



Ohio Competitive Workers Compensation Task Force Meeting

Ohio Bureau of Workers Compensation
Columbus, OH

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■ Insurance, Monopoly and Workers Compensation

- ◆ Economic tests/rationale for monopoly: 2010 vs. 1910
- ◆ Competition: Market concentration metrics

■ A Brief History of Workers History in Ohio

- ◆ Social policy, economics, legislation, litigation and politics

■ Workers Compensation Operating Environment: Intense Competition

- ◆ Size, Growth, Underwriting Performance, Residual Markets, Employer Cost

■ The Importance of Free, Open and Fair Competition

- ◆ Benefits of competition
- ◆ The need for all insurers to compete on a level playing field, irrespective of size

■ Workplace Safety

- ◆ The workplace has never been safer
- ◆ Workers comp insurers are critical players in safety and risk management

■ Q & A

Insurance, Monopoly and Workers Compensation

**What Does Economics Have to Say About
Monopoly in Workers Compensation
Insurance Markets?**

Depends on Which Century You Ask

Figure 1: Economic Test for Rationalization of Monopoly, 2010 vs. 1910

Economic Tests that Could Be Used to Rationalize the Existence of Monopoly in Workers Compensation	Do the Criteria Apply in 2010?	Observations	Did the Criteria Apply in 1910?	Observations
Does any insurer have exclusive ownership of a resource, expertise or capital necessary to write workers compensation coverage?	No	<ul style="list-style-type: none"> 46 states allow private sector competition 764 private insurers wrote workers comp insurance in these 46 states in 2009 	Possibly	<ul style="list-style-type: none"> State insurers often would have been in a better position to secure capital, data
Do any insurers have an exclusive patent or process necessary to write workers compensation insurance?	No	<ul style="list-style-type: none"> Actuarial and underwriting methodologies for workers compensation are similar throughout the industry Necessary skills/expertise and technology can be readily acquired through training or purchase 	N/A	<ul style="list-style-type: none"> There were established actuarial or underwriting procedures for WC in 1910
Do high fixed costs render the cost of providing workers compensation too high unless there is just a single provider of coverage?	No	<ul style="list-style-type: none"> The marginal cost of offering workers comp in Ohio is relatively low, especially for insurers already offering the coverage in other states 	Yes (in Some States)	<ul style="list-style-type: none"> Creating a WC product and distribution system would have been costly

Rationale for Government Monopoly & The Standard Monopoly Critique

- **Governments Do Not Create or Sanction Monopolies for the Purpose of Wealth Creation**
- **Governments Create Monopolies When They Believe the Public Interest Is Being Served**
 - ◆ To provide a necessary service that otherwise would be unavailable
 - ◆ To provide a service that otherwise would be unaffordable to most
 - ◆ To create an unavoidable service (e.g., toll road)
- **Any Level of Government Can Create a Monopoly: Federal, State, Local**

Standard Critique of Monopoly

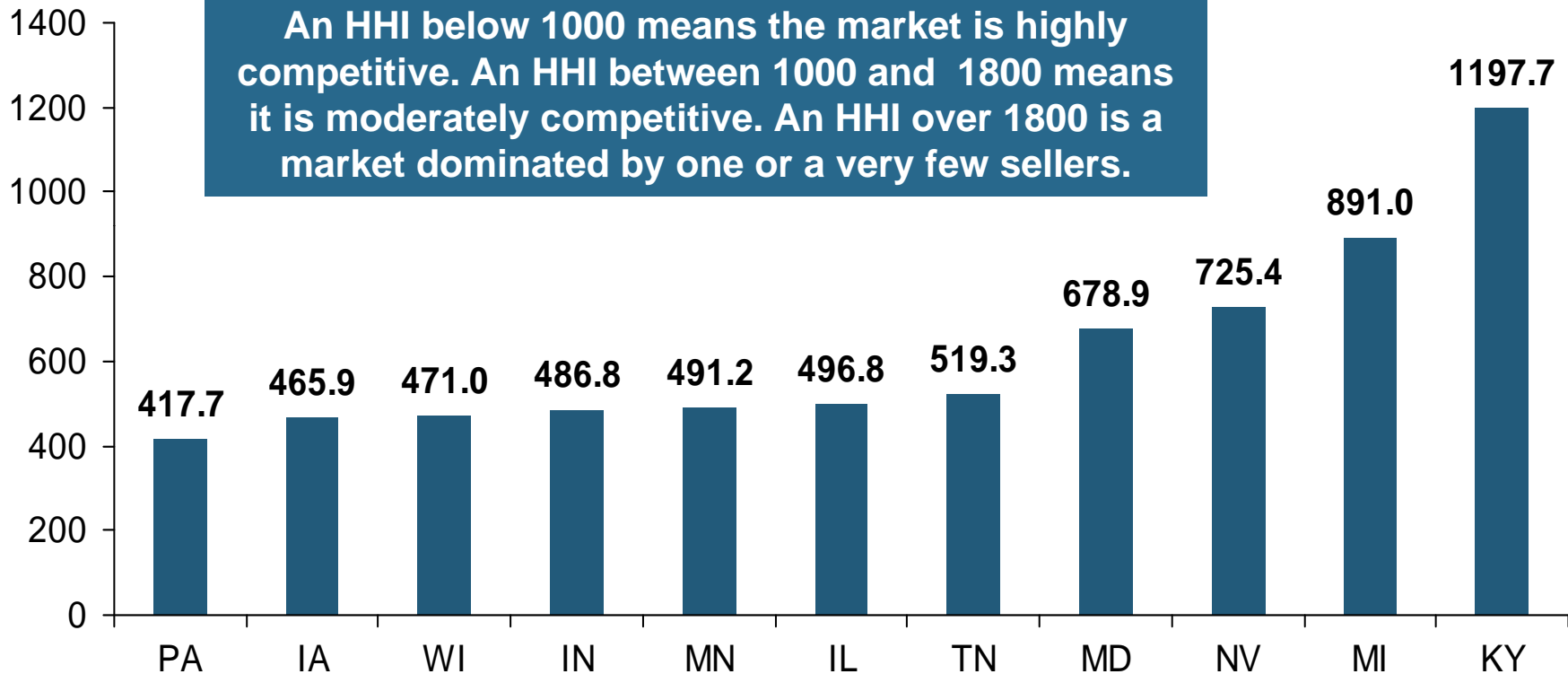
- **Monopolies (Including Government Monopolies) Produce Products and Services that Are of Inferior Quality**
 - ◆ Due to the fact that the monopolist has no market-based incentive to provide high-quality service or to improve
 - ◆ Market share and finances are guaranteed by the government
 - ◆ No external benchmark for performance
 - ◆ In contrast, competition drives sellers to improve/innovate or lose market share
- **The Quality-of-Product Issue is One of the Most Frequently Leveled Criticisms Against Government Monopolies**
 - ◆ Examples: DMVs, highway maintenance, education, sanitation, public safety

Competition and Workers Compensation in the 21st Century: Market Observations

- **46 or the 50 State Allow Competition in their Worker Comp Markets**
 - ◆ Means most states believe competition in WC markets is feasible and desirable
 - ◆ Also implies that insurance departments can adequately regulate WC market
- **764 Insurers (Comprised of 314 Insurance Groups) Wrote Workers Coverage in 2009**
 - ◆ By U.S. Dept. of Justice standards, the WC market in every non-monopolistic fund state fits the definition of “competitive” (no antitrust concerns)
 - ◆ Even the largest WC carrier had only an 11% market share nationally in 2009
- **Barriers to Entry in Workers Compensation Are Low**
 - ◆ New insurers can enter WC markets with relative ease
- **Many Insurers Compete in States Near/Like Ohio**
 - ◆ IN: 88; PA: 85; IL: 95, MI: 62; WI: 82
 - ◆ If OH were competitive today, 65-85 private insurers would likely be writing coverage
- **No Traditional Economic Criteria that Would Justify the Existence of Monopoly Exist in 2010**
 - ◆ In 1910, the situation was different
- **Residual Market Shares Are Very Small and Are Shrinking**
 - ◆ Nationally, WC residual market share was just 5% of DPW in 2009 (NCCI states)
 - ◆ Combined underwriting loss of these states was just \$75 million in 2009

