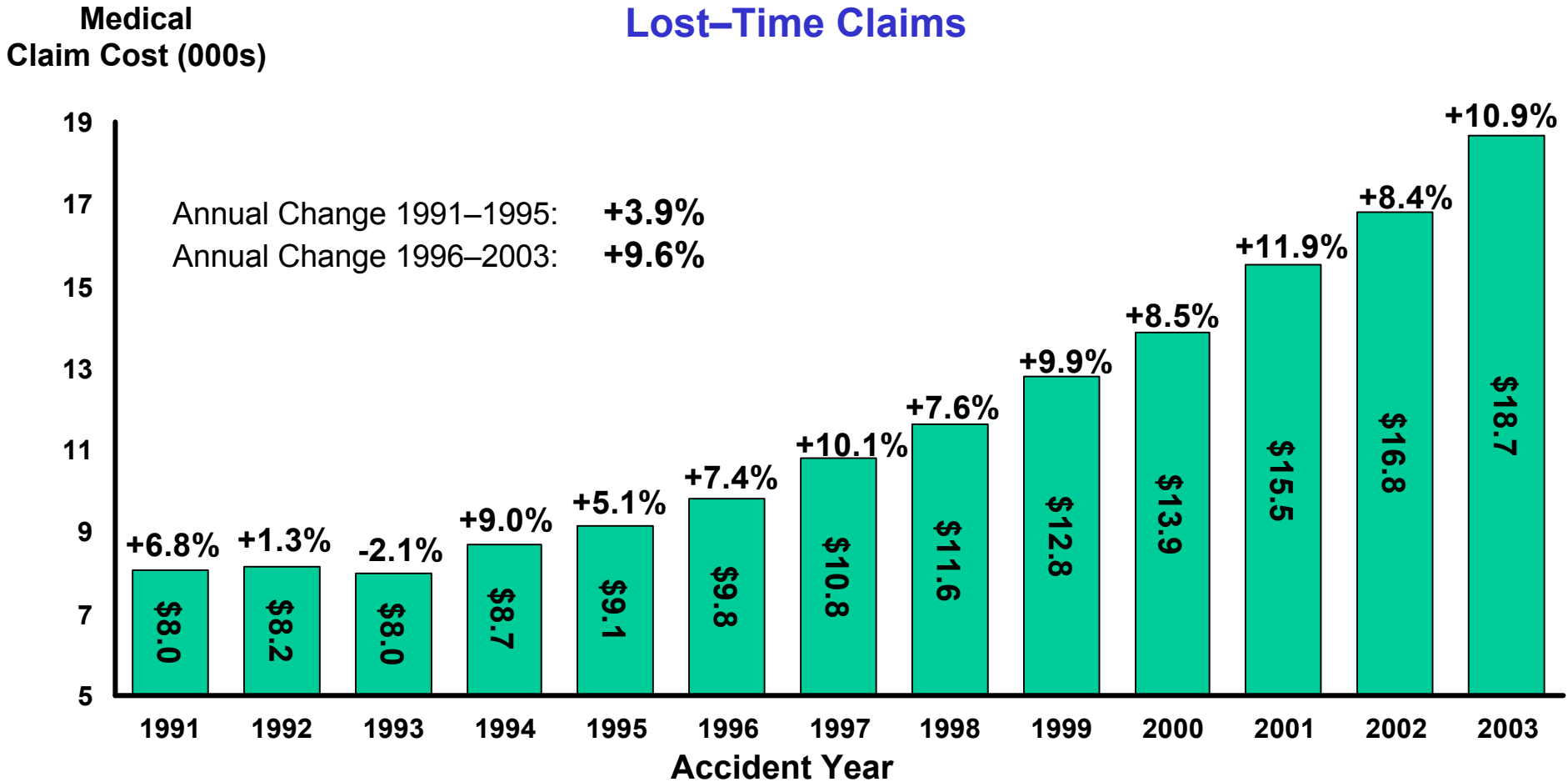
Source: Calendar Year Current Population Survey, Economy.com; Accident Year Indemnity Severity, NCCI

Based on data through 12/31/2003, developed to ultimate

Based on the states where NCCI provides ratemaking services

Excludes the effects of deductible policies

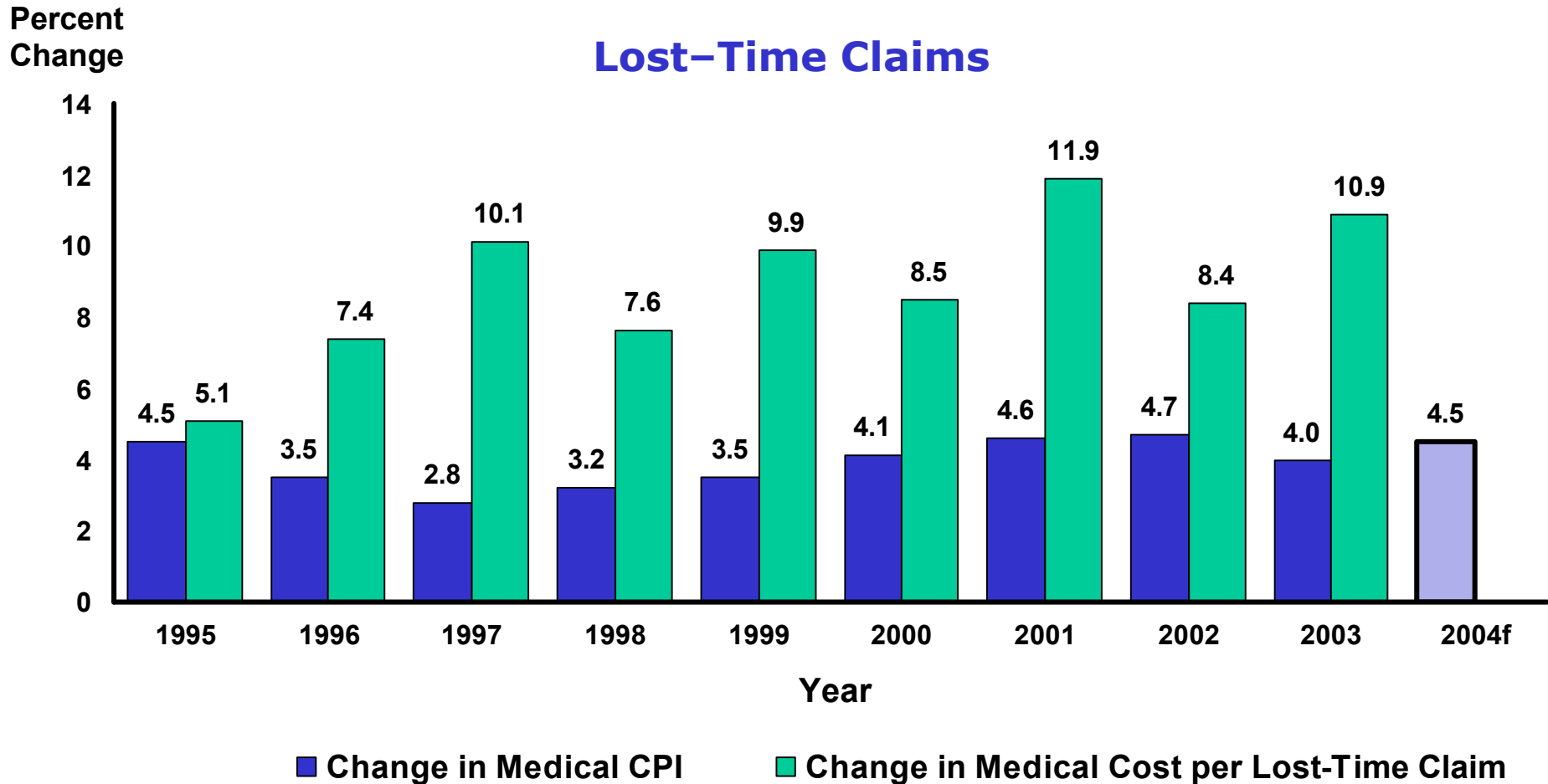
# Workers Compensation Medical Claim Cost Trends Continue to Climb



