

**WORKERS COMPENSATION
STATE OF THE MARKET**
(SESSION WC-5)

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Casualty Actuarial Society
Ratemaking and Product
Management (RPM) Seminar
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Another Year of Premium Declines

Net Written Premium by Line

Line of Business	2006	2007	2008p	Change
Personal Auto	\$ 160.2 B	\$ 159.1 B	\$ 159.9 B	0.5%
Homeowners	\$ 56.9 B	\$ 57.3 B	\$ 58.7 B	2.5%
Workers Compensation	\$ 46.9 B	\$ 44.2 B	\$ 40.4 B	-8.7%
Other Liability (Incl Prod Liab)	\$ 45.7 B	\$ 44.3 B	\$ 41.2 B	-7.0%
Commercial Multiple Peril	\$ 31.7 B	\$ 31.1 B	\$ 29.5 B	-5.0%
Commercial Auto	\$ 26.7 B	\$ 25.5 B	\$ 23.7 B	-7.0%
Fire & Allied Lines (Incl EQ)	\$ 20.0 B	\$ 21.9 B	\$ 25.0 B	14.5%
All Other Lines	\$ 69.3 B	\$ 70.1 B	\$ 71.3 B	1.7%
Total All Lines	\$457.3 B	\$453.4 B	\$449.7 B	-0.8%

Source: Best's Review/Preview

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Combined Ratios and ROE Deteriorate in 2008

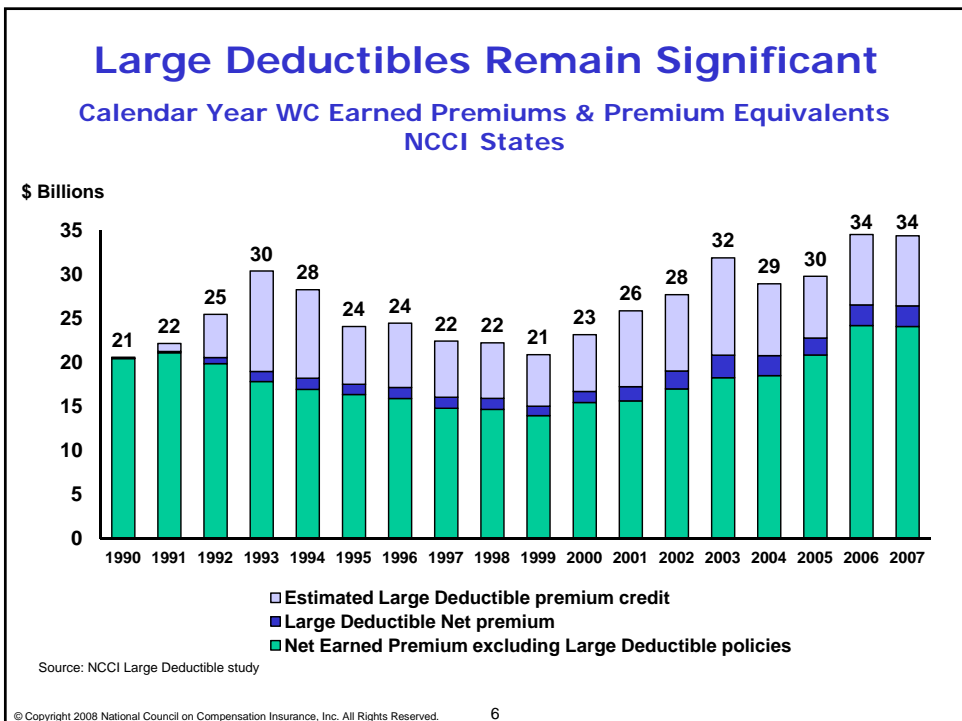
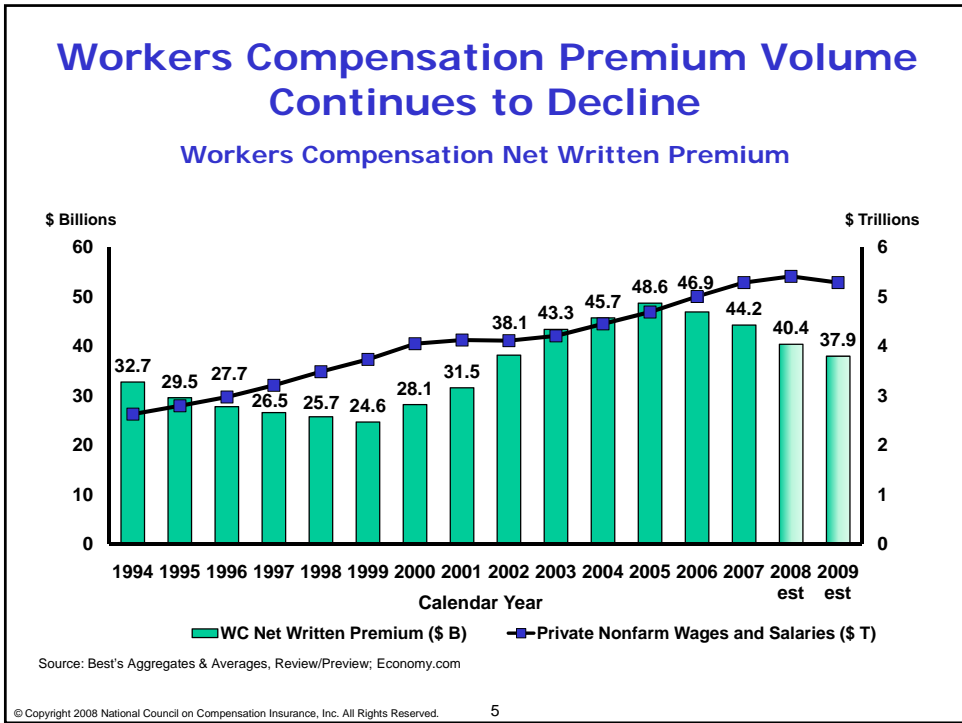
Net Combined Ratios (C/R), After-Tax Return on Surplus (ROE)

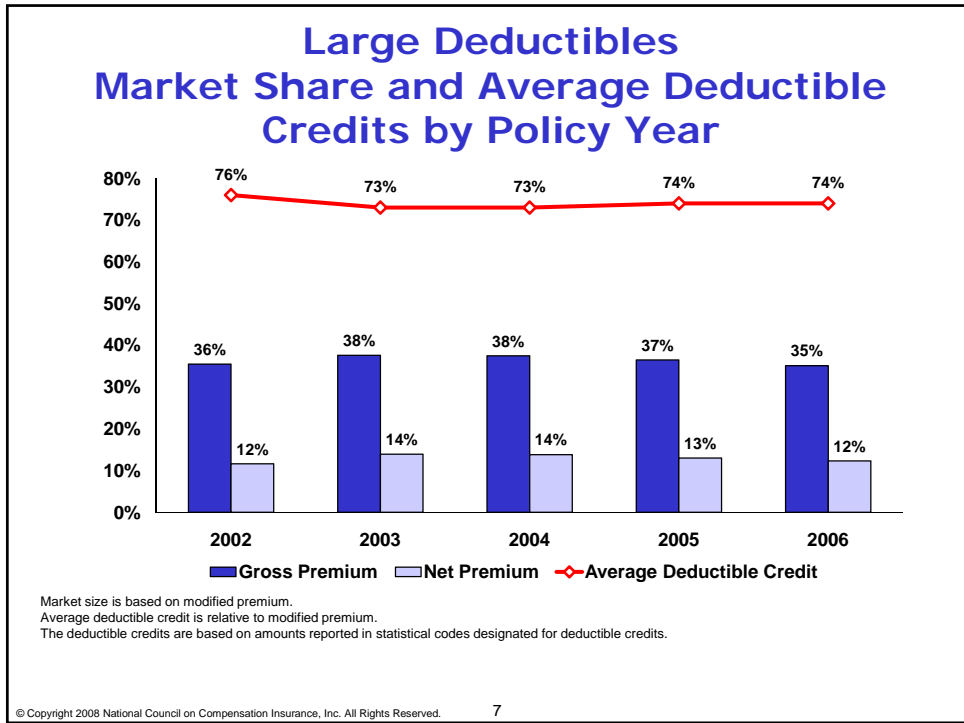
Line of Business	2006	2007	2008p
Personal Auto	96%	98%	99%
Homeowners	89%	96%	117%
Workers Compensation	98%	103%	106%
Other Liability (Incl Prod Liab)	95%	99%	101%
Commercial Multiple Peril	93%	92%	106%
Commercial Auto	92%	94%	99%
Fire & Allied Lines (Incl EQ)	80%	70%	105%
All Other	85%	93%	115%
C/R All Lines (P/C)	92%	96%	105%
ROE All Lines (P/C)	15.0%	12.6%	2.7%