WC Market Concentration* by HHI in Selected States, 2009

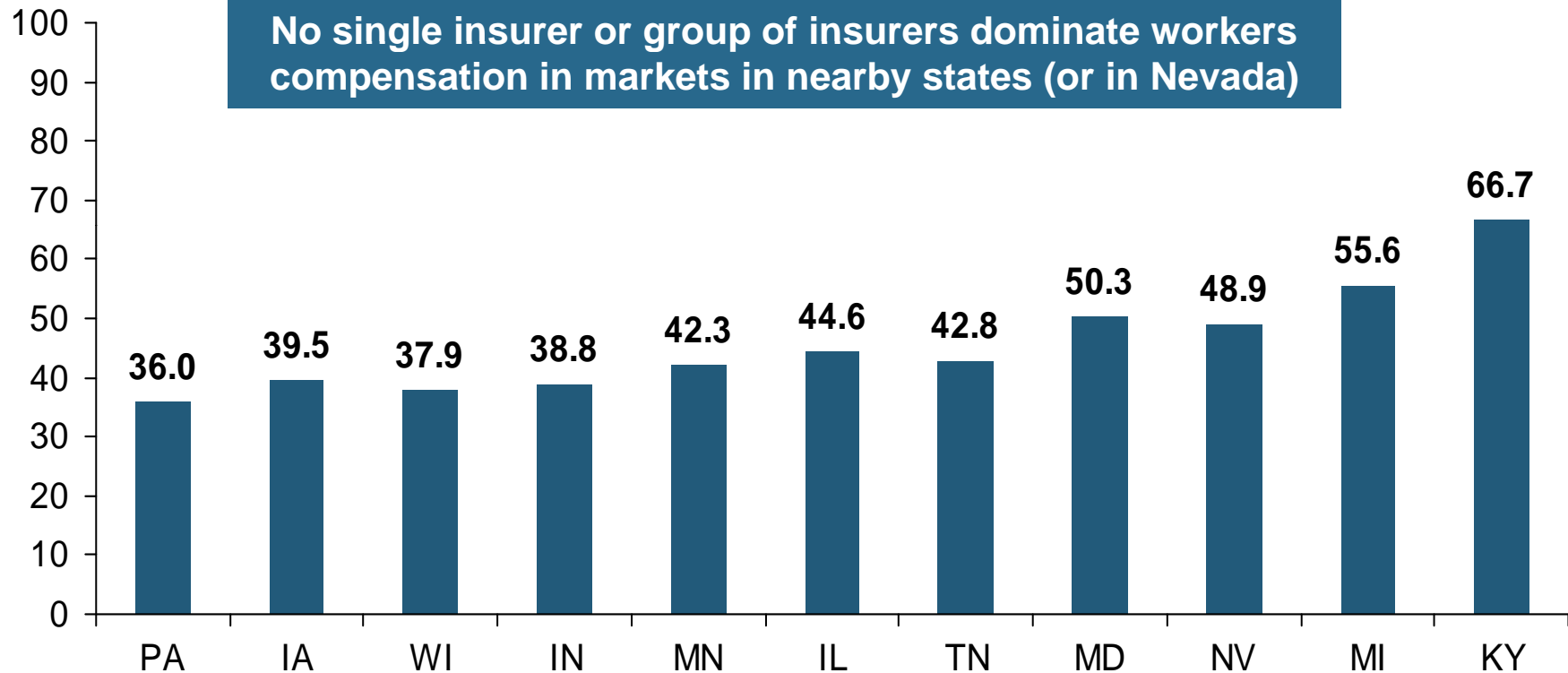
Herfindahl-Hirschman Index



In every state near Ohio and with similar economies, the private market for Workers Compensation insurance is highly competitive

WC Market Share of Top 5 Insurers in Selected States, 2009

Market
Share (%)

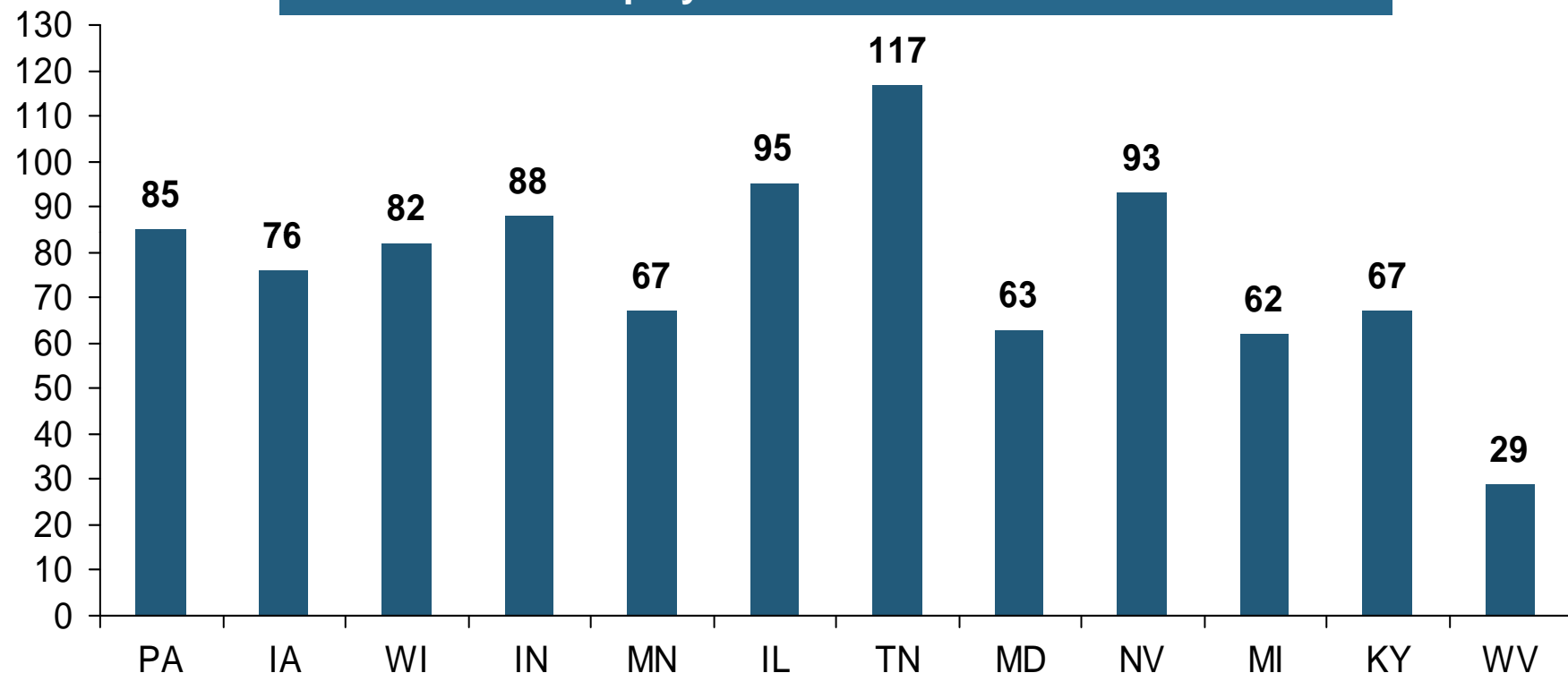


In every state near Ohio and with similar economies, the private market for Workers Compensation insurance is highly competitive

Number of Insurers in the WC Market in Selected States, 2009

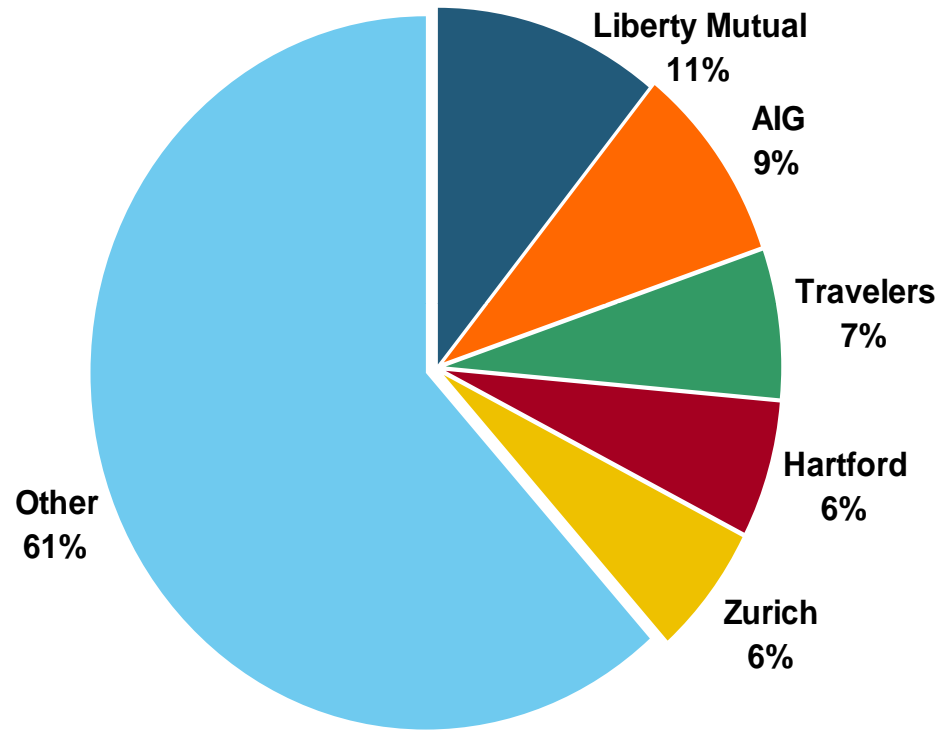
Number of
Insurers

WV's market is transitioning to a competitive state; in 2009 the former monopoly state fund had a 75% market share.



