

**IN THE**

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## **Will rising workers compensation costs lead the way to a hard P&C insurance market?**

**By Dan Kuczek, LUTCF**

It may be one of the leading indicators. The National Council on Compensation Insurance (NCCI) recently released its “State of the Line” report for workers compensation in 2010, and results indicate that a hardening of the work comp market is inevitable. So what does that mean to the insuring public, and what exactly is a hard or soft insurance market?

Generally, in a soft market, insurance companies experience growth and profitability and will compete fiercely for market share by reducing rates, creating favorable terms and conditions, and becoming more flexible with underwriting criteria and claims payments to attract more business. However, in their struggle to gain the most market share, insurance carriers inevitably end up cutting rates to the point where they start losing money. Enter the transition to a hard market. In a hard insurance market, it is *hard* to get the pricing and terms you want or may have enjoyed at your last renewal. Rates increase, coverage becomes more restrictive, underwriting and loss control tightens up, claims become debatable, carriers begin to pass on risk, and market access can become problematic. Insurers become conservative until they become profitable again. It is a cyclical trend in the industry that has gone on since the beginning. However, despite insurance companies’ behavioral influence on market conditions, hard markets are also event-driven by external factors such as recent catastrophes, investment and reinsurance market fluctuation, regulation, increased health care costs, and other factors. While carriers have endured pretty well in the soft market cycle for some time now, the transition to a hard workers comp market is beginning.

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Examine a few of the recent NCCI statistics on work comp:

- The combined ratio for insurance carriers workers comp as a line of business was up five points from 2009 to 1.15 (loss of 15 cents on the dollar after investment income). This is the fifth consecutive year insurance carrier combined ratios have deteriorated.
- Premiums have consistently declined since 2005, while the average claim cost increased approximately 27% since 2005.

- Workers comp lost-time claim frequency increased for the first time since 1997.
- Calendar year loss reserve deficiencies increased for the fourth year in a row, from \$2 billion in 2007 to \$10 billion in 2010.
- The NCCI filed for rate increases in 14 of the 35 NCCI states and DC versus 8 the previous cycle. They have also proposed changes in the calculation of the maximum experience modification formula and increased the split point in the rating methodology, among other changes.

There are a number of reasons for the work comp results; however, the trends in the statistics cited above speak for themselves and point to a hardening work comp market. Additionally, while increased health care and prescription costs are a contributing factor, we don't yet know the impact federal health care reforms in the form of the Patient Protection and Affordable Care Act (PPACA) will have on the work comp market, let alone the on-the-job education of 24 newly-appointed state insurance commissioners and the newly-formed Federal Insurance Office.

Whether or not a hard workers comp market will lead the way for the rest of the property casualty industry is yet to be determined. However, according to Towers Watson, commercial insurance prices increased nearly 1.5% during the second quarter compared with the same period last year, which Towers Watson & Company said is the first time prices for all standard commercial product lines increased since the fourth quarter of 2003. Another bell-weather, Lloyd's of London, posted a \$2.4 billion loss the first half of 2011.

### **What can you do to offset the hardening work comp market?**

Workers compensation for many industries is a very controllable risk. It depends on how you answer the following questions:

*When was the last time you had someone verify the calculation of your experience modification factor? How do you know if rating plan adjustments assure the use of fair values in computing experience modification factors, credits, and debits? The fact is that they are not set in stone and can often be miscalculated based on your actual loss experience.*

*Do you have a process to verify the fairness of audit calculations?*

*Do you have someone to conduct a periodic review of claims reserves to assure appropriate action in a timely manner?*

*Are you reporting claims promptly? Do you have someone actively involved in monitoring questionable claims, rehabilitation claims, litigated claims, and subrogated claims?*

*What are you doing to proactively manage risk and enforce safe work practices and procedures? Do you have a return to work program?*

*Have you considered retaining a large deductible, self insuring, joining a captive insurer, or other method of alternative risk transfer?*

*Do you have an agent or consultant with enough experience, creativity, and market knowledge and access to help you with a customized solution?*

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Sources:

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