Source: Best's Review/Preview

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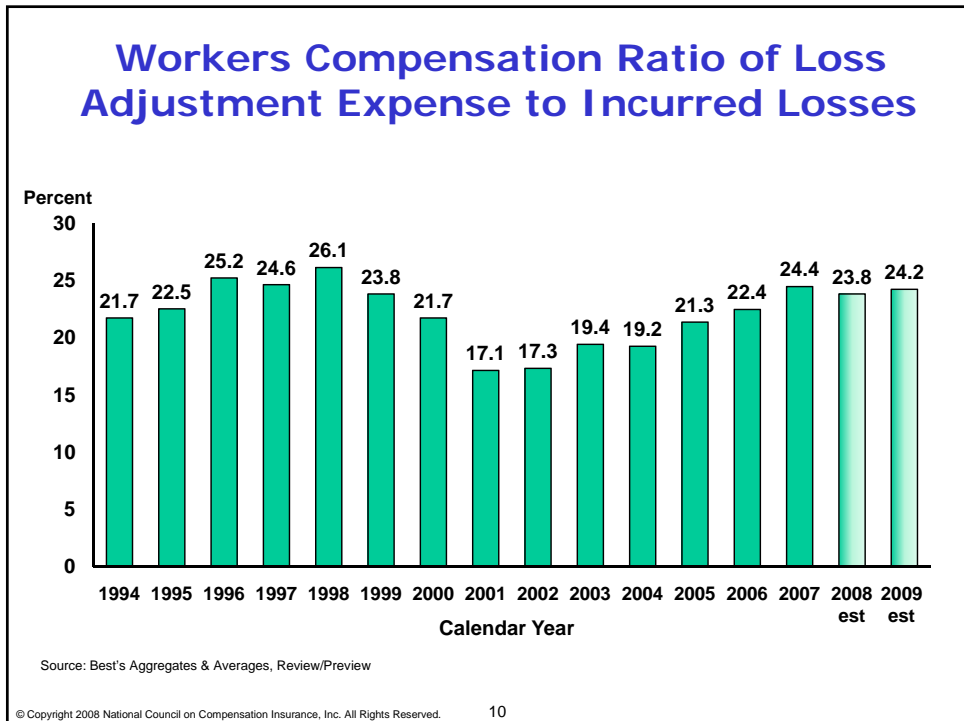
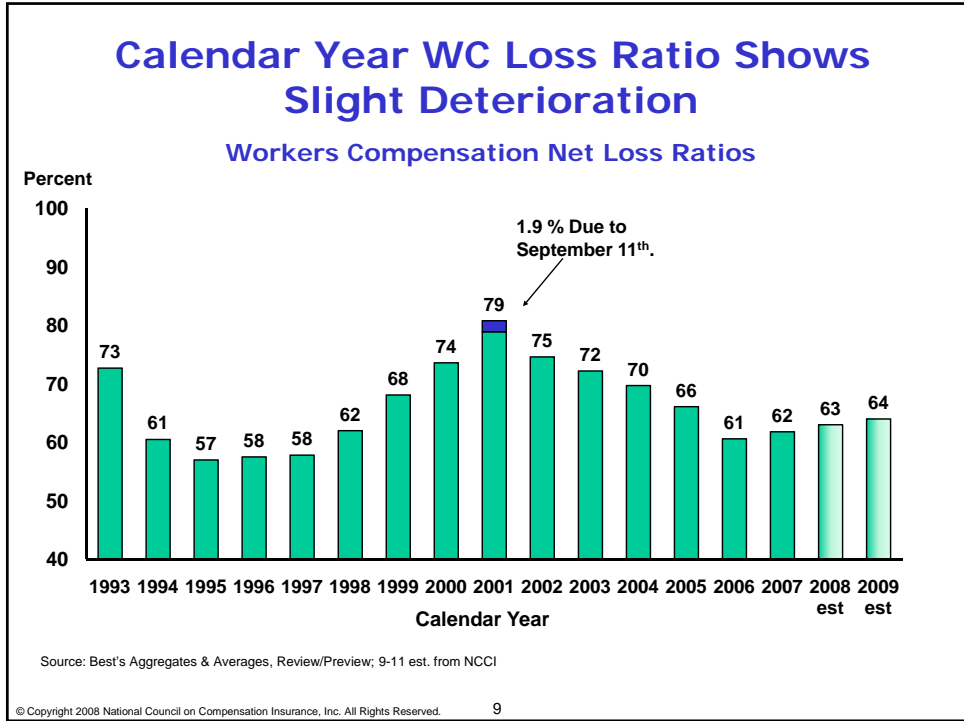


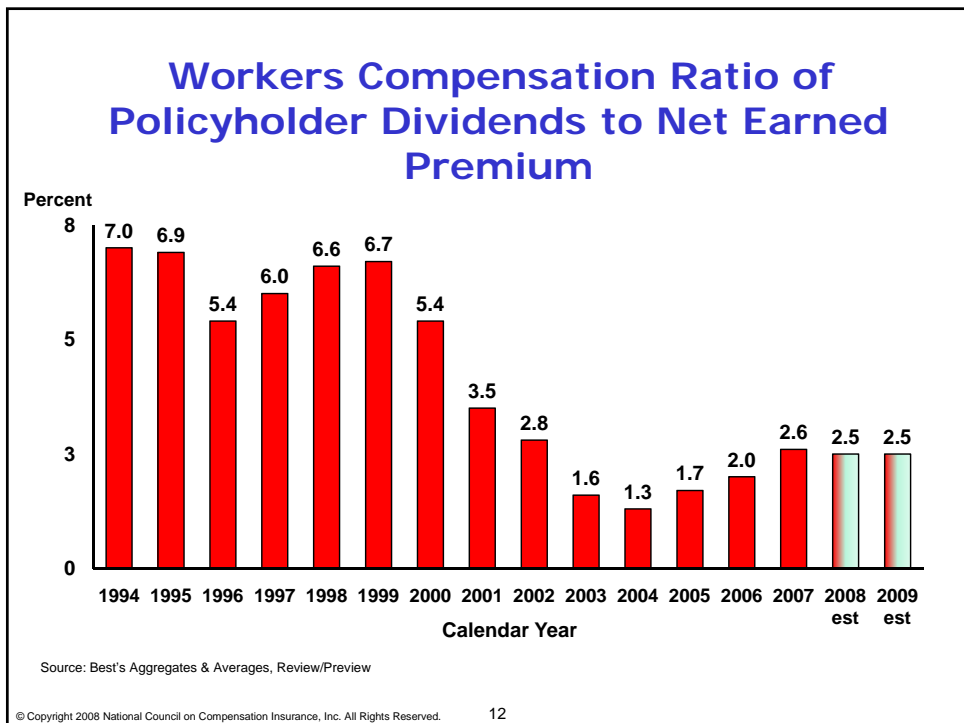
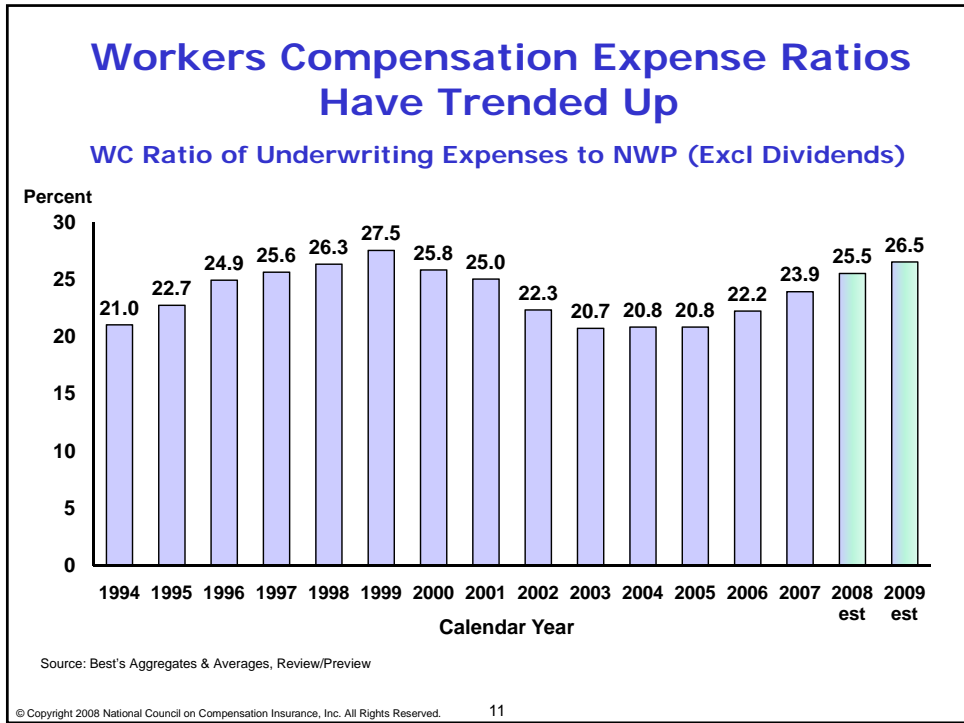


WC Loss Ratios—Impact of Large Deductible Policies

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

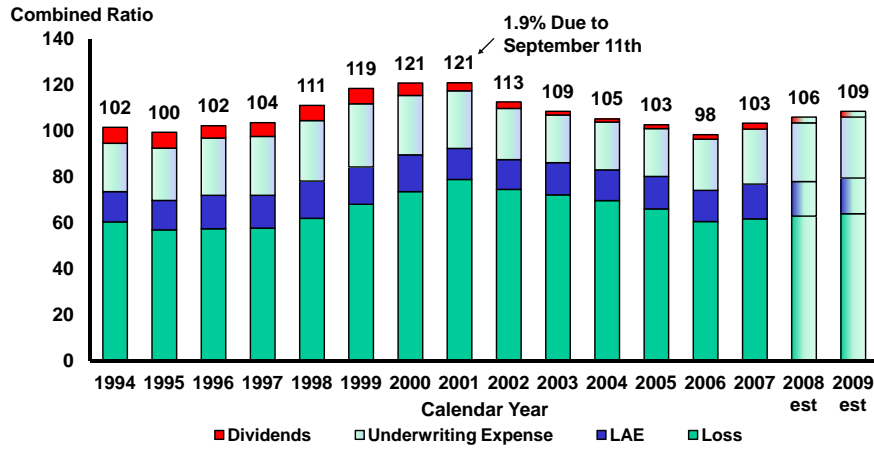
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Workers Compensation Calendar Year Combined Ratio is Trending up