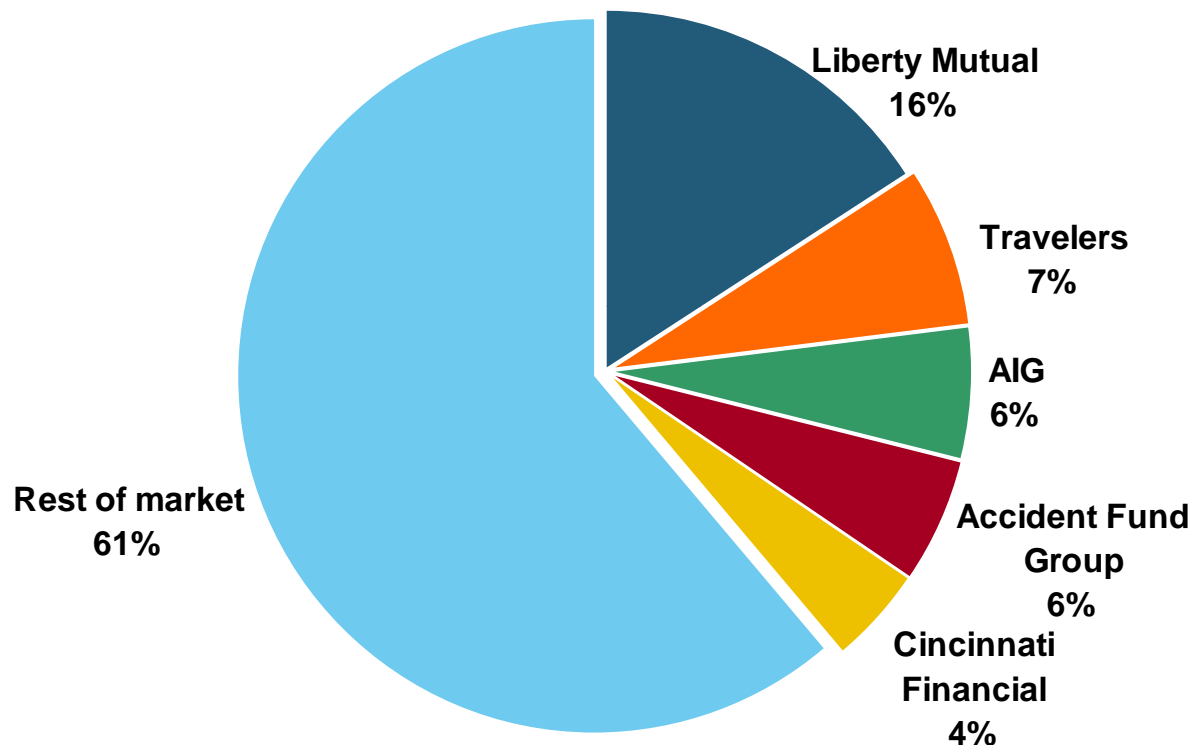
In every state near Ohio and with similar economies, the private market for Workers Compensation insurance is highly competitive

No Single Company Dominates Workers Comp Market in U.S.



The five largest writers command 39% of the market. The 10 largest command 51%.

Like Most of the US, Indiana's WC Market Is Competitive



The five largest writers command 39% of the market. The 10 largest command 54%.



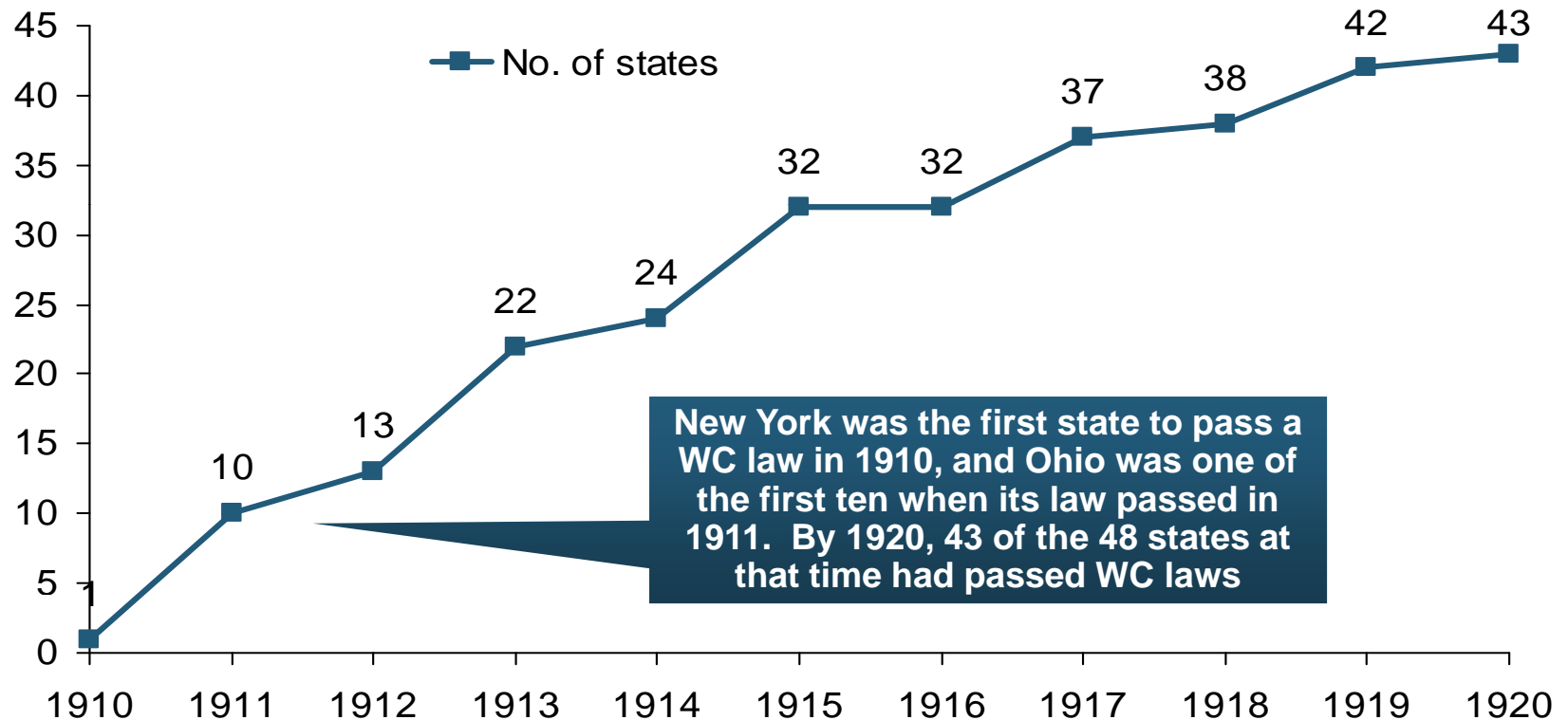
A Brief History of Workers Compensation in Ohio

**Social Policy, History, Economics and
Politics All Played Important Roles in the
Development of Modern WC Systems,
Including Ohio's**