Based on data through 12/31/2003, developed to ultimate  
 Based on the states where NCCI provides ratemaking services  
 Excludes the effects of deductible policies

# Workers Compensation Medical Severity Has Been Growing Faster Than the Medical CPI

## Lost-Time Claims



Source: Calendar Year Current Population Survey, Economy.com; Accident Year medical severity, NCCI

Based on data through 12/31/2003, developed to ultimate

Based on the states where NCCI provides ratemaking services

Excludes the effects of deductible policies

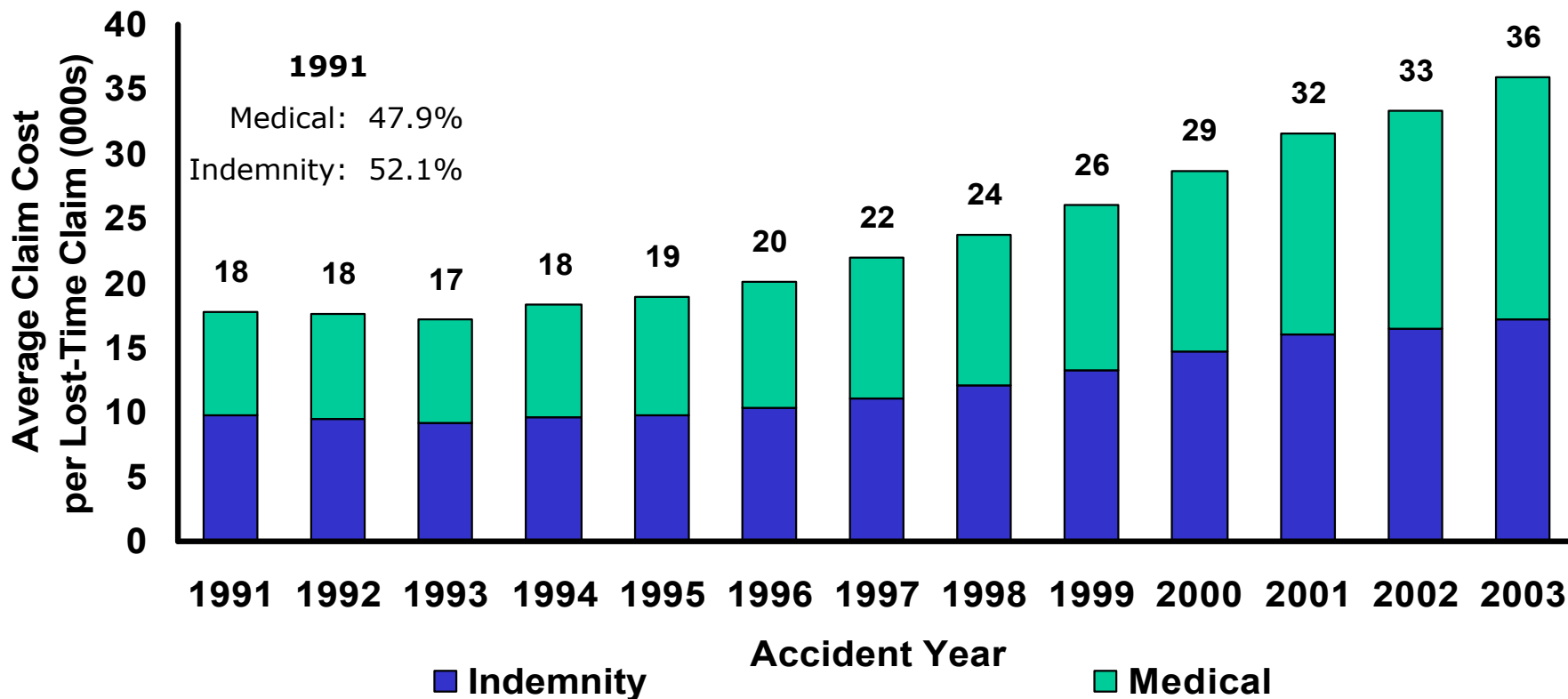
# WC Medical Losses Eclipsed More Than Half of Total WC Losses