Workers Compensation Combined Ratios

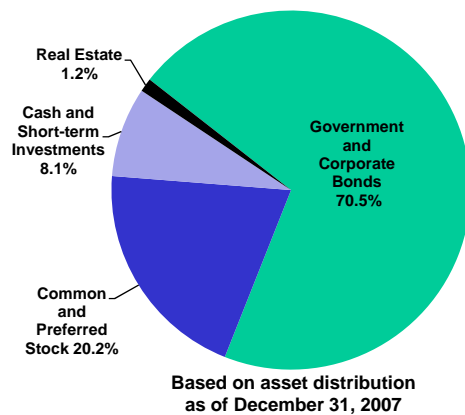


Source: Best's Aggregates & Averages, Review/Preview

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Bonds Comprised Roughly 70% of P&C Investments and Yields Declined



Portfolio Mix Adjusted Yield

2006	5.2%
2007	4.5%
2008	3.3%

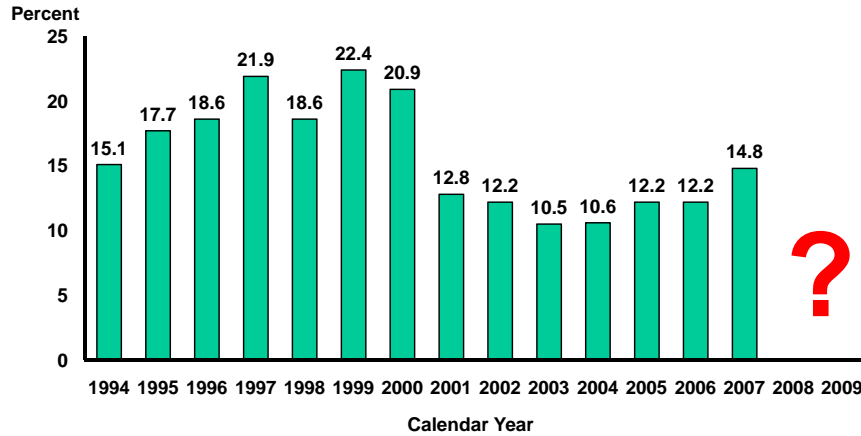
Source: Asset distribution, Best's Aggregates and Averages, 2008 Edition; Yields, NCCI

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WC Investment Returns Remain Low

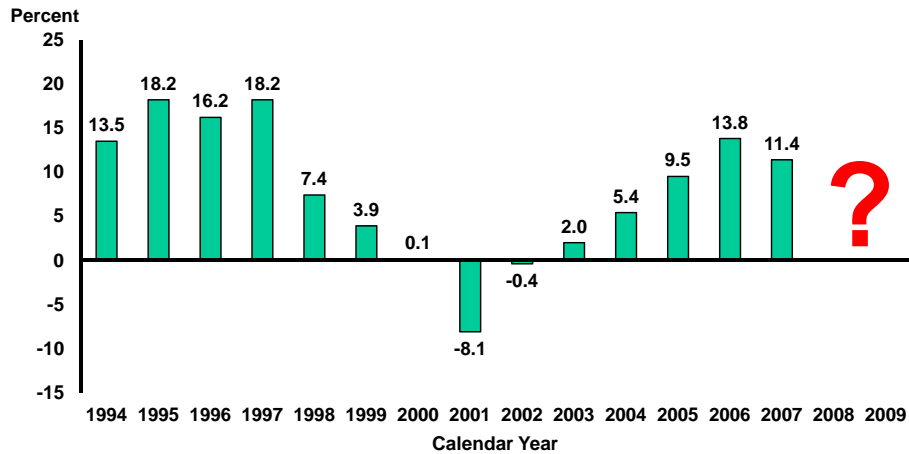
WC Ratio of Investment Gain and Other
 Income to Premium



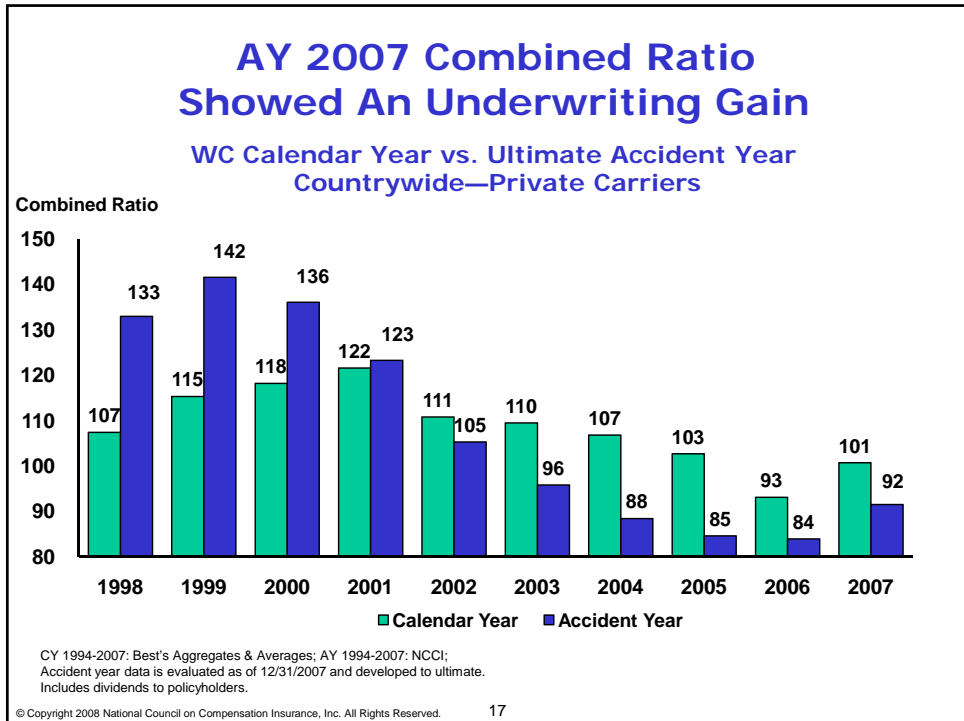
Source for 1994–2007: A.M. Best Aggregates & Averages
 Investment gain includes investment income on insurance transactions and realized capital gains.

WC Results Deteriorated in 2007

WC Pretax Operating Gain/Loss Ratio

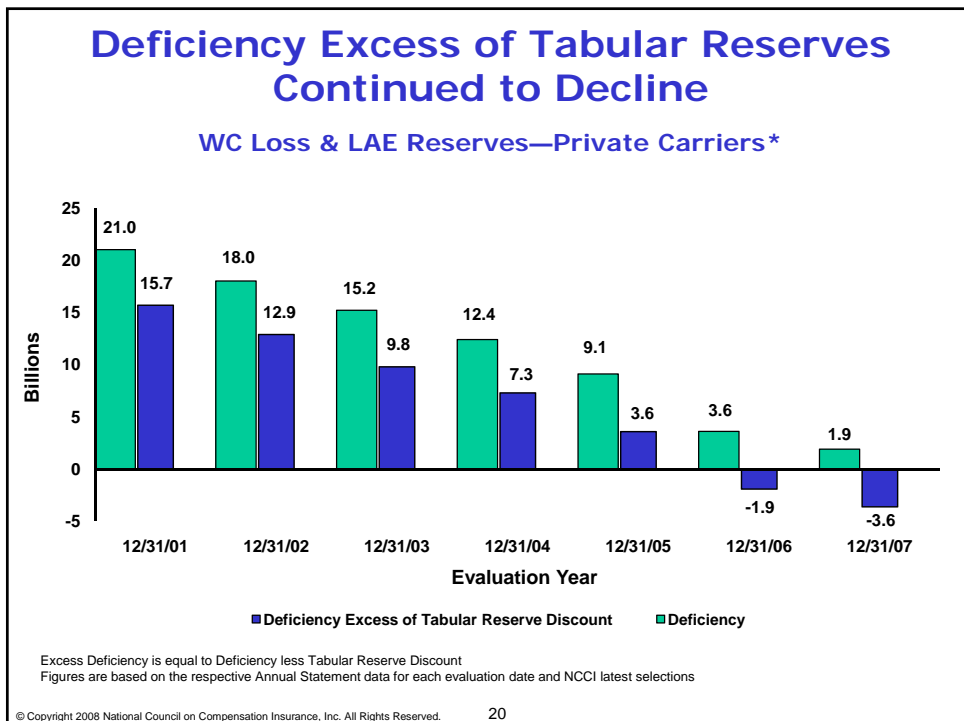
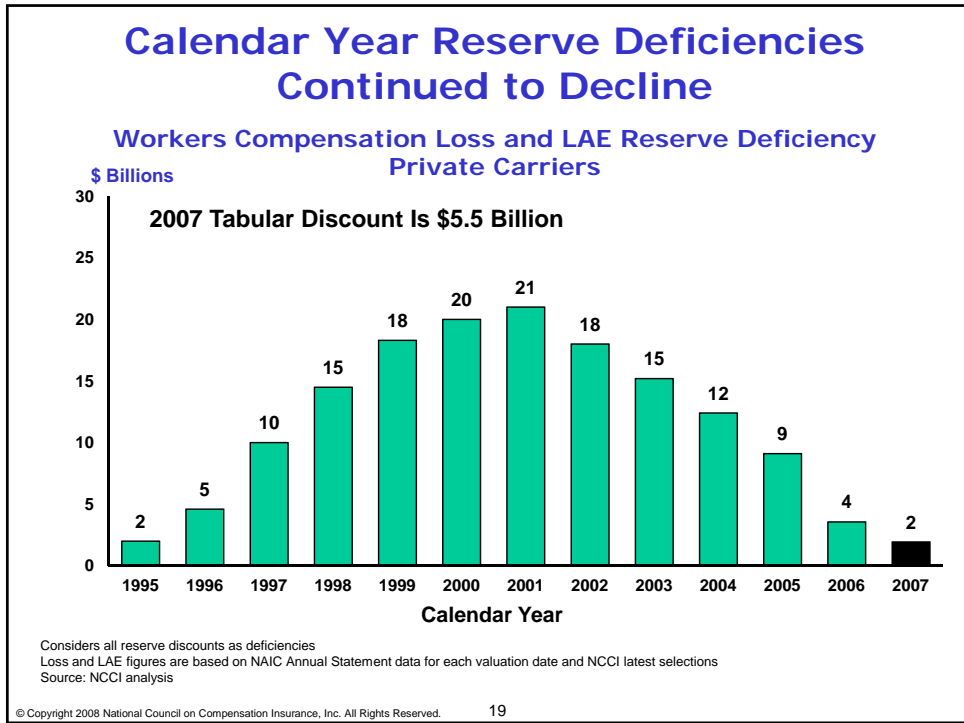


