

BESTWEEK

Property/Casualty Supplement

September 6, 1994

Release 16

Years of Reform Yield Stunning Upturn in Workers' Comp

It took more than half a decade and a near crisis situation in many states, but efforts to revamp the workers' compensation system finally paid off. Last year, underwriting losses narrowed \$3.67 billion, to \$2.75 billion—the smallest underwriting loss in 10 years.

Since the early 1980s, underwriting losses ballooned, rising from \$1.76 billion in 1983 to \$7.31 billion in 1991. Throughout the mid-1980s, increases in claims costs far exceeded premium gains. The largest difference occurred in 1986, when claims costs jumped nearly 25%, while premiums grew 18%. This occurred because rate increases, while substantial, couldn't keep pace with increases in underlying medical and indemnity costs.

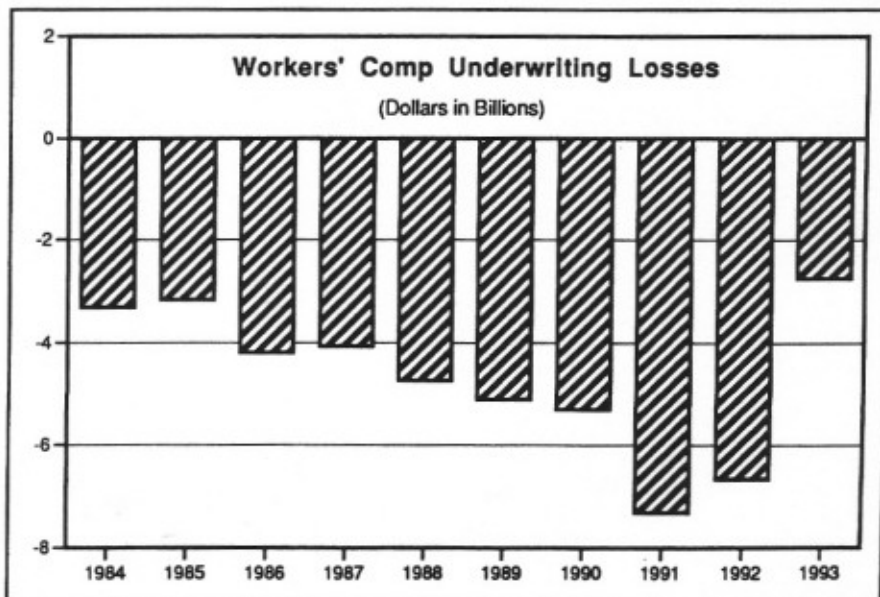
According to the National Council on Compensation Insurance, workers' comp medical costs grew at an average annual rate of 10.9% from 1985 to 1992 compared with a 7.6% annual medical inflation rate as measured by the Medical Consumer Price Index (MCPI). This disparity reflected cost shifting between workers' comp and

health care systems, excessive use of medical services, low deductibles or coinsurance, and fraud.

Likewise, workers' comp indemnity costs also surged. As a replacement to lost wages during disability, these costs should track with wage increases, but from 1985 to 1992, workers' comp indemnity costs increased at nearly twice the wage inflation rate, says NCCI. Broadening the definition of job-related injury and growing legal costs were to blame.

As a result, the average cost of a workers' comp claim swelled to \$18,300 in 1992 from \$10,300 in 1985, according to NCCI. The widening difference between runaway claims costs and limited rate increases caused insurers to label the system as out of balance.

By 1990, the problems that plagued state workers' comp systems were well known to all parties. Rampant escalating costs mobilized business communities and led to the creation of effective



This report was prepared by Diane Ferraiolo, senior editor. The source of the information in this report is the A.M. Best Co. database.

coalitions between businesses and insurers, says Joseph A. DiGiovanni Jr., vice president and director of workers' comp for the American Insurance Association, an industry trade group. Over the past four years, reforms have been enacted in more than one-third of the state workers' comp systems.