NCCI States—Private Carriers—All Claims

2003

Medical: 55.2%

Indemnity: 44.8%



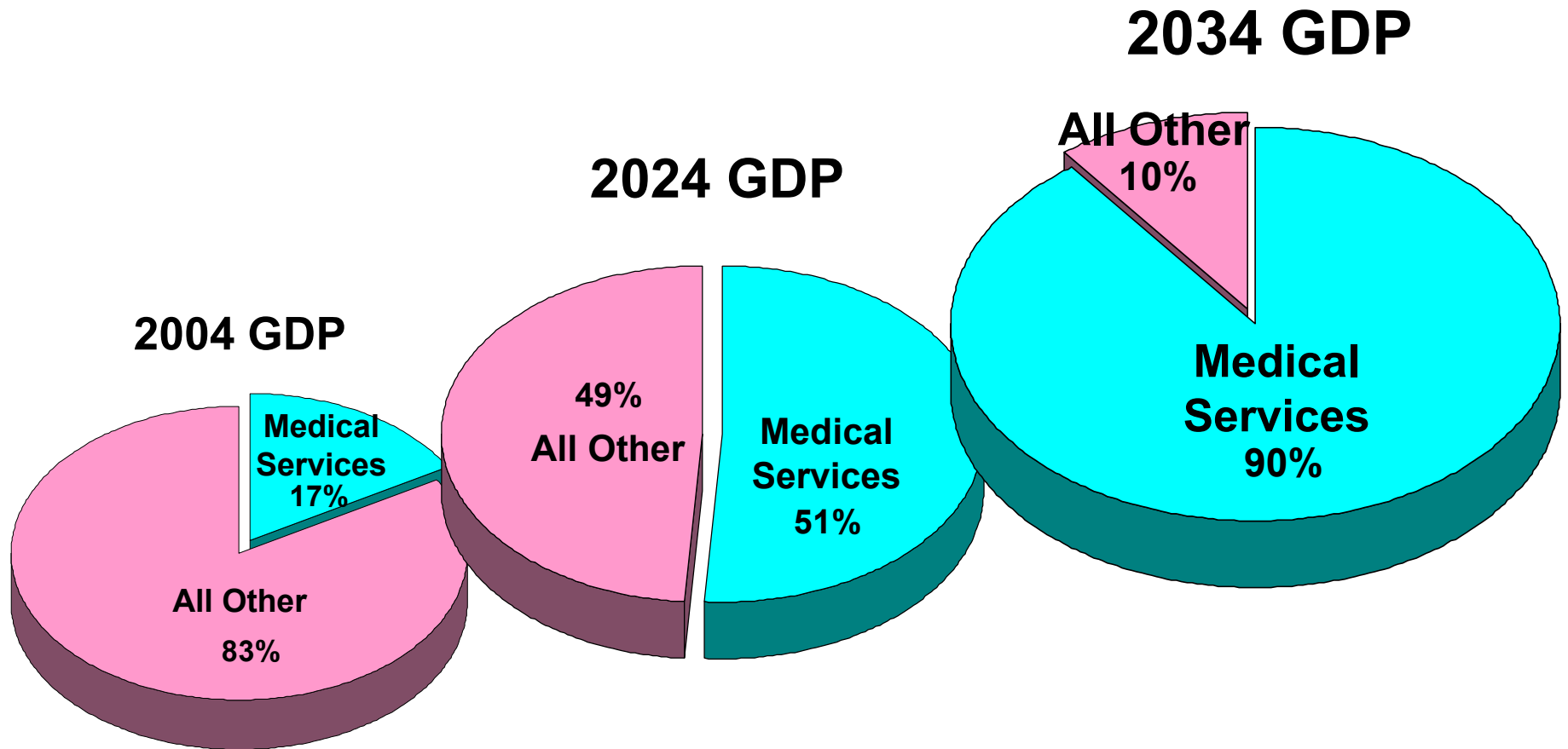
Based on data through 12/31/03, developed to ultimate.  
 Based on the states where NCCI provides ratemaking services.  
 Excludes the effects of deductible policies.

# **Rising Medical Costs – Can The Economy Sustain Double Digit Inflation**

- **Workers Compensation medical makes up 1-2% of total medical services**
- **Total medical services were 17% of GDP in 2004**
- **Total medical services have also been growing at much faster rate than other parts of the economy (8.4% vs 4.8%)**
- **What are implications to GDP if medical services were to grow at 10% while rest of GDP grew at 4%**



# Implications for Medical Trends



Medical services as % of GDP=17%

Medical services growth=10%, GDP Growth=4.0%

Medical Services include Medical Care, Drug Preparations and Sundries, and Ophthalmic Products and Orthopedic Appliances

# NCCI Prescription Drug Study

- The growth in WC prescription drugs' share of total medical costs continues:
  - Accident Year 1997      10.1%
  - Accident Year 2002      12.1%
- Main driver of increase in WC prescription costs:
  - From 1997 to 2001: Utilization increases
  - In 2002: Rx price increases had slightly larger impact than utilization increases
- Prescription drug fee schedules exist in 28 states—all reimburse using average wholesale prices (AWP)
- Using Pharmacy Benefit Managers (PBMs) looks promising as a cost containment strategy. Other factors also need to be assessed and addressed.

# The Impact of Inflation is More Sensitive on Excess Policies

	<u>Year 1</u>	<u>Year 2</u>	<u>Change</u>
Gross Loss	\$360,000	\$385,200	7%
Deductible	\$250,000	\$250,000	-
Excess Loss	\$110,000	\$135,200	23%

# With Medical Technology, How Big Can a WC Claim Become?

- Consider a 25-year old quadriplegic
- Indemnity benefits of \$23,500 a year
- 24-hour attendant care costs of \$135,000 a year
- Other medical costs of \$72,500 a year
- These costs continue until death

Age at Death	Medical Inflation Rate		
	5%	7%	9%
45	\$7	\$8	\$8
60	\$16	\$20	\$27
75	\$33	\$49	\$82
90	\$64	\$118	\$266