Workers Compensation Timeline

- **Industrialization of US in the Late 19th/Early 20th Century Led to Increasing & Unacceptably High Number of Deaths and Injuries Among Workers**
 - ◆ In 1912, an estimated 18,000 to 23,000 workers were killed on the job (compared to 5,071 in 2008) and approximately 4.7 million (12% of workforce) suffered a nonfatal illness or injury (compared to 3.7 million 2008)
 - ◆ The 1912 death/injury rates would imply 75,600 deaths and 17 million injuries today
 - ◆ More awareness of broader impacts on families of injured/killed workers
- **Workers Could Seek Redress Under Tort Law, But Seldom Prevailed**
 - ◆ Employers usually won suits filed by injured workers by arguing:
 - **Contributory Negligence:** Employee was at least partially to blame for the accident
 - **Assumed Risk:** By taking the job, the employee understood the hazards involved
 - **Fellow Servant Rule:** A fellow worker caused the accident, so the employer was not at fault
- **European Countries Began to Implement Workers Compensation Programs**
 - ◆ Germany (1884); England (1897)
- **Insurers Began to Sell Commercial Liability Coverage in the Late 1800s**
 - ◆ Coverage for inadvertent errors became more commonplace
 - ◆ In the workforce, such policies became the first employer liability policies

Cumulative Number of WC Laws Passed, 1910-1920



Ohio: A Workers Comp Trailblazer

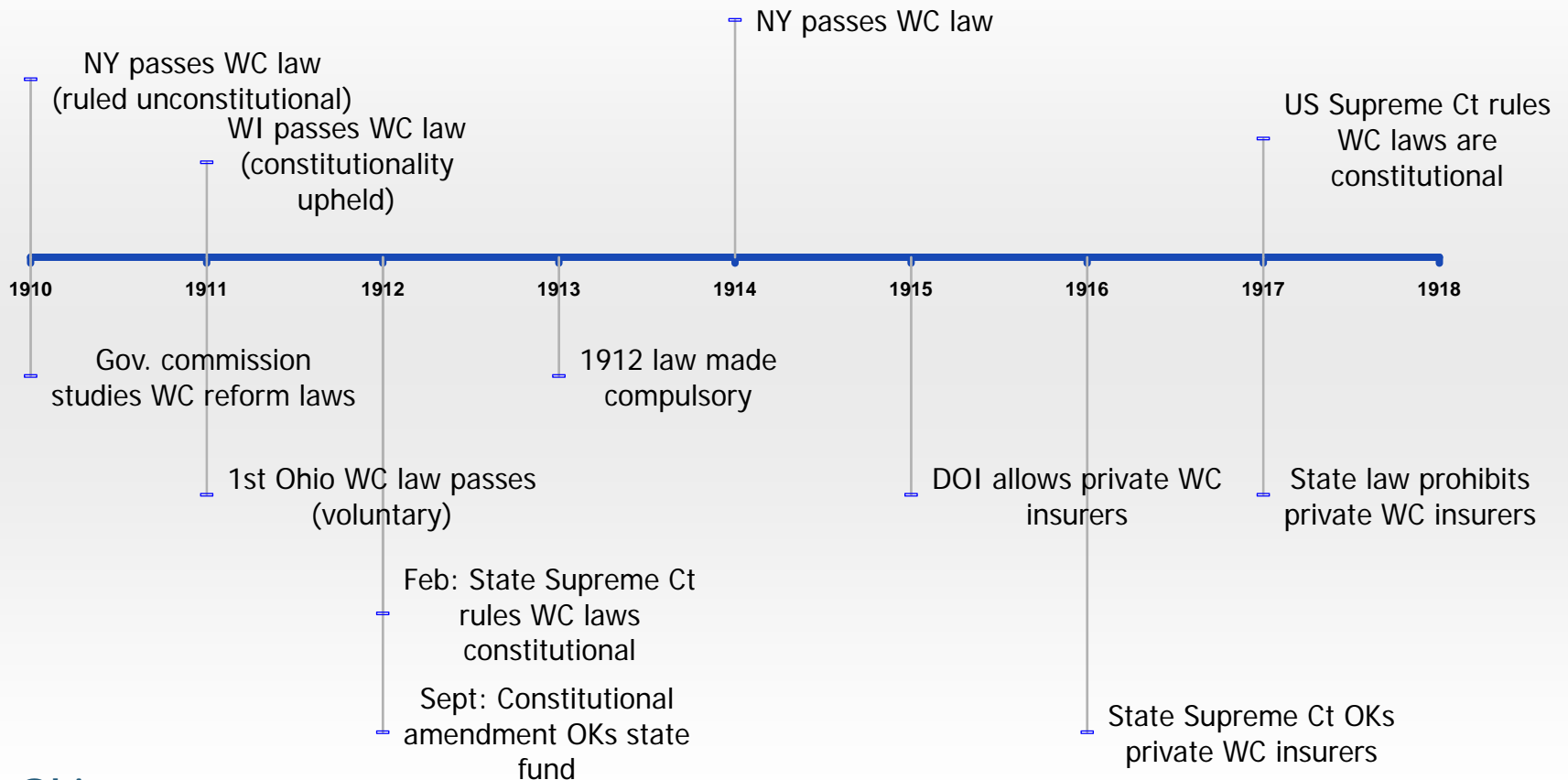
- **In 1910, Ohio General Assembly Authorizes Governor to Appoint a Commission to Explore a Workers Comp Law for the State**
- **Commission Issues Report in January 1911 Proposing a WC Law**
- **General Assembly in May 1911 Passed the *Workers Compensation Act***
 - ◆ Ohio's early response to one of the early 20th century's most important social and economic concerns was very progressive but also explains much about how Ohio's workers compensation market is structured today
 - ◆ Law was voluntary since mandatory nature of laws in other states (NY, MD, MA, MT) resulted in courts deeming the laws to be unconstitutional as an unjustified taking of an employers' property rights without due process
 - ◆ The WCA of 1911 also established a state fund (not necessarily a monopolistic fund)
- **Ohio's Law Survived Court Challenges Due to Its Voluntary Nature**
 - ◆ Problem: Since law was voluntary, employers generally didn't buy it; Stayed with tort law where they generally won suits lodged by employees
- **Advocates of WC Law Seized the Opportunity to Push their Cause at Ohio's Constitutional Convention in 1912**
 - ◆ Amendment to OH constitution regarding WC law offered and passed easily
 - ◆ WC *mandatory* law enshrined in state constitution in 1913

Ohio: A Workers Comp Trailblazer (cont'd)

- **By 1913, Ohio Had a WC Law and a State Fund**
 - ◆ Fund was operating as a de facto monopoly (though self insurance was allowed)
- **In 1915, Ohio Insurance Commissioner Frank Taggart Ruled that Private Insurers Could Compete with the State for Business**
 - ◆ Private insurers quickly enter the market
- **At the Time of Ohio's Original WC Law in 1911, How Workers Comp Markets Should Be Structured Was an Unsettled Question**
 - ◆ By 1911, 10 states including OH had WC laws; 6 states had private systems; 2 had competitive funds and 2 had monopolistic funds; By 1913, 3 other monopolistic systems had been created
- **Taggart Ruling Challenged but Upheld by State Supreme Court in 1916**
- **In 1917, Assembly Passes Legislation Banning Private Insurers from State**
 - ◆ Success of legislation in attributed to the influence of powerful unions
 - ◆ Also in 1917, US Supreme Court rules state WC laws are constitutional
- **State Cancels All Outstanding Private Policies**
- **Despite Several Efforts to Introduce Competition, System Remains Monopolistic to this Day**

Key Workers Compensation Developments in the 1910s

Nationwide



Ohio

Monopolistic State Funds: Where Are they Today?