While unique to each state system, these reforms focused on cost containment measures. Reforms in states like Texas and Connecticut are helping to rein in medical costs and make compensation guidelines more objective, says Tom Driscoll, vice president of government relations at Liberty Mutual. Texas

reforms included implementation of medical fee schedules and the adoption of American Medical Association guidelines for defining medical impairment. In Connecticut, cost savings between 15% and 20% are expected from a reduction in benefits, elimination of cost-of-living increases for certain dis-

Premiums and Leading Workers' Compensation Writers by State — 1993

State	Rank	No. of Cos.	Direct Premiums	% of U.S. Total	Premium Chg.(%)	Adjusted Loss Ratio	Market Agency Cos.	Share Direct Writers	Leading Writer	% of State Market	Second Leader	% of State Market
Ala.	27	288	\$337,267	1.0	-12.0	90.6	73.6	26.4	Liberty Mutual Group	14.3	Aetna Life & Cas Grp	6.9
Alaska	36	202	181,846	0.5	-1.3	59.5	80.0	20.0	Alaska National Ins	29.9	Talegen Ins Groups	16.8
Ariz.	28	286	311,090	0.9	4.0	73.7	82.8	17.2	Amer Intern Group	9.6	Liberty Mutual Group	8.1
Ark.	30	280	308,947	0.9	-3.3	54.7	71.1	28.9	Liberty Mutual Group	13.0	Nationwide Group	8.8
Calif.	1	336	7,327,262	22.0	6.8	65.3	86.9	13.1	Amer Intern Group	7.4	Amer Prem Undrs Grp	6.4
Colo.	20	283	385,322	1.2	5.0	77.7	67.5	32.5	Liberty Mutual Group	13.7	Farmers Ins Group	10.1
Conn.	15	252	626,691	1.9	2.6	76.1	80.1	19.9	ITT Hartford Ins Grp	15.0	Liberty Mutual Group	10.0
Del.	43	257	87,080	0.3	-6.9	89.6	77.0	23.0	Liberty Mutual Group	15.1	Selective Ins Group	6.9
D.C.	41	246	108,959	0.3	-7.3	75.7	86.2	13.8	ITT Hartford Ins Grp	15.2	Aetna Life & Cas Grp	10.2
Fla.	8	326	1,161,829	3.5	1.3	107.3	70.3	29.7	Commerce Mutual Ins	18.1	Liberty Mutual Group	16.0
Ga.	11	326	831,975	2.5	-7.2	71.2	75.2	24.8	Liberty Mutual Group	12.0	Nationwide Group	6.7
Hawaii	26	167	340,413	1.0	21.9	98.9	95.6	4.4	Continental Ins Cos	20.9	Island Ins Group	9.9
Idaho	38	237	120,099	0.4	22.0	66.0	71.0	29.0	Talegen Ins Groups	17.2	Liberty Mutual Group	13.4
Ill.	3	353	2,069,997	6.2	1.1	68.5	80.6	19.4	Continental Ins Cos	15.3	Liberty Mutual Group	8.5
Ind.	16	336	618,877	1.9	14.1	63.8	77.1	22.9	Liberty Mutual Group	8.5	Nationwide Group	6.1
Iowa	21	308	382,630	1.1	10.0	58.2	78.2	21.8	EMC Ins Cos	11.4	Liberty Mutual Group	8.0
Kan.	23	283	371,390	1.1	-	63.3	80.2	19.8	Travelers Ins Group	11.2	ITT Hartford Ins Grp	8.6
Ky.	19	294	437,260	1.3	10.5	95.9	66.4	33.6	Liberty Mutual Group	17.0	Nationwide Group	11.4
La.	35	286	189,582	0.6	-60.3	64.2	82.1	17.9	Amer Intern Group	13.9	Cigna Group	10.1
Maine	42	189	101,331	0.3	-53.2	74.7	95.5	4.5	Allmerica P & C Cos	36.1	Comm Union Ins Cos	22.6
Md.	22	311	378,277	1.1	-0.5	79.4	81.3	18.7	ITT Hartford Ins Grp	10.2	Liberty Mutual Group	9.6
Mass.	6	245	1,396,817	4.2	6.6	56.0	68.5	31.5	Liberty Mutual Group	22.7	Aetna Life & Cas Grp	9.9