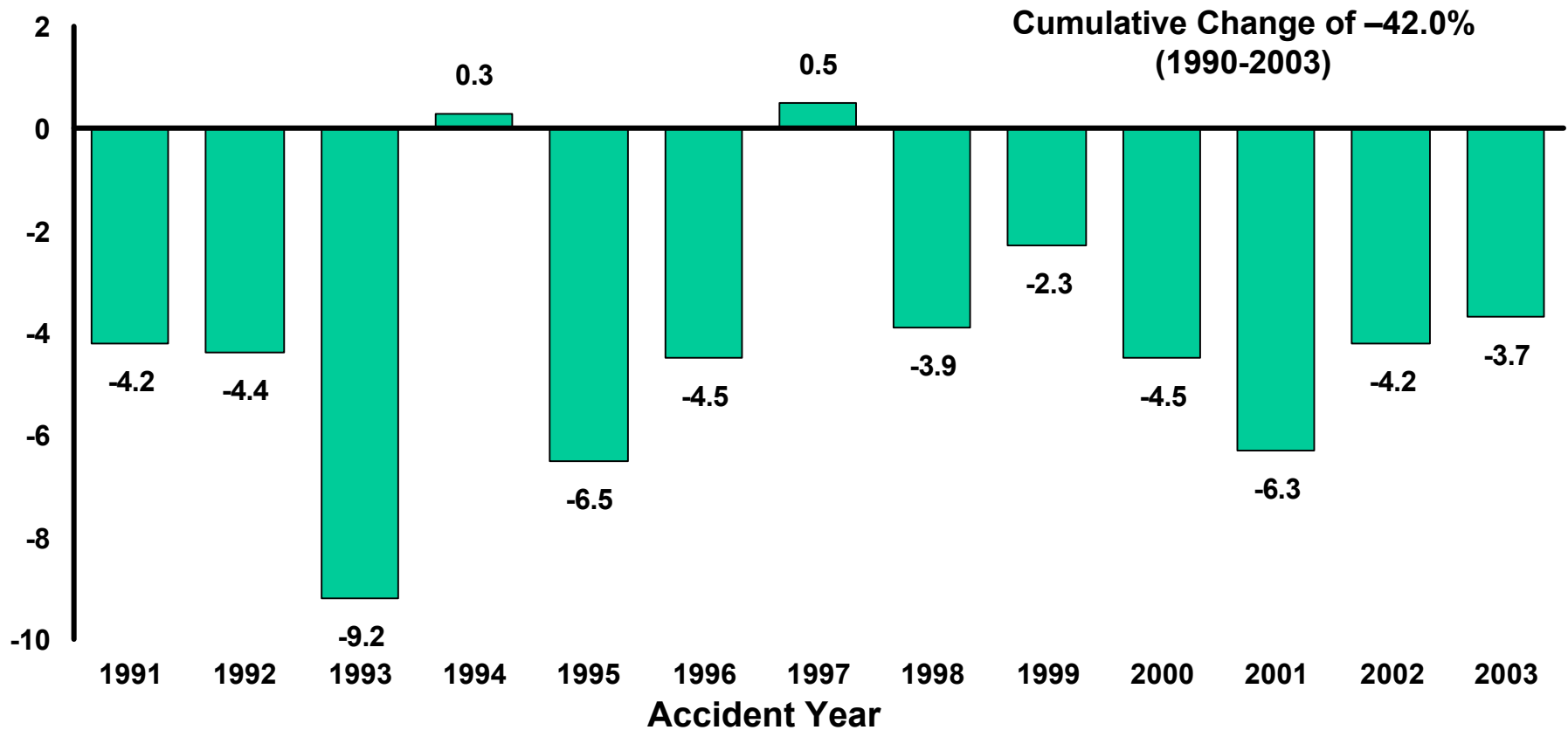
\$ amounts are in millions.