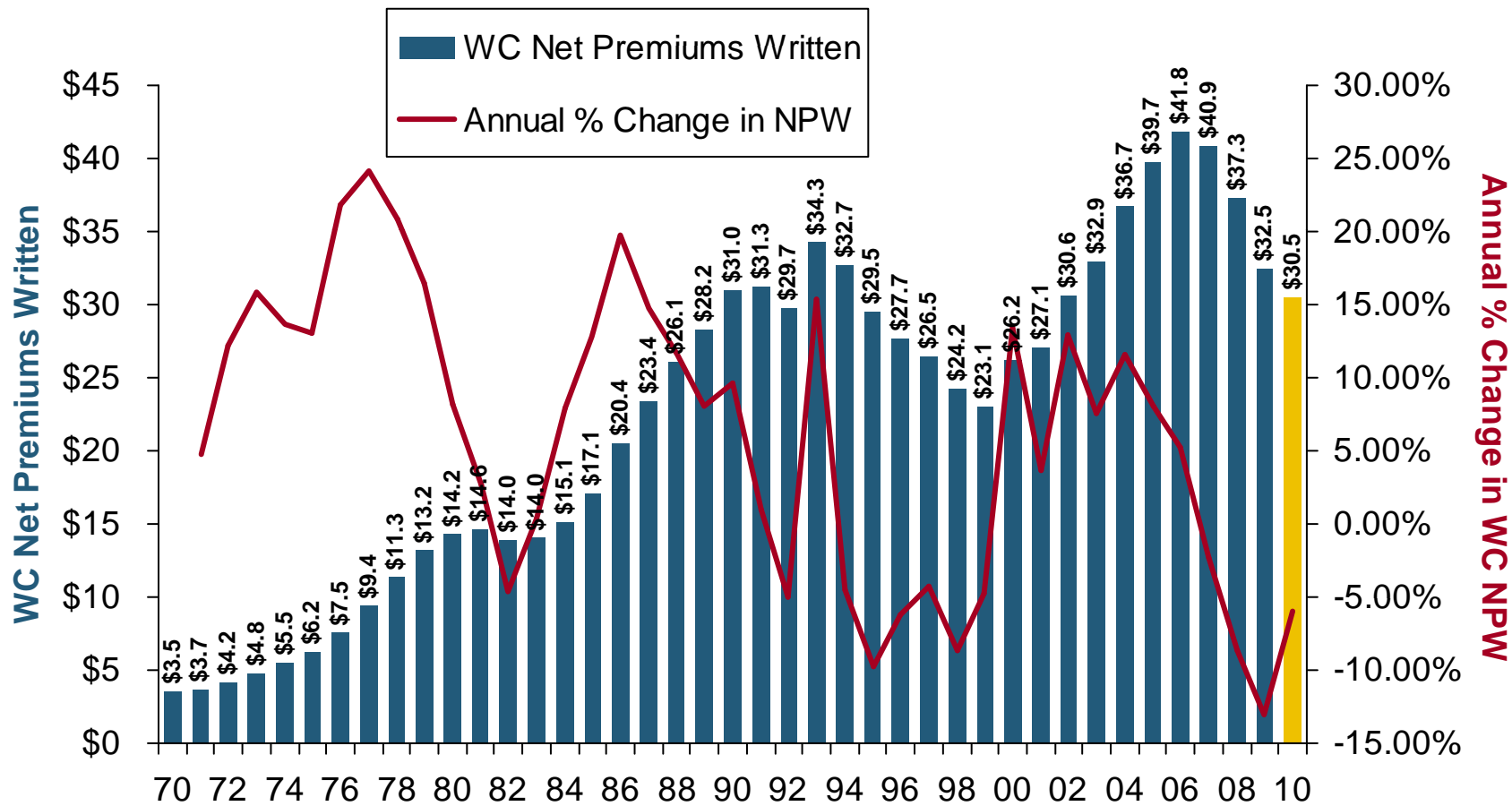
State	Date started	Status
Ohio	1911	Still monopolistic
Washington	1911	Monopolistic; referendum sought in 2010
Nevada	1913	State fund privatized in 1999
Oregon	1913	Allowed competition in 1980
West Virginia	1913	Allowed competition in 2008
Wyoming	1915	Still monopolistic
North Dakota	1919	Still monopolistic

Workers Compensation Operating Environment

**Despite Significant Volatility in the US
Economy and Labor Force, Workers
Compensation Remains a Vigorously
Competitive Line**

Workers Compensation Net Premiums Written & Annual Growth Rates: 1970-2010P

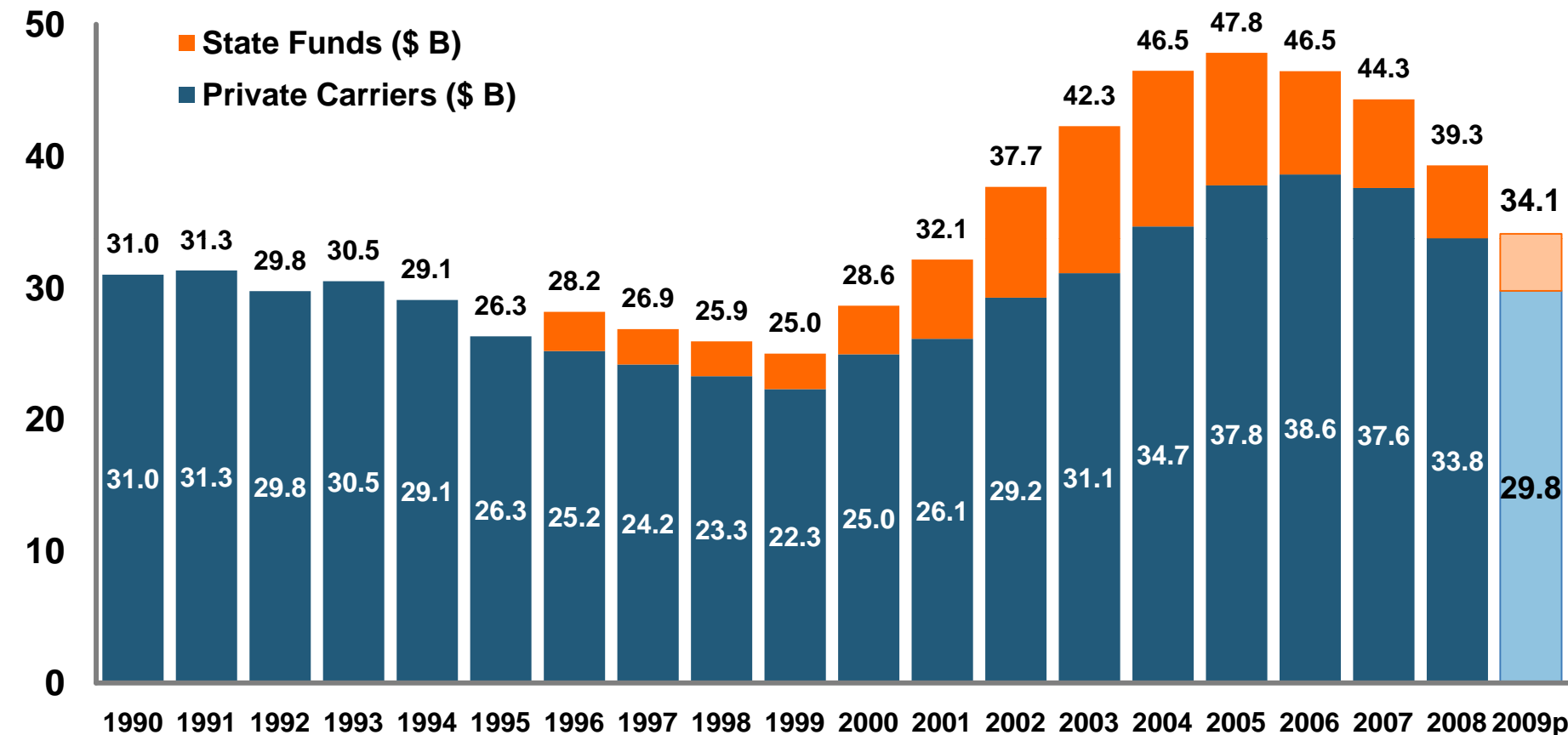
(\$ Billions)