Mich.	10	307	1,025,308	3.1	-2.6	72.1	78.1	21.9	Allmerica P & C Cos	10.8	Liberty Mutual Group	9.8
Minn.	17	301	601,765	1.8	6.1	83.0	68.5	31.5	Liberty Mutual Group	8.5	CNA Ins Companies	8.5
Miss.	33	278	222,166	0.7	0.9	56.8	67.7	32.3	Liberty Mutual Group	15.0	United States F&G Gr	13.5
Mo.	12	318	731,113	2.2	-2.0	66.2	71.5	28.5	Liberty Mutual Group	12.4	Nationwide Group	7.4
Mont.	44	220	62,831	0.2	10.3	66.7	79.6	20.4	Kemper Nat Ins Cos	15.7	Liberty Mutual Group	12.0
Neb.	31	295	263,023	0.8	8.0	66.4	77.3	22.7	ITT Hartford Ins Grp	9.6	Liberty Mutual Group	7.5
Nev.	48	139	7,327	0.0	-35.9	118.2	106.4	-6.4	Aetna Life & Cas Grp	55.3	Amer Intern Group	20.6
N.H.	32	241	222,331	0.7	18.2	66.3	52.7	47.3	Liberty Mutual Group	38.1	ITT Hartford Ins Grp	6.9
N.J.	7	309	1,327,998	4.0	14.6	95.7	62.8	37.2	New Jersey Mfrs Grp	24.0	Liberty Mutual Group	9.1
N.M.	34	255	191,096	0.6	-13.1	38.1	84.6	15.4	Mountain States Mut	30.0	United States F&G Gr	21.2
N.Y.	4	324	1,900,349	5.7	-2.2	76.0	85.9	14.1	Amer Intern Group	10.8	ITT Hartford Ins Grp	8.2
N.C.	13	287	667,878	2.0	9.7	78.2	73.0	27.0	Liberty Mutual Group	13.9	ITT Hartford Ins Grp	8.5
N.D.	51	132	3,047	0.0	231.3	11.3	96.9	3.1	Aetna Life & Cas Grp	52.0	ITT Hartford Ins Grp	24.4
Ohio	46	195	41,149	0.1	1.6	92.5	88.0	12.0	Aetna Life & Cas Grp	31.7	ITT Hartford Ins Grp	20.4
Oklahoma	29	285	309,381	0.9	12.8	77.5	83.1	16.9	Amer Intern Group	18.4	Travelers Ins Group	8.0
Ore.	24	245	355,580	1.1	-10.7	67.1	47.7	52.3	Liberty Mutual Group	40.9	Amer Intern Group	6.5
Pa.	2	347	2,389,936	7.2	4.1	97.5	84.1	15.9	PMA Group	9.4	Liberty Mutual Group	8.7
R.I.	45	216	59,297	0.2	-51.5	30.3	75.8	24.2	Aetna Life & Cas Grp	36.5	Nationwide Group	21.4
S.C.	25	276	348,316	1.0	7.5	64.5	70.8	29.2	Liberty Mutual Group	16.8	ITT Hartford Ins Grp	10.6
S.D.	39	260	109,951	0.3	15.7	88.5	66.9	33.1	Nationwide Group	11.9	Travelers Ins Group	7.3
Tenn.	14	310	649,075	1.9	3.4	75.3	73.2	26.8	Liberty Mutual Group	15.5	Travelers Ins Group	10.0
Texas	5	367	1,773,199	5.3	-26.6	64.6	78.6	21.4	Kemper Nat Ins Cos	8.3	Travelers Ins Group	7.8
Utah	37	246	128,414	0.4	31.9	63.3	75.5	24.5	TIG Holdings Group	9.0	Liberty Mutual Group	8.4
Vt.	40	211	109,772	0.3	24.4	93.7	78.9	23.1	Liberty Mutual Group	17.5	ITT Hartford Ins Grp	9.2
Va.	18	313	567,172	1.7	3.4	87.1	79.6	20.4	Liberty Mutual Group	10.6	ITT Hartford Ins Grp	8.1
Wash.	47	169	37,478	0.1	-21.6	30.0	95.7	4.3	Eagle Ins Group (WA)	22.6	Talegen Ins Groups	20.9
W.Va.	49	143	7,263	0.0	12.7	92.0	95.4	4.6	ITT Hartford Ins Grp	28.3	Kemper Nat Ins Cos	23.7
Wis.	9	314	1,154,921	3.5	15.8	62.7	69.3	30.7	Nationwide Group	12.4	Liberty Mutual Group	6.0
Wyo.	50	142	7,111	0.0	76.7	21.6	88.6	11.4	Old Republic Gen Grp	26.9	Aetna Life & Cas Grp	23.1
Total		860	\$33,348,189	100.0	0.5	73.6	78.4	21.6	Liberty Mutual Group	9.8	Amer Intern Group	5.5

Premiums are in thousands (000 omitted) and before reinsurance.