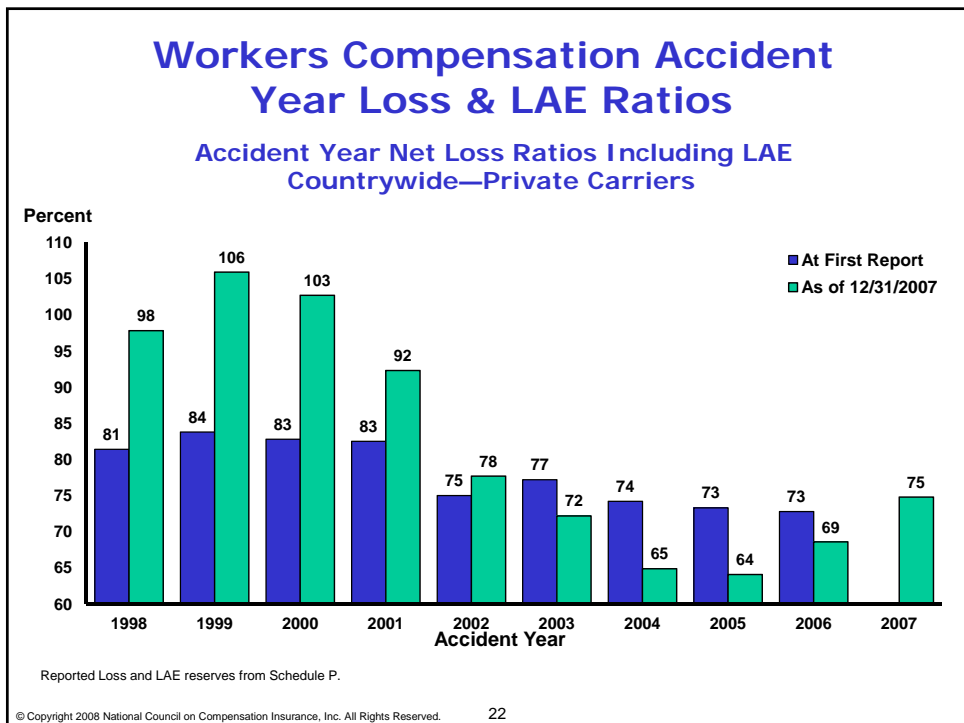
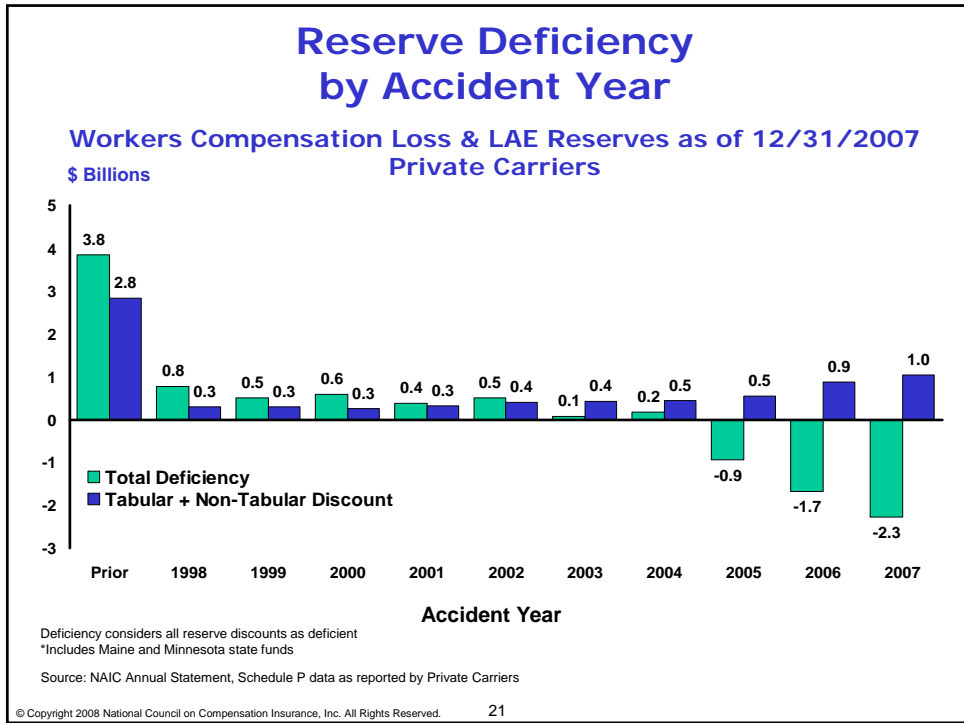
Source for 1994–2007: A.M. Best Aggregates & Averages
 Investment gain includes investment income on insurance transactions and realized capital gains.



What Have Been The Key Factors Impacting Workers Compensation Results?

- Reserve Levels
- Pricing
- Economic Downturn
- Loss Severity Trends
- Frequency Trends
- Investments





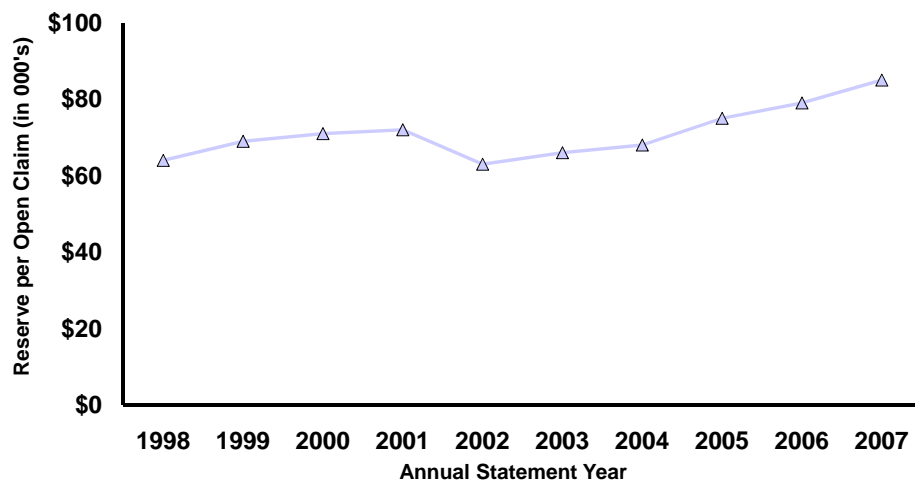
Industry Prior Period Reserves

Age 11 Years and Older

For claims aged 11 years and Older (as shown in Schedule P):

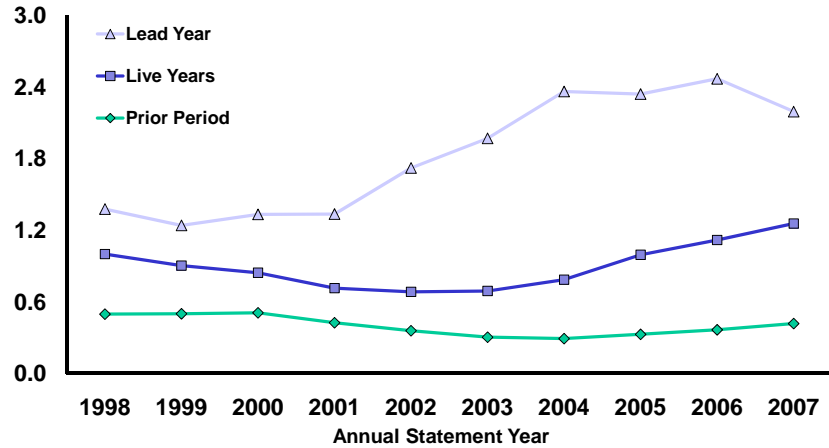
- Average carried reserves per claim have been increasing steadily, but through case reserves, not IBNR
- Industry reserve strengthening since 2001 is not nearly as strong as claims aged 10 years and younger
- Their share of reserves increased in 2007