Attendant care assumed to increase at 3% per year

# Workers Compensation Lost-Time Claim Frequency Continues to Fall

## Frequency per 100 Workers (Lost-Time Claims)

Percent Change

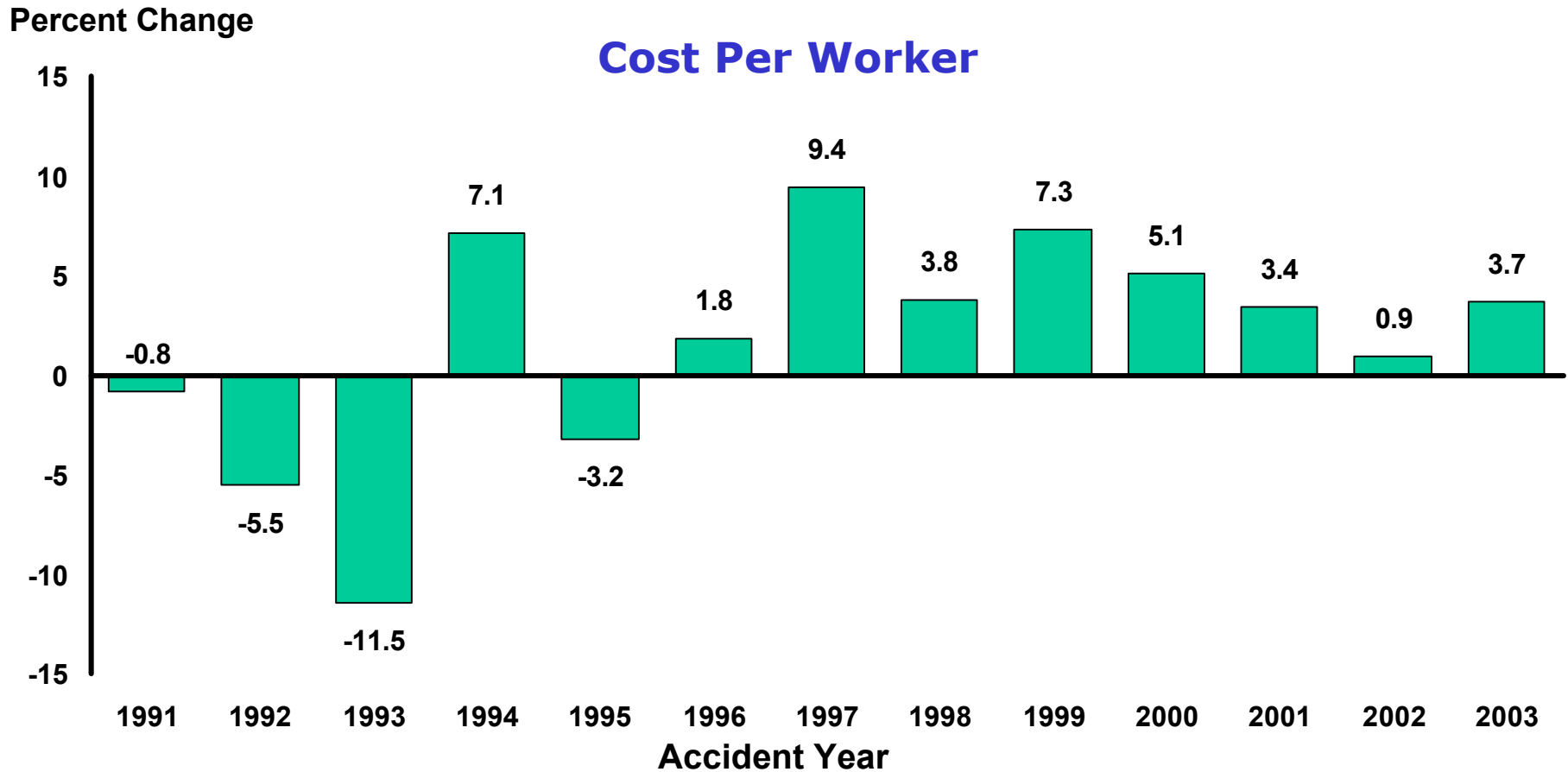


Based on data through 12/31/2003, developed to ultimate  
 Based on the states where NCCI provides ratemaking services  
 Excludes the effects of deductible policies

# NCCI's Frequency Study Update

- The continued decline in frequency remains a bright spot for workers, employers, and their insurers
- The claim frequency decline is most pronounced for smaller claims, causing indemnity and medical severity trends to be higher than those of solely prices and utilization
- The decline in claim frequency spanned occupations, claim types, regions, employer size, use of large deductibles, and experience modification factors
- The significant rise in indemnity and medical costs per claim diminishes the effect of the favorable reduction in claim frequency on overall claim costs

# The Annual Change in Lost-Time Claim Costs per Worker Continued to Increase in 2003



Based on data through 12/31/2003, developed to ultimate  
Based on the states where NCCI provides ratemaking services  
Excludes the effects of deductible policies

# What Are Today's Key Issues in Workers Compensation?

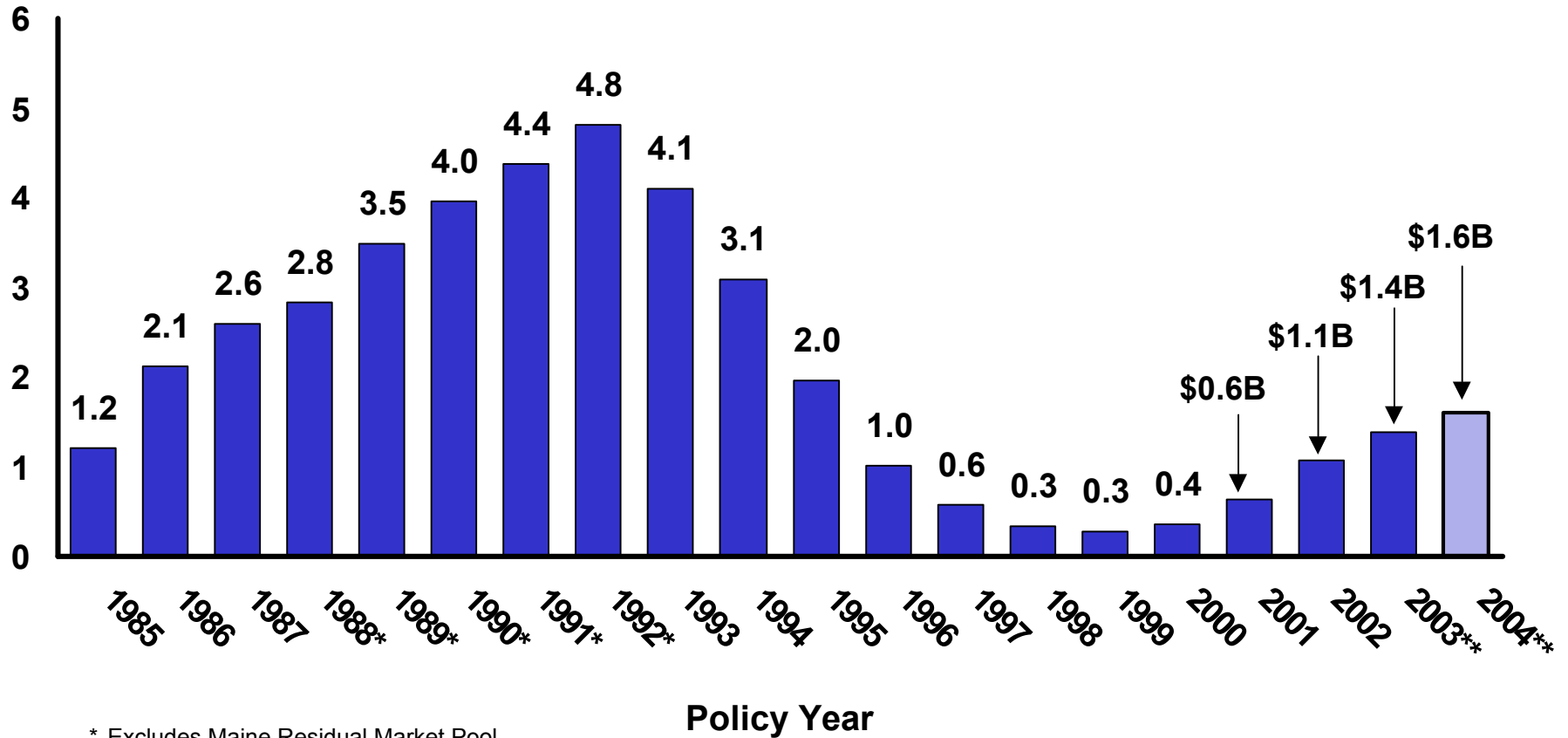
- WC Medical Inflation
- Reserve Levels
- Growth in Residual Markets
- Expiration of Terrorism Risk Insurance Act (TRIA) 12/31/2005
- Legislative Issues
- Developments in Ratemaking



# Workers Compensation Residual Market Premium Volume

NCCI-Serviced Workers Compensation Residual Market Pools  
as of September 30, 2004