Adjusted loss ratio includes pure losses and policyholders' dividends but not loss adjustment or underwriting expenses.

abilities and managed care incentives.

Long sought-after reforms to tighten compensability rules also have been enacted in many states. A Florida bill requires that the workplace be the major cause of injury or death to obtain coverage. California workers now must prove that conditions in the workplace were the predominant cause of a psychiatric injury. Formerly, workers' comp benefits would have been provided if the workplace contributed as little as 10% to mental-injury claims. Mental stress claims for personnel actions like firings and layoffs are prohibited. Other fine-tuning of the systems included reforms aimed at reducing attorney fee schedules, enhancing dispute resolution procedures and increasing penalties for fraud.

Cost increases are moderating. NCCI reports that workers' comp medical inflation rose only 6.9% in 1992, slightly below the 7.4% increase in the MCPI, and indemnity-cost increases slowed to 2.5% in 1992, in line with the wage inflation rate.

Other signposts show improvement. Claims costs fell for the second consecutive year, tumbling 15% in 1993. This huge drop in claims costs and stabilizing premium levels caused

the net loss ratio to improve a hefty 13.1 percentage points from the year-earlier 97.1 ratio. This improvement caused the combined ratio to fall to 109.1—its lowest level in 12 years.

Between four to six percentage points of last year's improvement came from reforms and rate increases, says Geoff Smith, vice president for ITT Hartford. Loss cost inadequacy has narrowed greatly, Smith says. In 1989, loss costs were nearly 25 points deficient for an insurer with a geographic business mix identical to that for which NCCI files. This deficiency narrowed to roughly five points for 1994, Smith says.

Leading Writers of Workers' Compensation Insurance

Company/Group	1993 Direct Premiums	Premium Chg.(%)	← Market Share →			← Adjusted Loss Ratios →			% of Co. Pems.
			1993	1992	1991	1993	1992	1991	
Liberty Mutual Group	\$3,255,453	2.1	9.8	9.6	10.7	88.5	100.7	94.3	51.3
Amer Intern Group	1,840,084	2.4	5.5	5.4	5.9	83.9	88.8	98.8	20.8
ITT Hartford Ins Grp	1,590,529	10.2	4.8	4.4	4.9	74.1	93.6	86.6	28.2
Travelers Ins Group	1,542,784	-10.3	4.6	5.2	5.2	84.5	88.3	96.1	32.8
Nationwide Group	1,521,404	-6.7	4.6	4.9	4.5	59.8	91.2	99.9	19.1
Kemper Nat Ins Cos	1,446,143	-4.7	4.3	4.6	4.6	62.7	73.7	89.5	46.9
CNA Ins Companies	1,441,165	-6.6	4.3	4.6	3.6	71.8	59.0	98.7	25.1
Continental Ins Cos	1,150,017	-0.6	3.4	3.5	3.3	86.3	85.2	91.0	24.1
Aetna Life & Cas Grp	1,109,832	-17.3	3.3	4.0	4.5	68.7	84.0	78.4	20.3
Cigna Group	1,020,316	9.6	3.1	2.8	4.6	98.7	94.4	107.5	29.7
Fireman's Fund Cos	845,196	1.1	2.5	2.5	2.1	86.0	110.7	99.3	26.5
Talegen Ins Groups	584,417	-17.7	1.8	2.1	2.2	67.5	105.6	78.4	25.2
Zurich Ins Group-U S	582,617	8.3	1.7	1.6	2.2	87.7	75.8	73.8	16.9
Home Ins Cos	581,400	4.1	1.7	1.7	1.6	69.2	82.9	82.2	27.0
Reliance Ins Group	576,026	-0.5	1.7	1.7	1.6	91.8	88.2	80.9	23.1
TIG Holdings Group	472,763	-5.4	1.4	1.5	1.3	79.3	85.7	78.1	27.7
Amer Prem Undrs Grp	469,534	17.1	1.4	1.2	1.0	51.7	59.6	60.8	37.7
Golden Eagle Ins Co	447,309	73.5	1.3	0.8	0.4	63.2	73.5	62.4	58.2
Fremont General Grp	433,400	11.1	1.3	1.2	1.1	60.0	83.9	80.7	94.3
United States F&G Gr	428,260	-8.6	1.3	1.4	1.8	40.7	81.5	139.7	18.3
Top 20 Cos.	\$21,338,738	-0.8	64.0	64.8	67.0	77.2	87.5	92.9	28.0
Total U.S. Cos.	\$33,348,189	0.5	100.0	100.0	100.0	73.6	84.8	89.2	13.6

Premiums are in thousands (000 omitted) and before reinsurance.