Prior Period Average Loss and LAE Reserve Per Open Claim Is Rising Steadily



Source: NAIC Annual Statement Schedule P data as reported by Private Carriers (average reserve includes IBNR)
Open claims are Direct and Assumed
"Prior Period" is all accident years more than 10 years old in a Schedule P

The Ratio of IBNR to Case Reserves for Prior Period Is Lower in 2007 Than in 1998



Source: NAIC Annual Statement data as reported by Private Carriers
 "Lead Year" is the most recent accident year in a Schedule P
 "Live Years" are the 10 most recent accident years in a Schedule P
 "Prior Period" is all accident years more than 10 years old in a Schedule P

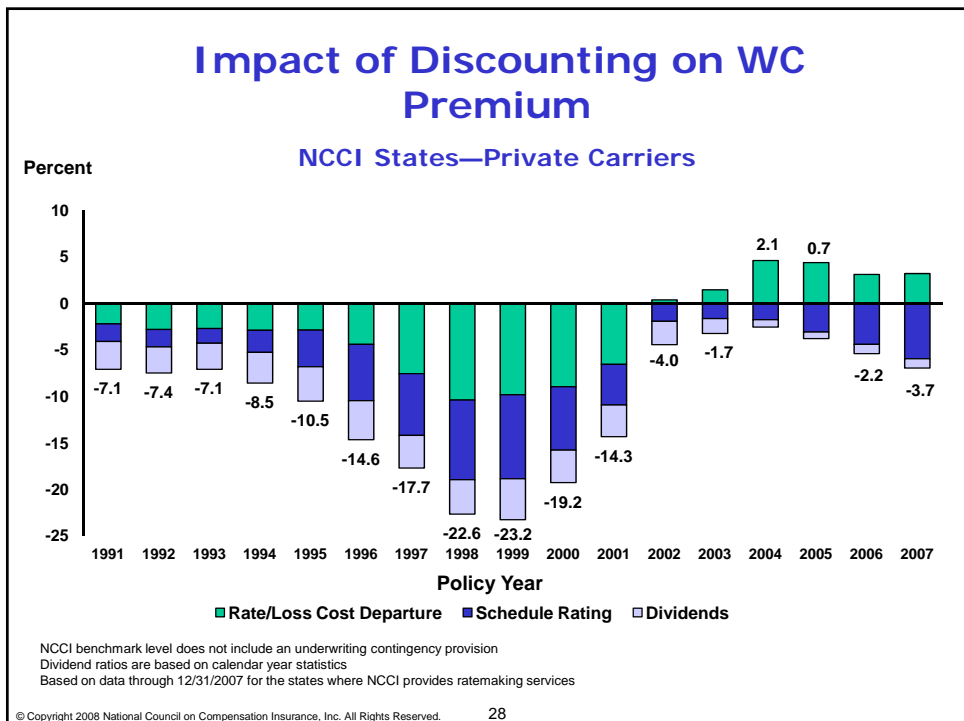
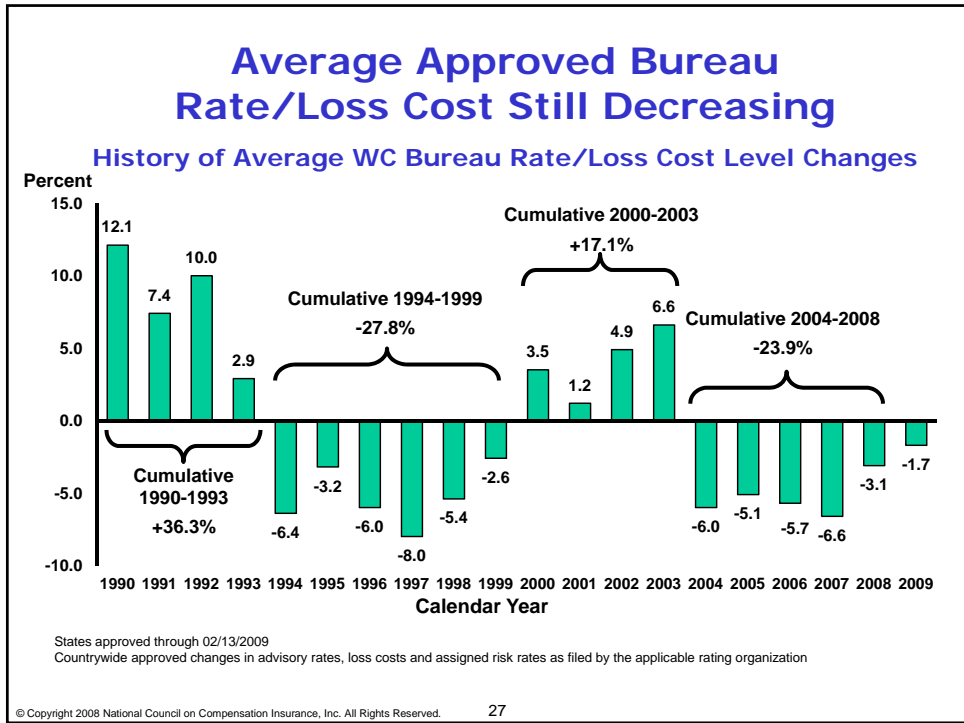
How Are Final WC Premiums Determined?

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

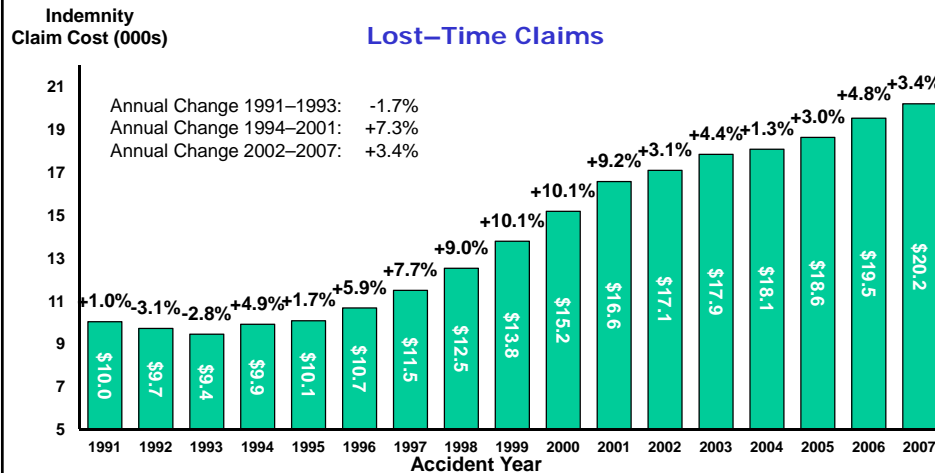


What are Some Primary Components and Factors of WC Premiums?

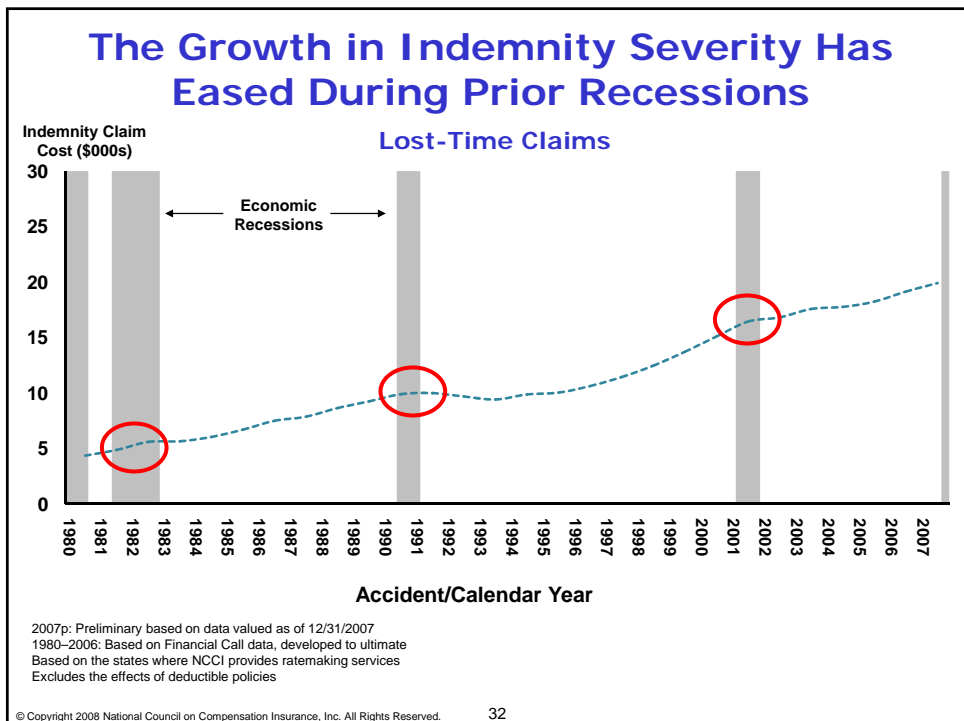
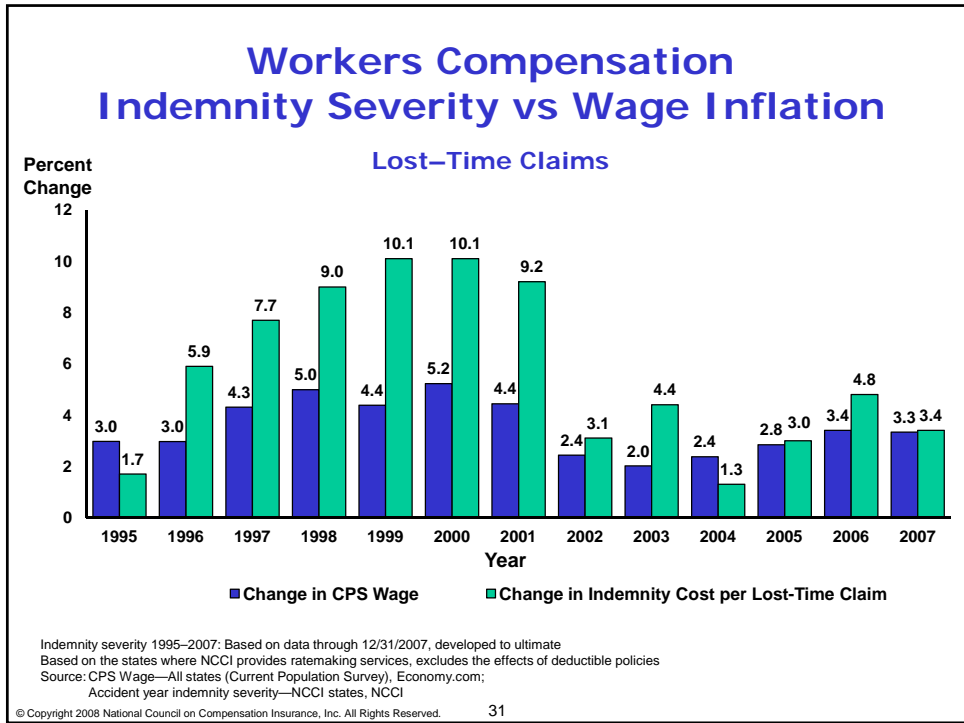
Loss Cost = f (customer, company,
 and/or industry losses,
 inflation, interest rate, medical
 technology, economy, etc.)