Workers Compensation Premium Continues Its Sharp Decline

Net Written Premium

\$ Billions



p Preliminary

Source: 1990–2008 Private Carriers, *Best's Aggregates & Averages*; 2009p, NCCI

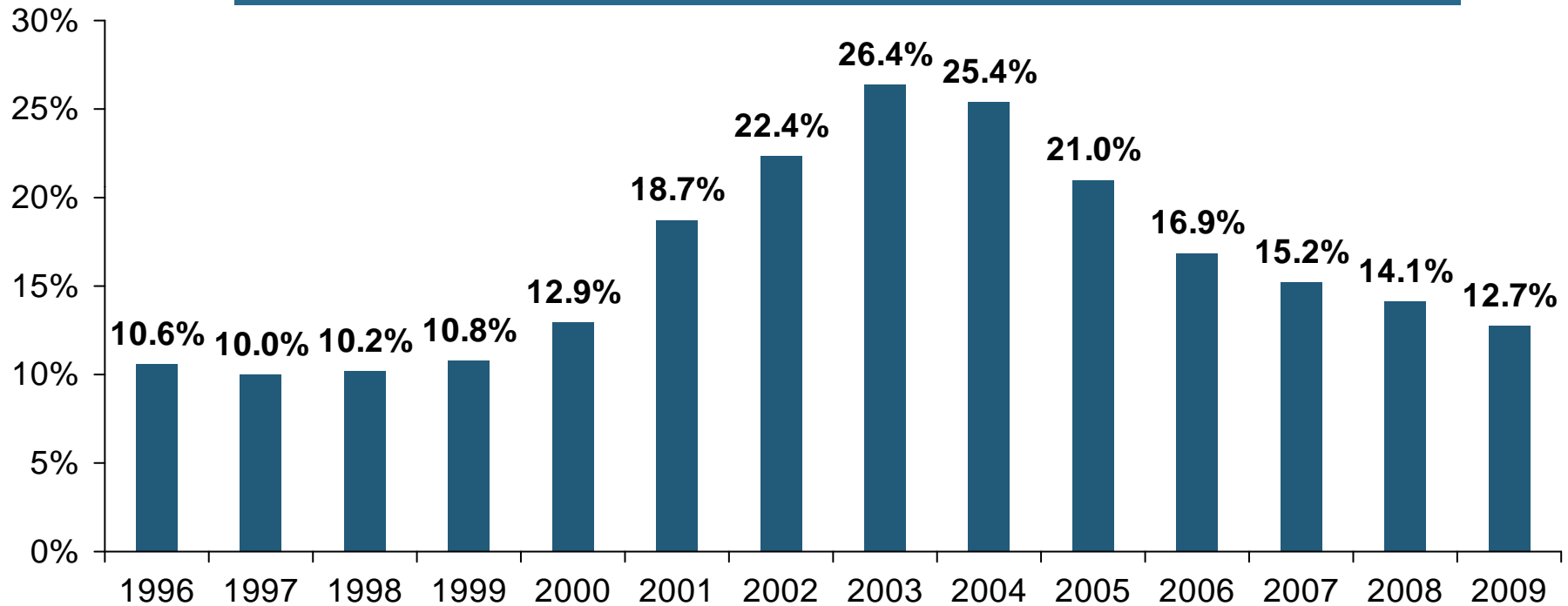
1996–2009p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT Annual Statements

State Funds available for 1996 and subsequent

WC State Fund Market Share, 1996 – 2009p

Market
Share (%)

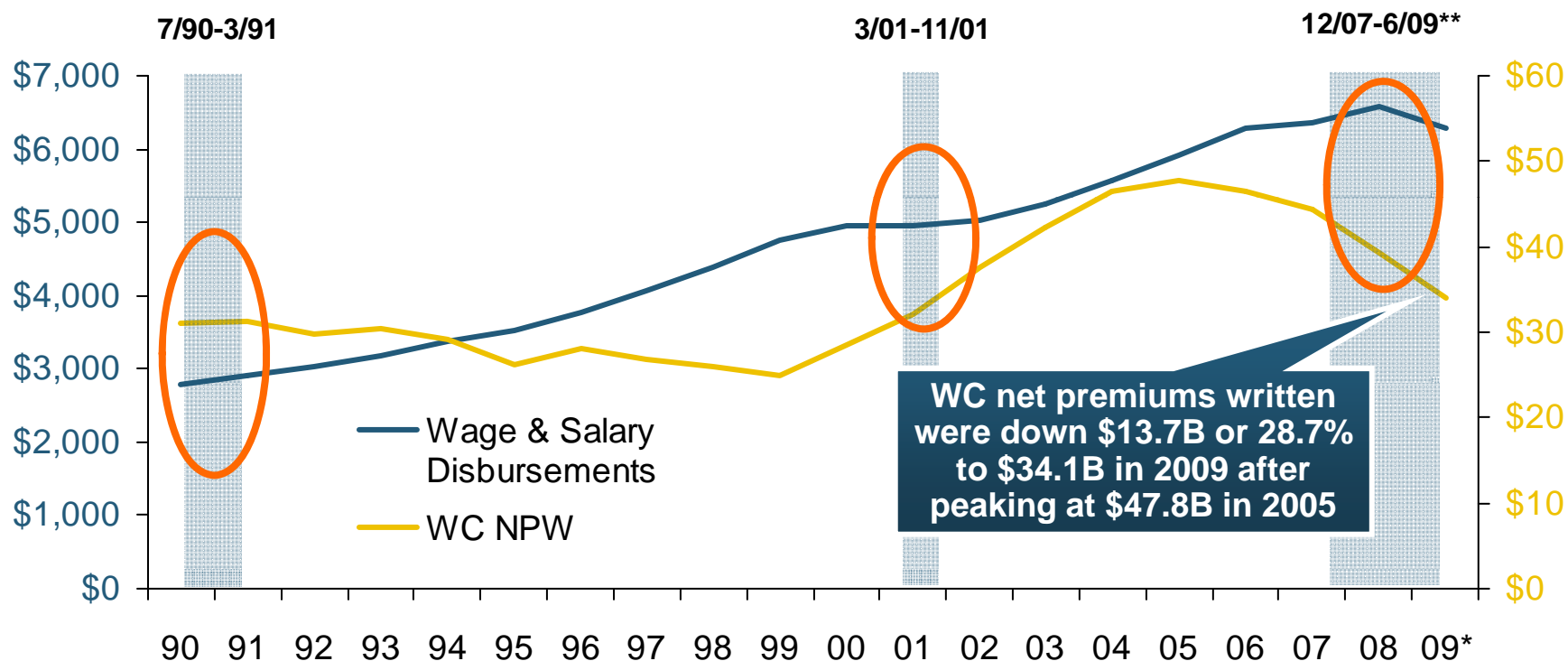
Private insurance markets are highly competitive. State fund market shares have been falling steadily since 2003.



Competition, favorable underwriting trends, coverage options, private insurer innovations in risk management have all helped to make the private sector WC insurance the most attractive option in most cases

Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums

Wage & Salary Disbursement (Private Employment) vs. WC NWP (\$ Billions)



Weakening Payrolls Have Eroded \$2B+ in Workers Comp Premiums; Nearly 29% of NPW Has Been Eroded Away by the Soft Market and Weak Economy

* Average Wage and Salary data as of 10/1/2009. Shaded areas indicate recessions.

**Estimated "official" end of recession June 2009.

Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at <http://research.stlouisfed.org/fred2/series/WASCUR> ; I.I.I. Fact Books