Adjusted loss ratio includes pure losses and policyholders' dividends but not loss adjustment or underwriting expenses. Percentage of company's premiums is the ratio of workers' compensation premiums to the insurer's total.

An additional three to four percentage points of improvement is because of narrowing residual market losses, says Smith. Here too, reforms to streamline administration, modify benefit levels and adopt managed care techniques have reined in losses.

Indeed, NCCI says that residual market underwriting losses shrank to

for high-risk employers and some small business bars subsidies from the voluntary market to cover deficits. And Texas' residual market, which had a cumulative deficit of \$1.5 billion at one time, was abolished and replaced with a state fund that competes for business with private insurers. Lifting these involuntary burdens have caused many insurers to revise their geographic strategies.

NCCI says that direct assignment also reduced residual market losses. This option gives insurers the choice of fulfilling their involuntary market obligation by writing this business directly rather than participating in state pools. This option helps to depopulate the involuntary market. And some insurers think that they can better control claims and expenses when this business is written directly.

Even the recession helped to improve results. Says Smith, low inflation probably accounted for about one percentage point of last year's loss-ratio improvement.

Market Share % — Workers' Compensation					
	1993	1992	1991	1990	1989
Nat'l. Agency Cos.	54.1	56.5	58.7	60.7	60.5
Reg'l. Agency Cos.	24.3	21.8	19.3	18.1	16.9
Total Agency Cos.	78.4	78.2	78.0	78.8	77.4
Direct Writers	21.6	21.8	22.0	21.2	22.6

\$900 million in 1993 from \$1.5 billion in 1992. Restructuring residual market mechanisms, premium surcharges and higher rate differentials steadily narrowed underwriting losses from 1989's trough of \$2.3 billion.

Meeting with mixed success, many residual market reforms centered on making this market self-funding. A new Florida joint underwriting association

While years of reform finally filtered to insurers' bottom line last year, improvement probably started before then, Smith says. In fact, insurers have lowered reserve estimates for claims reported in 1990 through 1992. Estimates for 1992 reserves were reduced by \$475 million.

Fine-Tuning Claims Management

For most insurers, loss ratios sharply improved. Of the 20 largest insurers, 14 posted net loss ratios that improved from the previous year's result by 10 percentage points or more. While reform and rate actions accounted for the bulk of these gains, fine-tuning claims management programs also bolstered results. Early intervention techniques, which focus on close monitoring of an injury by a registered nurse, have taken precedence over the process of reviewing bills for over-

charges, says James S. Kemper III, executive vice president of Kemper National's commercial lines division.

Kemper doesn't think the company's pure loss ratio of 56 will improve much more. Last year was the third consecutive year that Kemper National's ratio improved. It is hard to get a loss ratio much lower than it is now, says Kemper, but the industry results probably will improve through 1995.

The application of managed care techniques is still in its infancy, and cost savings from the flurry of reforms haven't fully filtered down to insurers' bottom line.

Indeed, it is unlikely that insurers are going to see much improvement from revenue growth. Net premiums written, the basis for insurers' future earnings, rose only 2.1% in 1993. Self-insured and high-deductible plans have siphoned off premium. A flurry of rate

reductions followed hard on the heels of reforms.

Even the growth of a service economy has somewhat depressed premium growth. These classes of business generate less premium than do manufacturing classes, because they are less risky.

With many problems resolved, the challenge is to remain vigilant, says Smith of ITT Hartford. Inflation, challenges to recent reforms, efforts to scale back antitrust protections for insurers all threaten to erode insurers' gains.

These problems, however, are all minor nuisances compared with the possibility of workers' comp being folded into a reformed health care system. Integrating these systems breaks the crucial link between treatment and return-to-work efforts that keep costs down. Breaking this link is the biggest threat to the system, says Driscoll of Liberty Mutual. ■