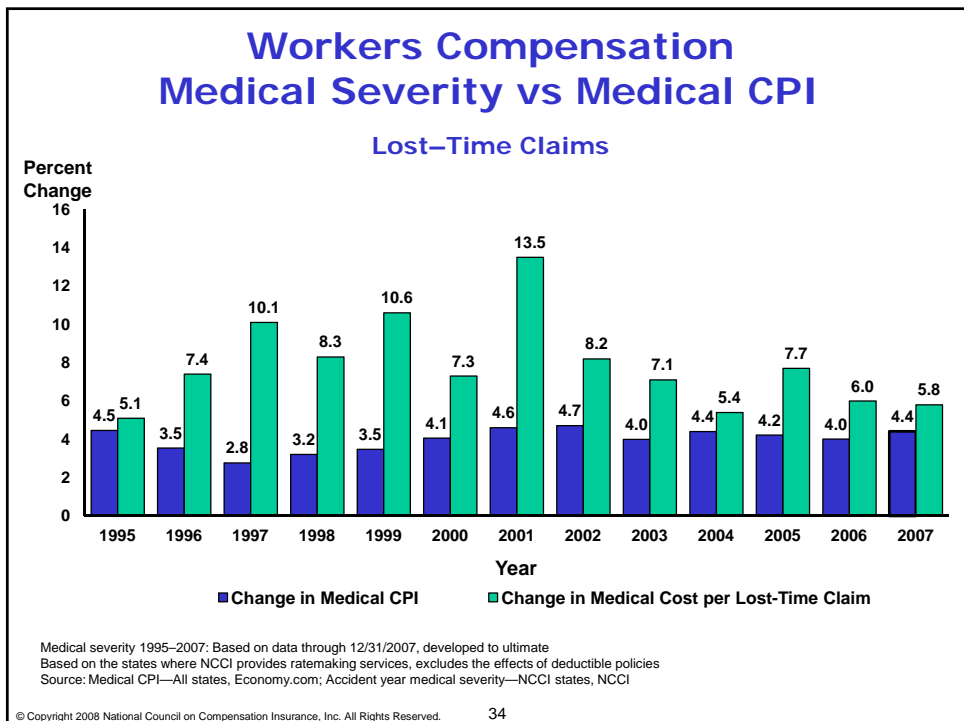
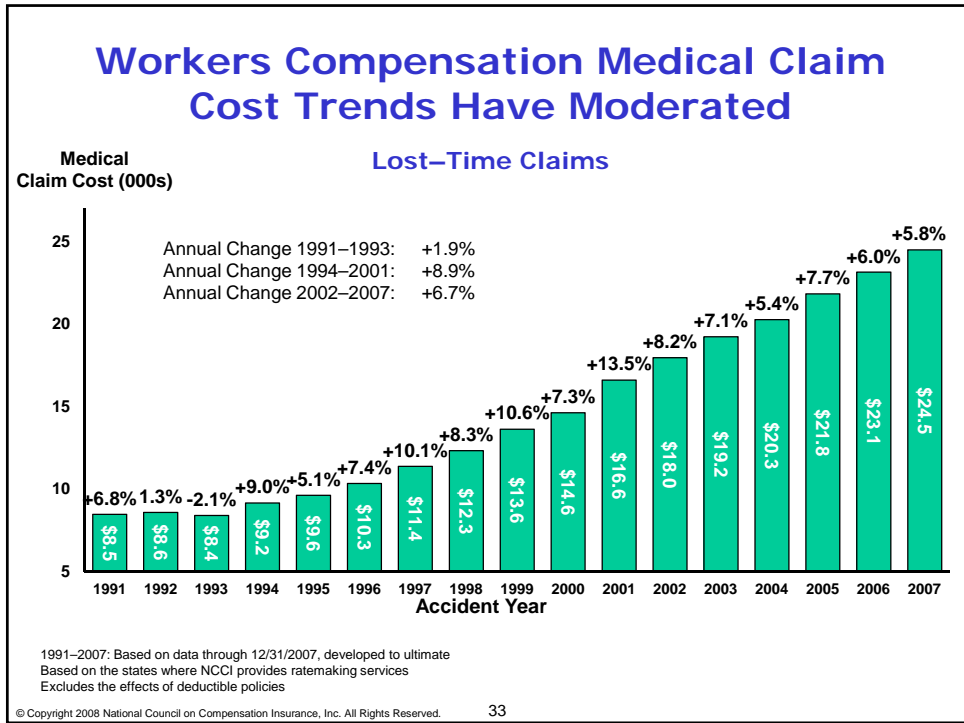
+ Risk Charge
 + Expenses
+ Tax
 Premium

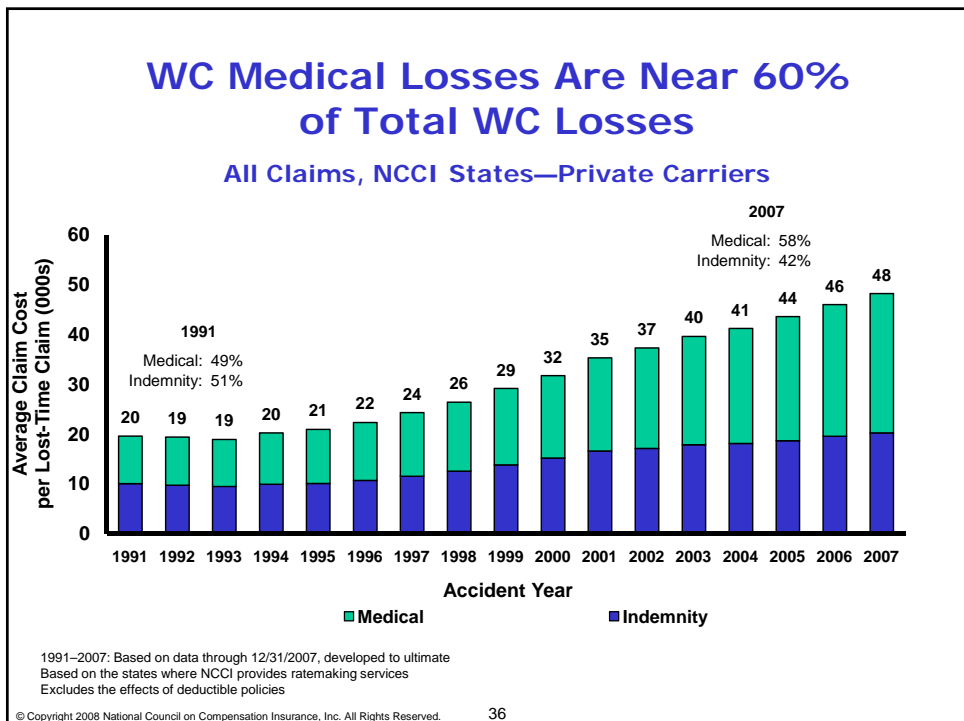
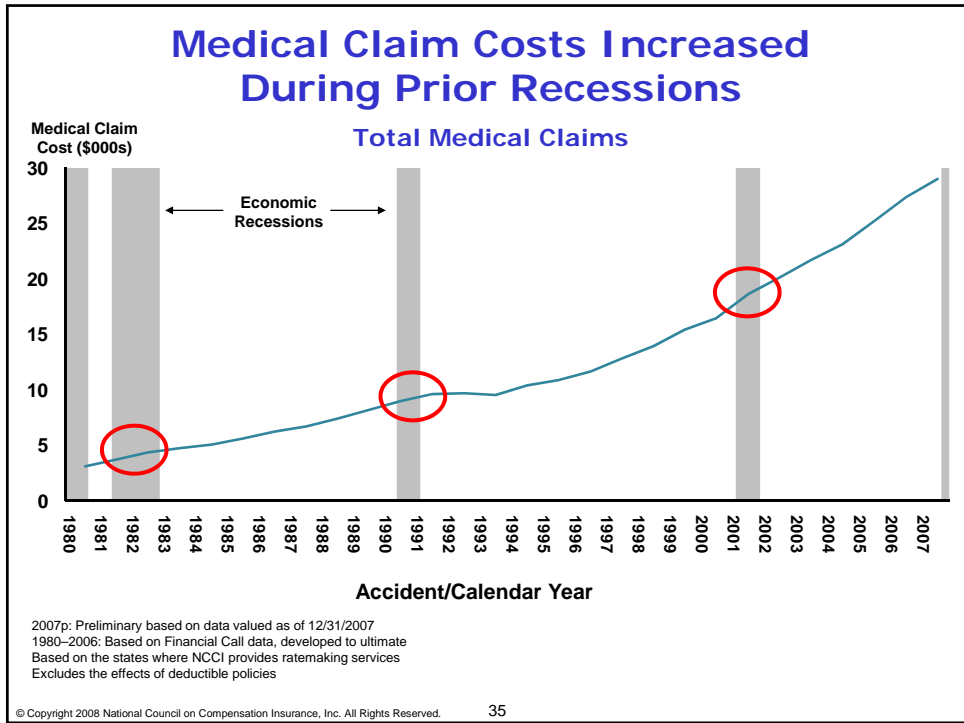
The Rate of Change in Workers Compensation Indemnity Claim Costs Have Moderated