Contributions to WC Net Written Premium Decline

Calendar Years 2007–2009

2-Year Change in Countrywide NWP

-23%

Known Pricing Impacts

Change in Bureau Rates and Loss Costs **-7%**

Change in Carrier Pricing **-4%**

Economic Impacts

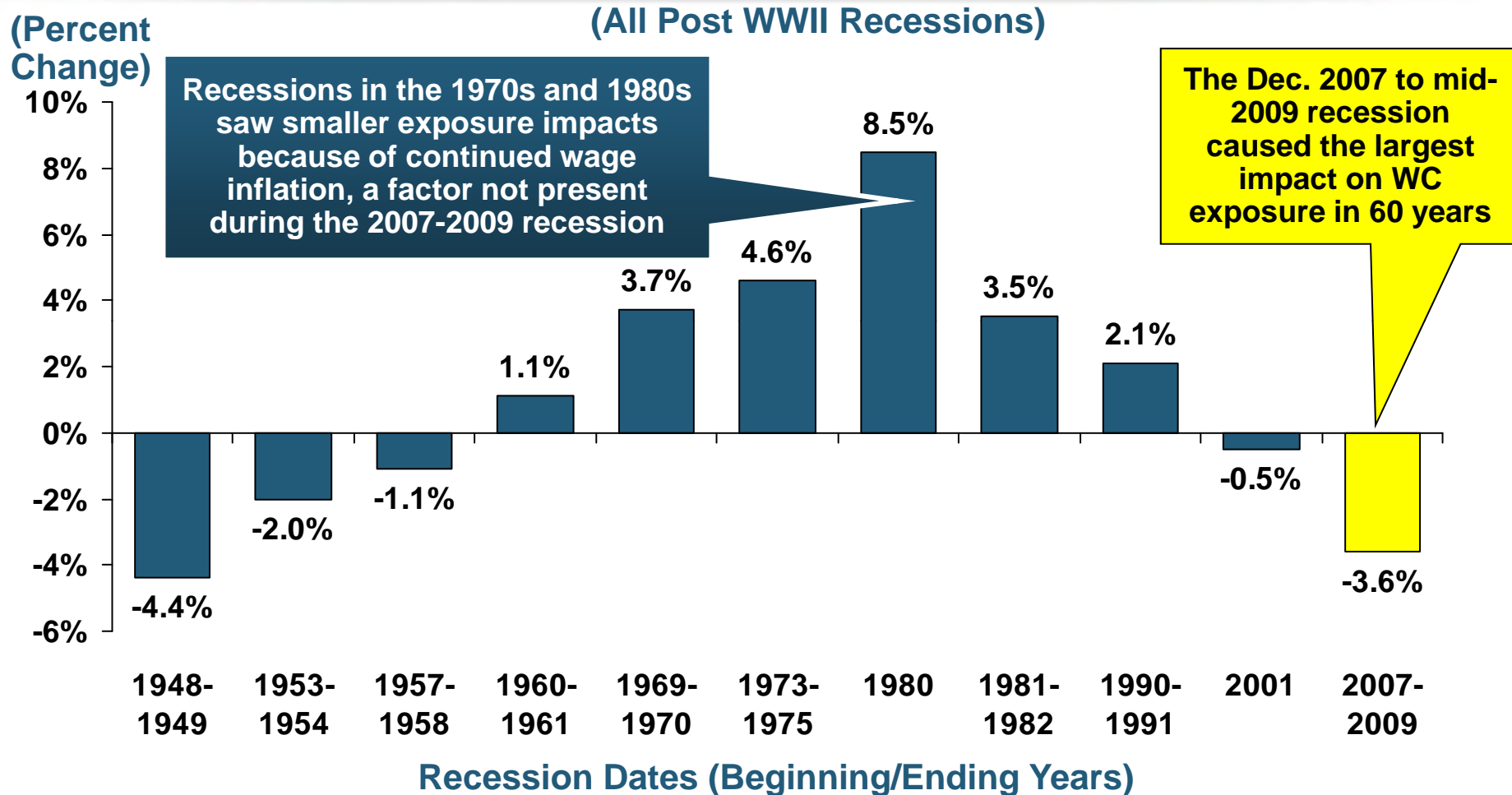
Change in Total Payroll **-4%**

Impact of Recession on Industry Group Mix **-4% to -6%**

Impact of Recession by Firm Size **-4% to -6%**

Other Impacts **+1% to -2%**

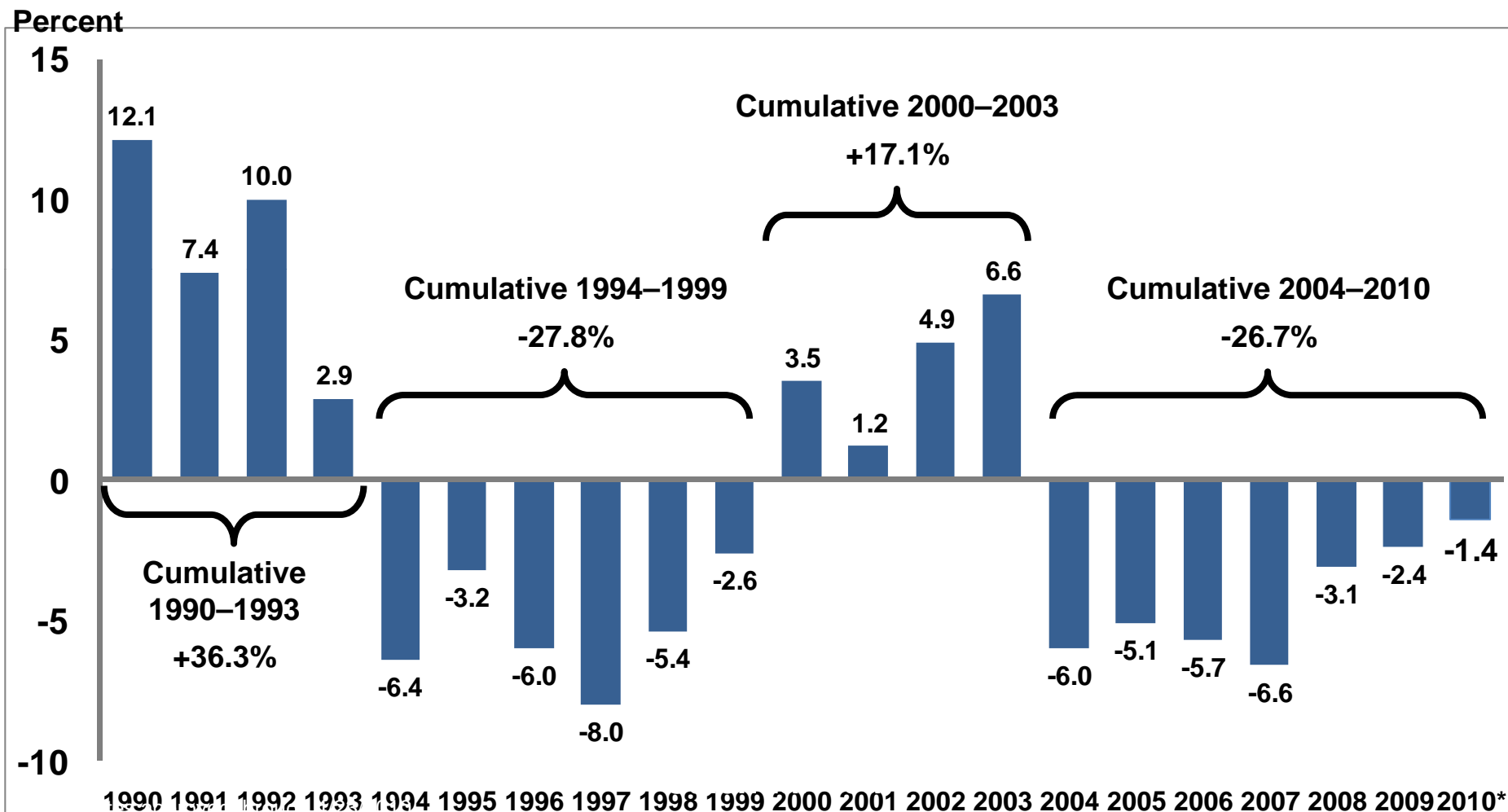
Estimated Effect of Recessions* on Payroll (Workers Comp Exposure)



*Data represent maximum recorded decline over 12-month period using annualized quarterly wage and salary accrual data
Source: Insurance Information Institute research; Federal Reserve Bank of St. Louis (wage and salary data); National Bureau of Economic Research (recession dates).

Average Approved Bureau Rates/Loss Costs

History of Average WC Bureau Rate/Loss Cost Level Changes



*States approved through 4/23/10.

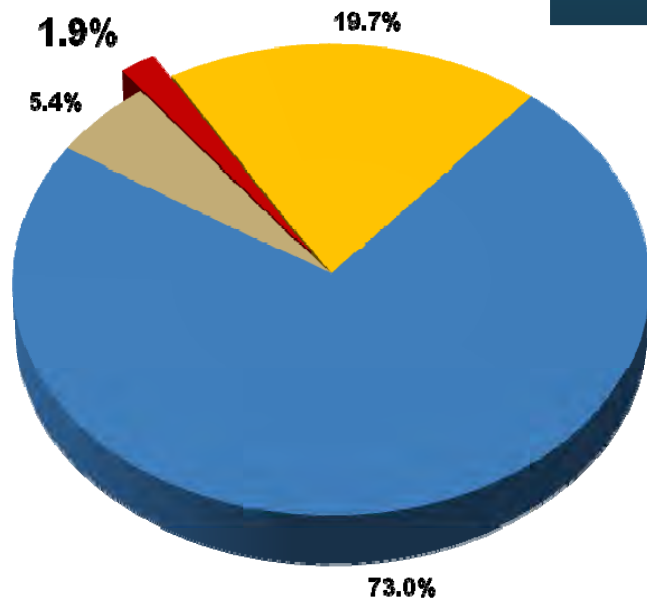
Note: Countrywide approved changes in advisory rates, loss costs and assigned risk rates as filed by applicable rating organization.

Source: NCCI.