\$ Billions

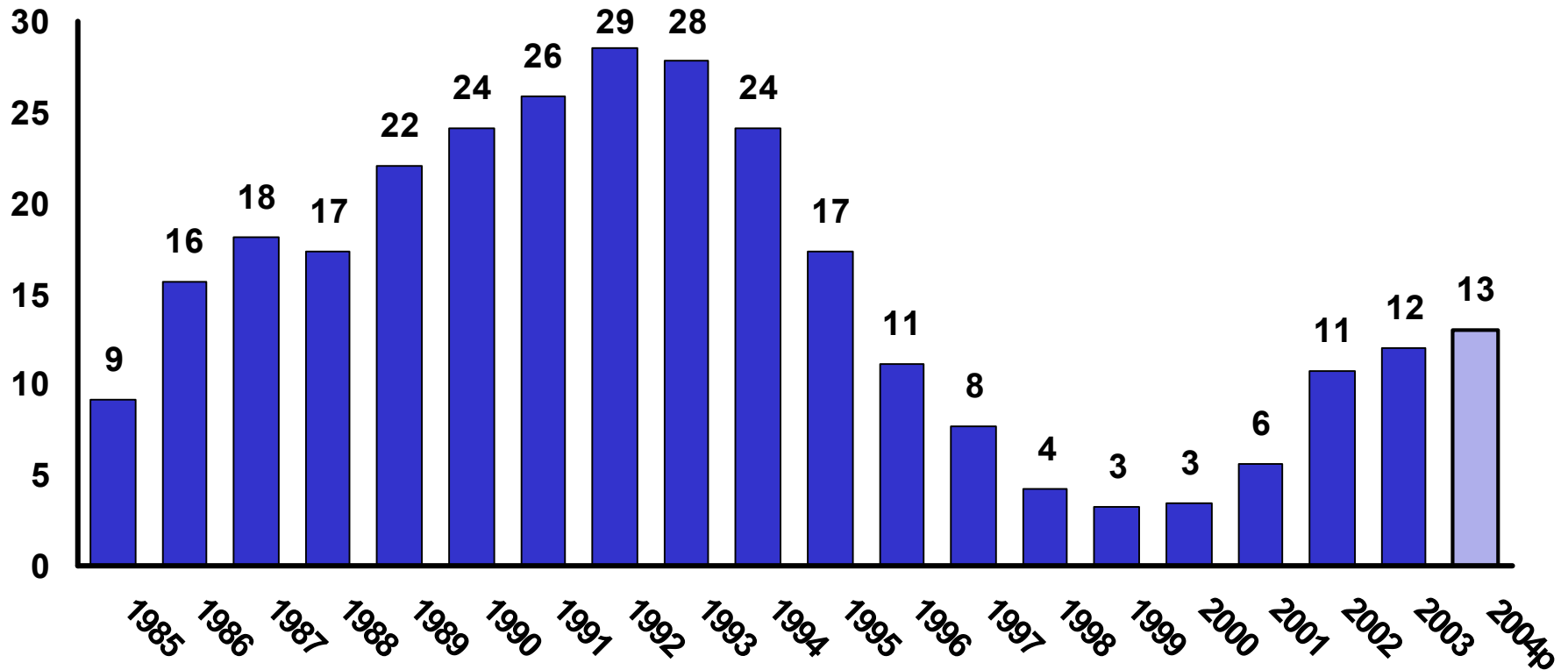


\* Excludes Maine Residual Market Pool  
\*\* Incomplete Policy Year Projected to Ultimate