1991–2007: Based on data through 12/31/2007, developed to ultimate
 Based on the states where NCCI provides ratemaking services
 Excludes the effects of deductible policies







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%

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Forecasting the Prescription Drug Share of Total Medical Costs

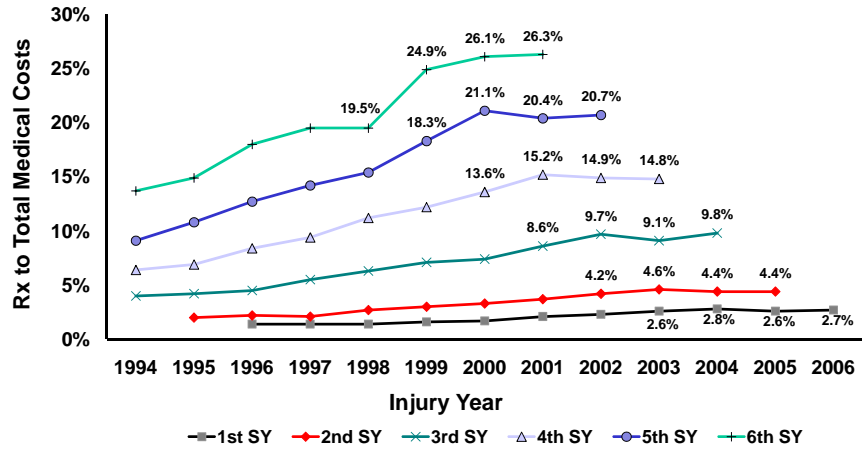
- **NCCI estimates that the ultimate prescription drug share of total medical cost is 19%**
- **Shares for early service years are emerging as expected**
- **Shares for older service years increased**

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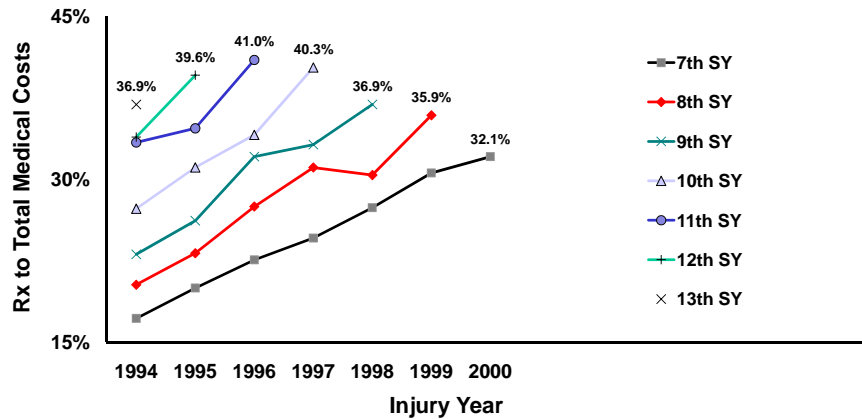
Is the Prescription Drug Share of Total Medical Costs Stabilizing in WC?

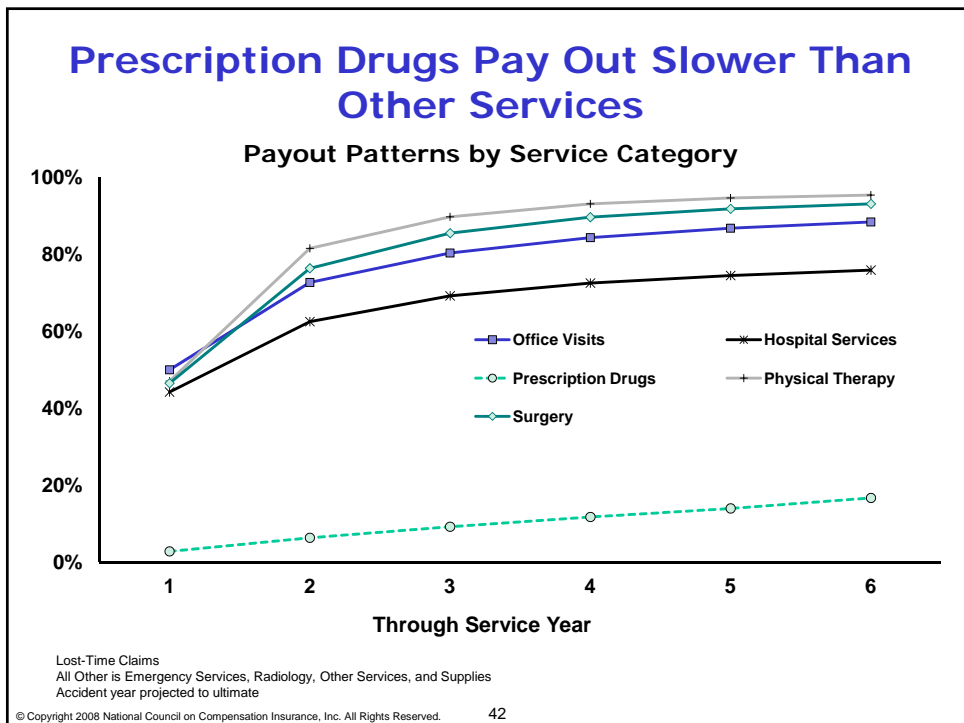
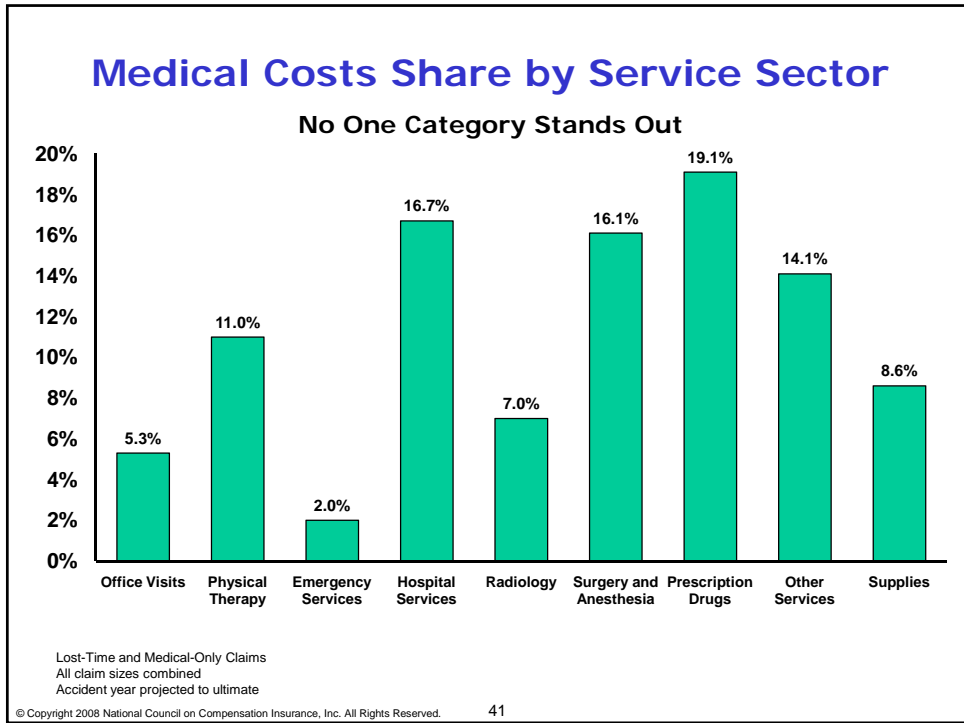
Portion of Costs Paid in Service Year (SY)



Is the Prescription Drug Share of Total Medical Costs Stabilizing in WC?