# Workers Compensation Residual Market Shares Continue to Rise

## Workers Compensation Insurance Plan States\* Premium as a Percent of Direct Written Premium

Percent



Calendar Year

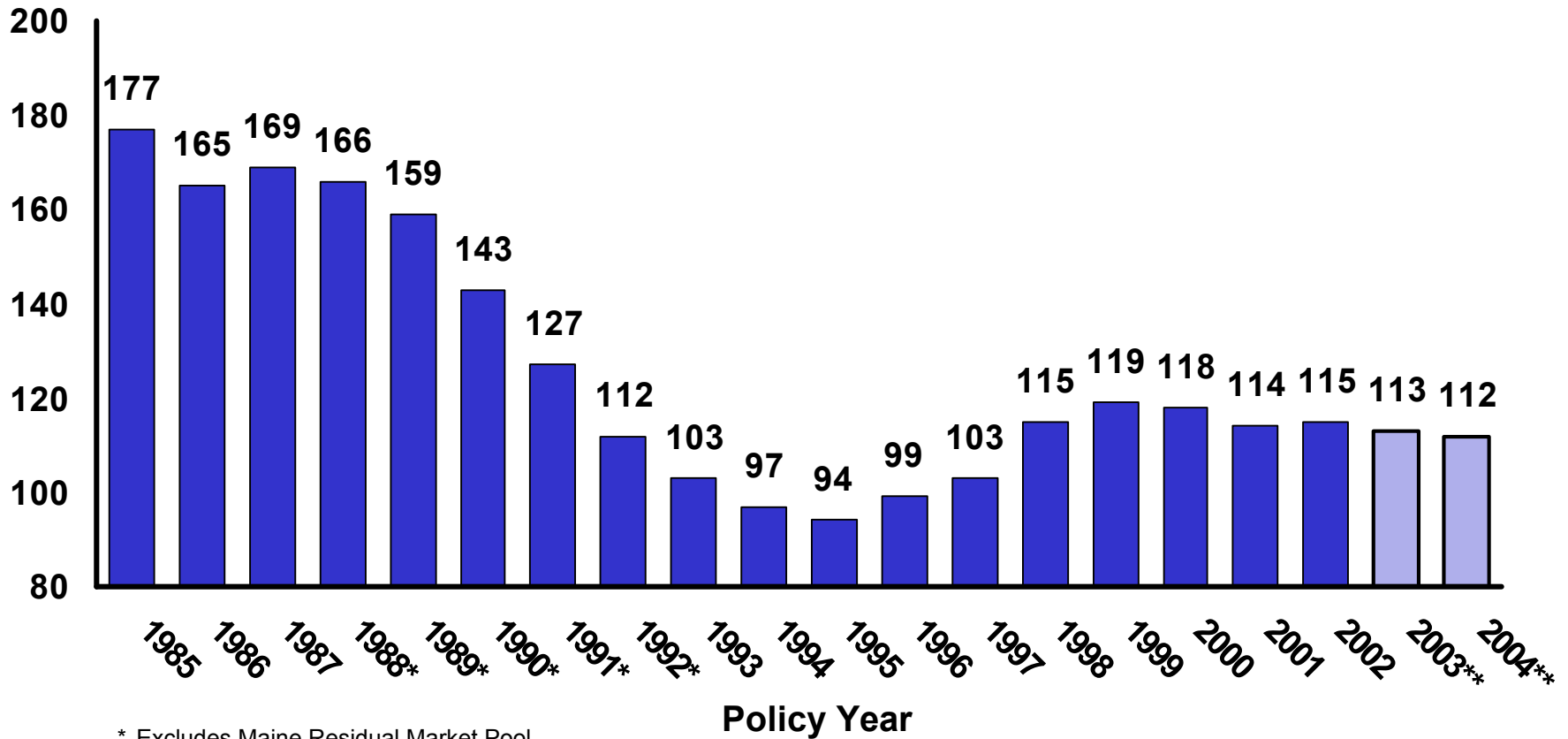
p Preliminary

\* NCCI Plan states plus DE, IN, MA, MI, NJ, NC

# Workers Compensation Residual Market Combined Ratios

NCCI-Serviced Workers Compensation Residual Market Pools  
As of September 30, 2004

Percent

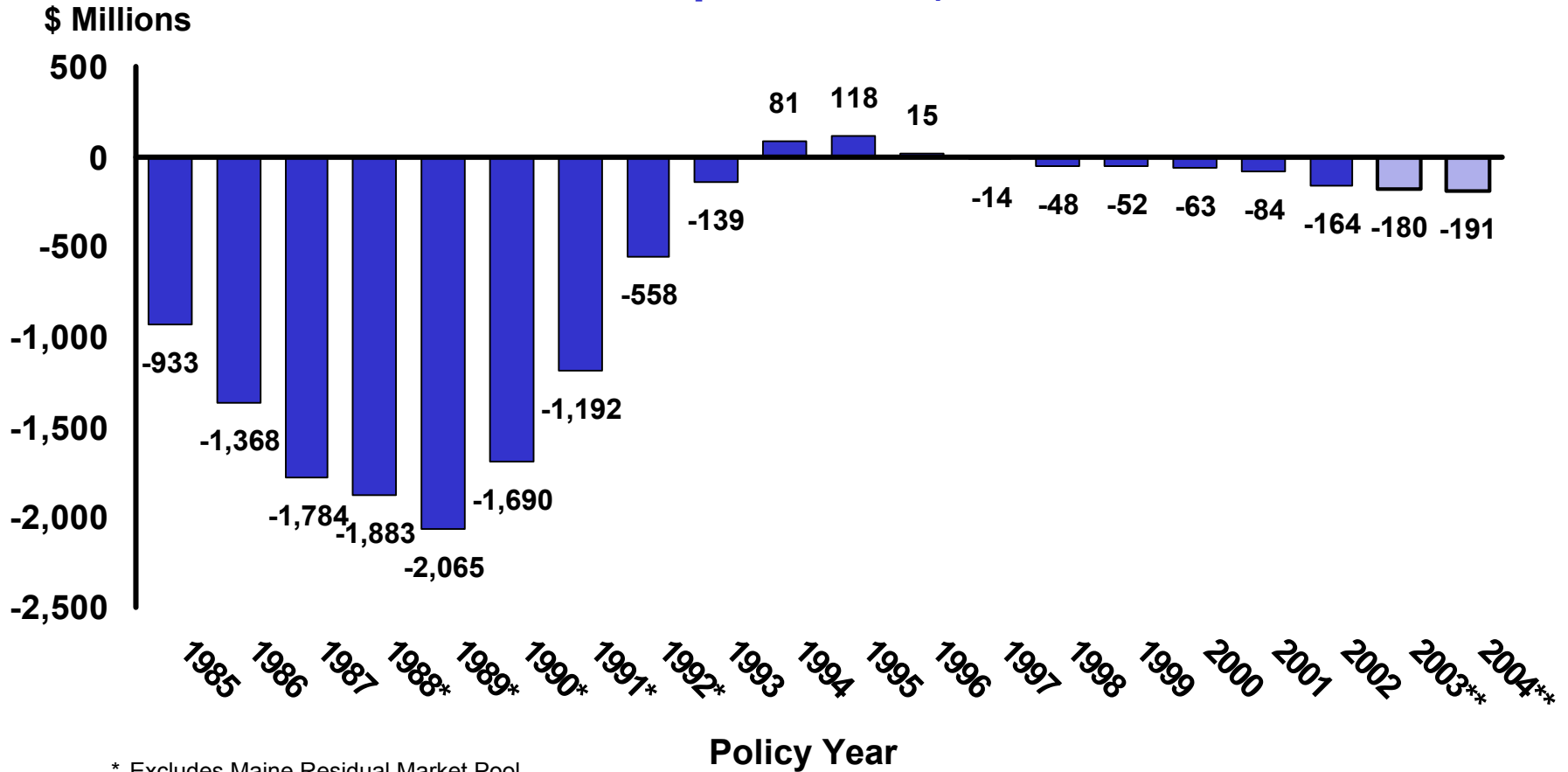


\* Excludes Maine Residual Market Pool

\*\* Incomplete Policy Year Projected to Ultimate

# WC Residual Market Underwriting Results Continue to Decline

## NCCI-Serviced Workers Compensation Residual Market Pools As of September 30, 2004



\* Excludes Maine Residual Market Pool  
 \*\* Incomplete Policy Year Projected to Ultimate

# Unique Challenges of Workers Compensation and Terrorism Coverage

- Coverage mandated by law, exclusions are not possible
- Benefits are defined by law, limits aren't possible
- Risks that aren't written voluntarily will be backed by the entire market through the involuntary pool
- Terrorism Risk Insurance Act (TRIA) expires 12/31/2005
  - Government backstop goes away, unless Congress renews
  - Any policy effective after 1/1/2005 has exposure
  - Notification endorsement in the event of TRIA's expiration
- Congressional Budget Office Report