Portion of Costs Paid in Service Year (SY)





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

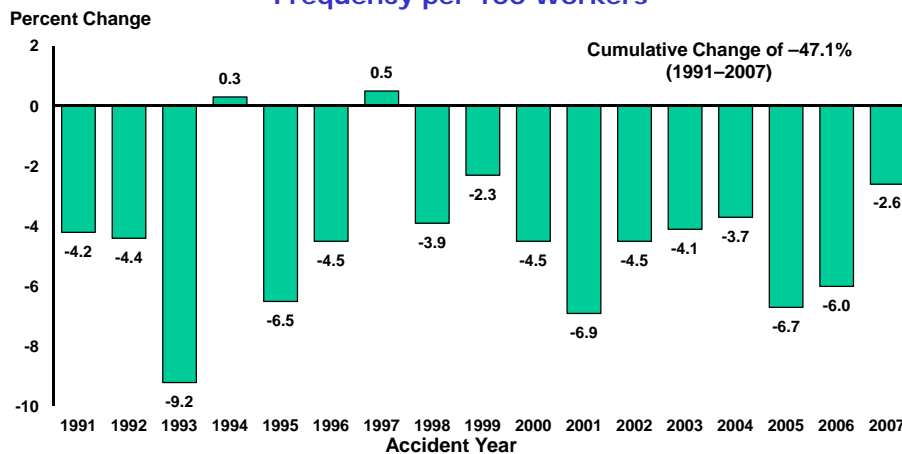
- Consider a 25-year old quadriplegic
- Indemnity benefits of \$23,500 a year
- 24-hour attendant care costs of \$135,000 a year
- Other medical costs of \$72,500 a year
- These costs continue until death

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

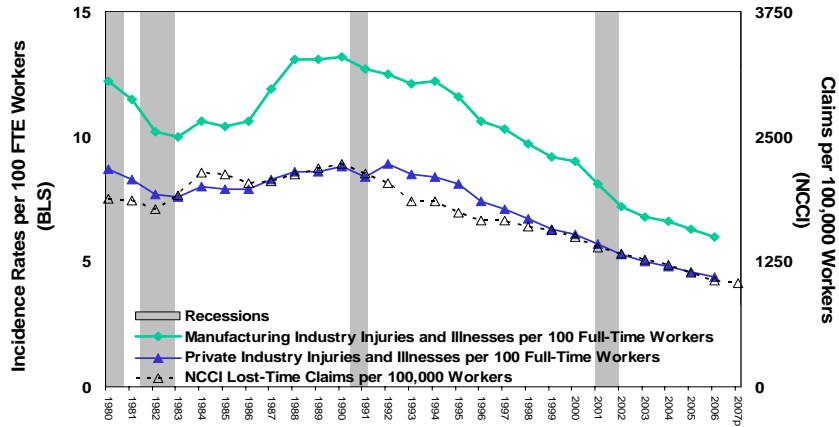
Workers Compensation Lost-Time Claim Frequency Continues to Fall

Frequency per 100 Workers



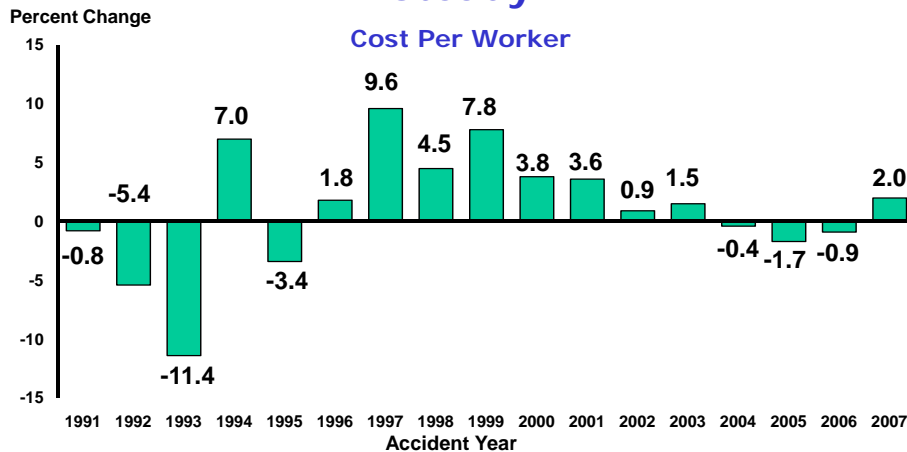
1991-2007: Based on data through 12/31/2007, developed to ultimate
 Based on the states where NCCI provides ratemaking services
 Excludes the effects of deductible policies

Workplace Injury Incidence Rates Have Shown Declines in Last Four Economic Downturns



p Preliminary
 Source : US Department of Labor, Bureau of Labor Statistics (BLS), National Bureau of Economic Research
 NCCI Frequency and Severity Analysis.

The Annual Change in Lost-Time Claim Costs per Worker Has Remained Steady



Based on data through 12/31/2007, 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?

- Impact of Economic Downturn
- WC Medical Inflation
- Reserve Levels
- Legislative Issues
- Developments in Ratemaking

Legislative Update Issues and Trends

2008 Key Themes

- **AMA Guides to Impairment Ratings**
- **Medical Benefits**
- **Florida—Emma Murray v. Mariner Health**
- **Compensability Criteria**
 - 1st Responder Legislation

Florida—Emma Murray v. Mariner Health Decision

- There were several cases challenging the constitutionality of the limitations on attorney fees imposed by 50A (originally enacted 10/03)
- Supreme Court decision reinstated hourly fees for claimant attorneys (10/08)
- Original estimated impact of the limitations on attorney fees was -2.1% of losses
- NCCI made Law Only filing to address Supreme Court Decision:
 - Filed +8.9% 1st year impact, +18.6% longer term impact
 - Approved +6.4% 1st year impact, +13.1% longer term impact

Legislative Update

2008 Enacted Legislation

- **Alaska Med Fee Change, effective 3/1/2009**
 - Sunset of physician fee schedule, impact +4.9%
- **Arizona , effective 10/1/2008**
 - HB 2195. Part 2 increases indemnity benefits, impact +4.4%
- **Montana Med Fee Change, effective 1/1/2008**
 - Decreases physician fees, impact -2.9%

Legislative Update

2008 Enacted Legislation (cont'd)

- **Nevada Med Fee Change, effective 2/1/2008**
 - Change in fees for physician and hospital services, impact +2.0%
- **Tennessee Med Fee Change, effective 7/1/2008**
 - Law Only Filing
 - Physician Fee Schedule Changes and Medical Cost Containment Rules, combined impact -3.1%
- **Texas Med Fee Change, effective 3/1/2008**
 - Change in fees for physicians, overall Impact +4.5%

Legislative Update Issues and Trends

2009 Session Overview

- **Extremely busy season first 45 days**
 - 75 proposals in 2009 compared to 48 in 2008
 - About 1/3 of all proposals deals with some aspect of medical
 - 1st Responder Bills still very popular
 - Indemnity increases far outweighing decreases

NCCI Developments in Ratemaking Methodology

- **NCCI conducted a comprehensive review of all class ratemaking methodologies**
- **The review concluded in August 2008**
- **The goal of NCCI's new class ratemaking methodology is to improve accuracy, class equity, and loss cost stability from year to year**
- **The new methodology will be in NCCI loss cost filings effective 10-1-09 and subsequent**

Areas Impacted by Class Ratemaking

- **Lower loss limits**
- **Revised loss development to include body part**
- **Replaced use of serious and non-serious partial pure premiums with indemnity partial pure premiums**
- **Revised excess loss treatment to incorporate ELPPFs**
- **Maintaining industry group differentials**
- **Adjusted class credibility to accommodate new partial pure premiums**

Experience Rating Plan Methodology Review

- **Experience Rating Plan in midst of three year review**
- **Excellent results in prior years performance testing**
- **Number of years in the plan will remain the same**
- **Progress to date includes:**
 - Review of performance by Hazard Group
 - Suggests that credibility should be modestly increased
 - Review of single vs. multiple split point options
 - We will maintain a single split point
 - Methodology for determining primary and excess credibility
 - We will use a Bayesian statistical approach

For More Information

- **Refer to Actuarial Committee and Individual Risk Rating Work Group (IRRWG) minutes posted on ncci.com**
- **CAS Ratemaking Call Paper titled, “Class Ratemaking for Workers Compensation: NCCI’s New Methodology” presented at this conference and available on CAS forum**
- **Other related presentations at this conference:**
 - WC-1, Impact of the Economy on Workers Compensation Insurance
 - WC-2, Trends in Workers Compensation Medical Costs
 - WC-3, Workers Compensation Claim Frequency
 - WC-4, Workers Compensation Ratemaking—An Overview

Key Issue for the Future—The Economic Downturn and its Impact on WC

- Will total industry premiums decline due to the economy?
- Will the historical drop in frequency during recessions repeat itself?
- Will indemnity severity changes track wage inflation or will we see additional impacts from utilization?
- Will medical severities continue to rise?
- What impact will earnings pressures have on reserve deficiencies?
- Where are investment returns headed?
- How will economic pressures impact current and future reforms?
- What others impacts will we see?

WORKERS COMPENSATION STATE OF THE MARKET (SESSION WC-5)

Q & A