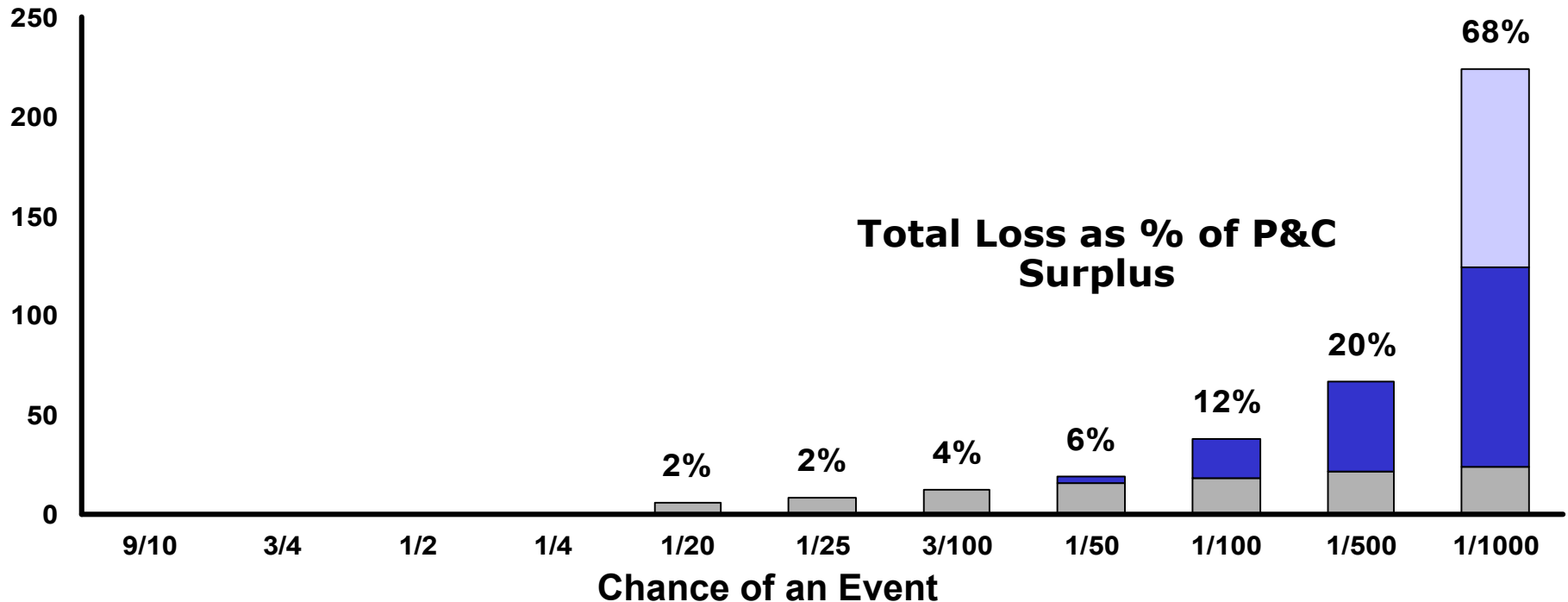
# When Does TRIA Make a Difference?

- **TRIA's direct financial impact is limited to infrequent extreme events**
- **TRIA is not triggered under approximately 98% of the modeled scenarios**
- **TRIA enables the P&C market to function effectively with minimal financial exposure to taxpayer funds**

# Under Most Scenarios TRIA Is Dormant But When TRIA Is Triggered It Is Vital

## P&C U/W Loss With and Without TRIA Support

U/W Loss (\$ B)



■ Industry Loss with TRIA ■ Federal Contribution ■ Excess of TRIA Limit

Source: EQECAT, NCCI

# Legislative Update Issues and Trends

## 2004 Session Overview

- Fairly active session
- More than 85 enacted
- Many proposals for benefit increases, but few enacted
- Workers Compensation high on the radar for governors as they compete to attract business



# Legislative Update Issues and Trends

## 2004 Key Themes

- Medical cost controls – physician fee schedules, hospital schedules
- Expanded presumption of compensability for safety workers and emergency responders
- Medical Privacy
- Indemnity benefit increases
- Attorney fees

# Legislative Update

## 2004 Key Enacted Legislation

- **California**
  - SB 899: major reform effort
- **Tennessee**
  - HB 3531: numerous benefit changes resulting in –6.3% impact
  - Medical fee schedule to be implemented effective in 2005
- **Vermont**
  - H-632: several definitional changes and administrative modifications resulting in a –1.2% impact
  - Medical fee schedule to be implemented effective in 2005

# Legislative Update

## 2004 Key Enacted Legislation (cont'd)

- **Iowa**
  - HF 2581: changes use of loss of earnings capacity, apportionment for 2<sup>nd</sup> injuries, resulting in a –2.6% impact
- **Nebraska, Florida, Maryland, South Dakota, Texas**
  - Changes in medical fee schedules
  - Adopting most recent Medicare RBRVS

# Legislative Update Issues and Trends

## 2005 Emerging Themes

- Containing Medical Costs
  - **Employer vs Employee Choice of Physician**
  - **Medical treatment networks, managed care**
  - **Medical Fee Schedules**
  - **Treatment guidelines**
- Indemnity Benefit Increases
- Second Injury Funds
- OK and TX major reform initiatives
- WV marketplace to allow private carriers

# Developments in Ratemaking

## **Expanded Data Reporting**

- Large Loss Call
- Expansion of Unit Statistical Plan to 10 reports

## **New Ratemaking Procedures and Methods**

- Aggregate Ratemaking
- Class Ratemaking Re-engineering
- Retrospective Rating

# Ratemaking Procedures

## Aggregate Ratemaking

- Large Loss Procedure
- Catastrophe Provision
- Implemented in 2004  
(with filings effective 1/1/2005 and after)
- Revamped Econometric Trending Model Underway

## Class Ratemaking Re-engineering

- Loss Development by Body Part
- Large Loss Treatment
- Credibility Methodology
- Analyses/Projects Currently Underway

# Ratemaking Procedures (continued)

## Retrospective Rating

- New ELF procedure
- Catastrophe Provision
- Implemented During 2004  
(with filings effective 1/1/2005 and after)

# Workers Compensation Key Issues for the Future

- How will the industry deal with terrorism exposure? And will the government renew TRIA?
- Where are severity trends headed – will they accelerate or moderate?
- Will written premiums continue to increase?
- What impact will changes in the economy have, especially on frequency?
- What impact will reserve deficiencies have on results?
- Will potential threats to rollback reforms or expand benefits succeed?
- Where are investment returns headed?



**WORKERS COMPENSATION  
- CURRENT ISSUES -  
(SESSION WC-4)**

**Q & A**