Workers Comp Employer Costs as Percentage of Total Compensation

Private Industry

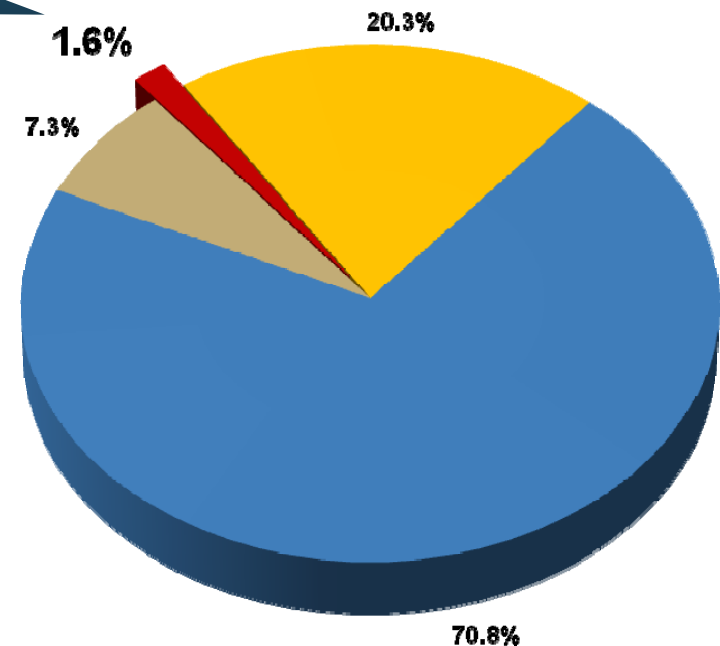
1999



Workers comp costs as a share of total compensation fell over the past decade

2009

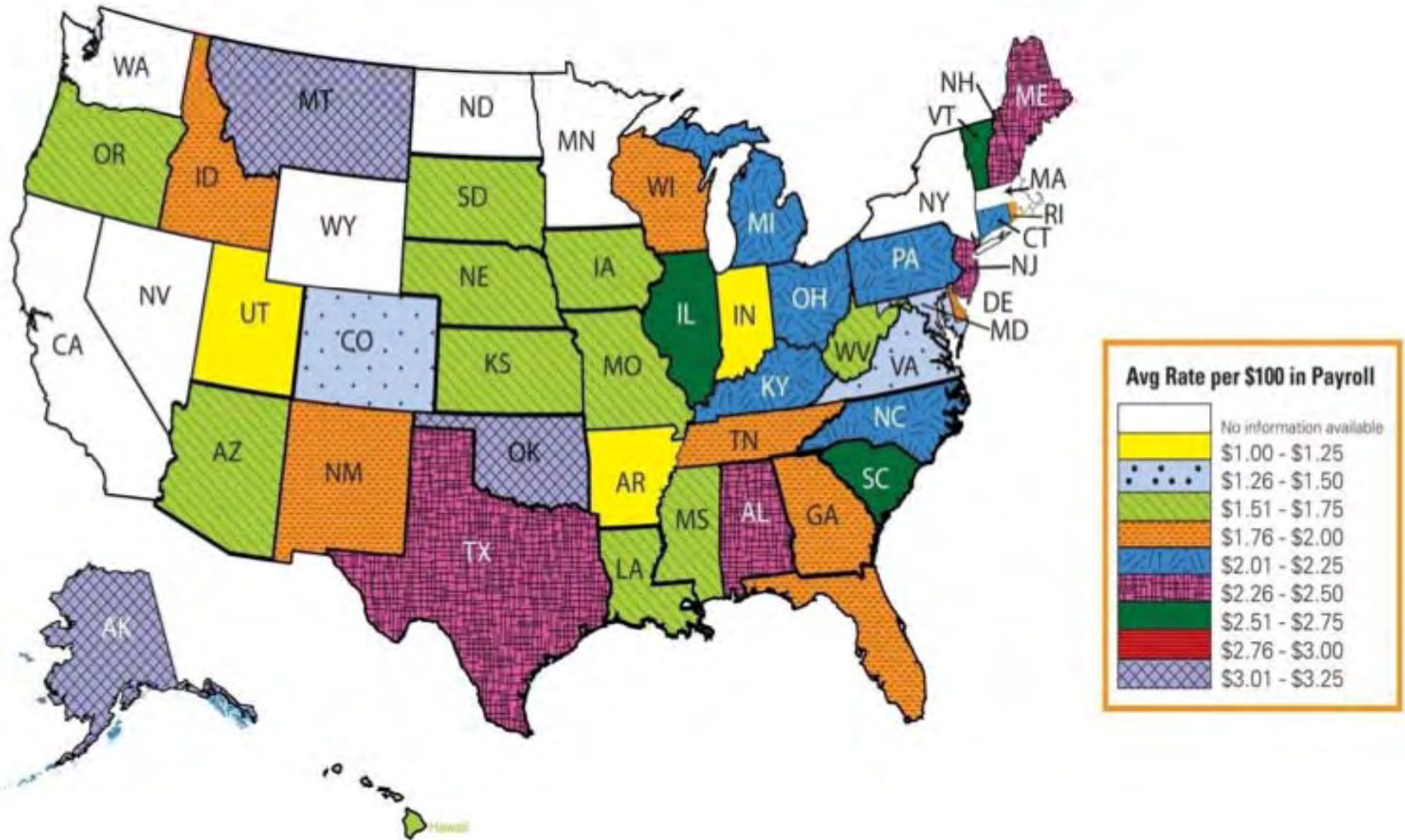
- Wages and Salaries
- Health Insurance
- Workers Compensation
- All Other



All Other category includes Paid Leave, Supplemental Pay, Insurance (other than Health), Social Security, Retirement and Savings

Source: US Department of Labor, Bureau of Labor Statistics.

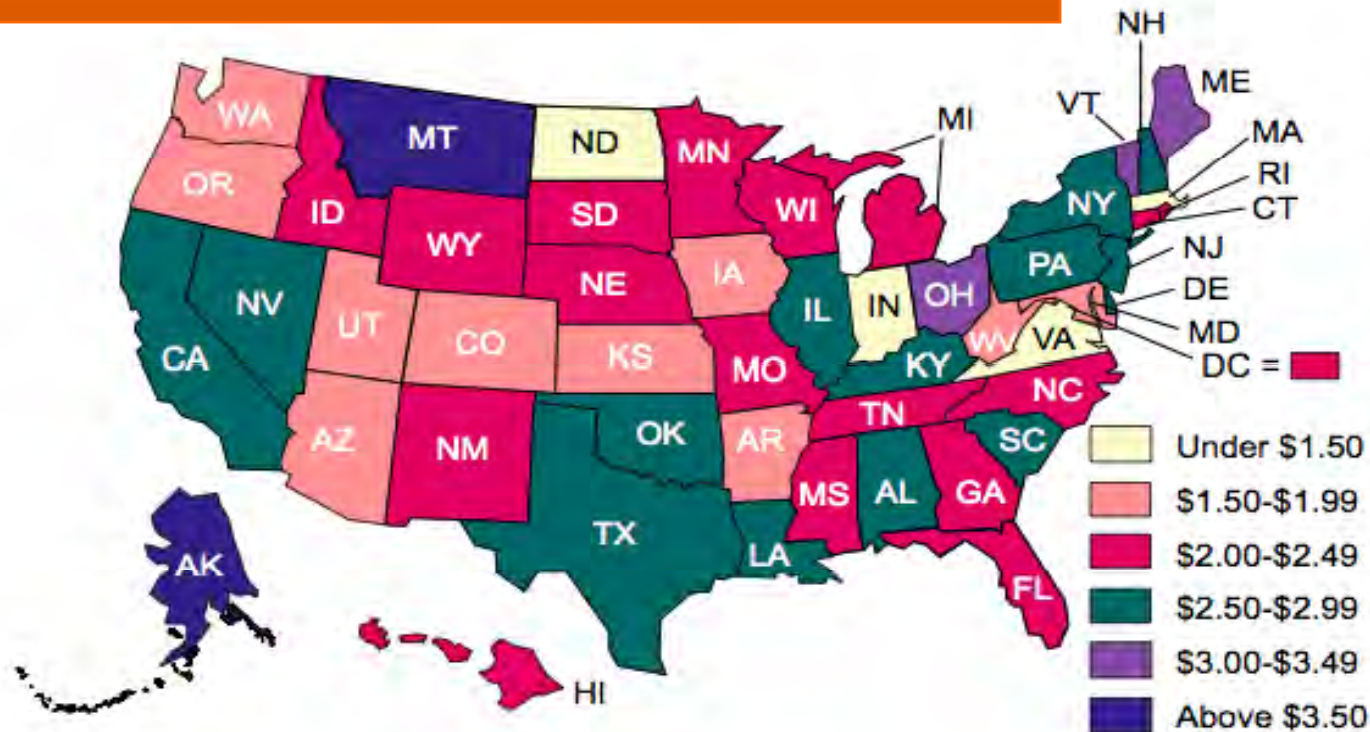
Comparison of State WC rates



Source: The Ohio Model: Presentation to the Competitive Workers Compensation Task Force, April 15, 2010. Rates weighted by Ohio's distribution of exposures by classification

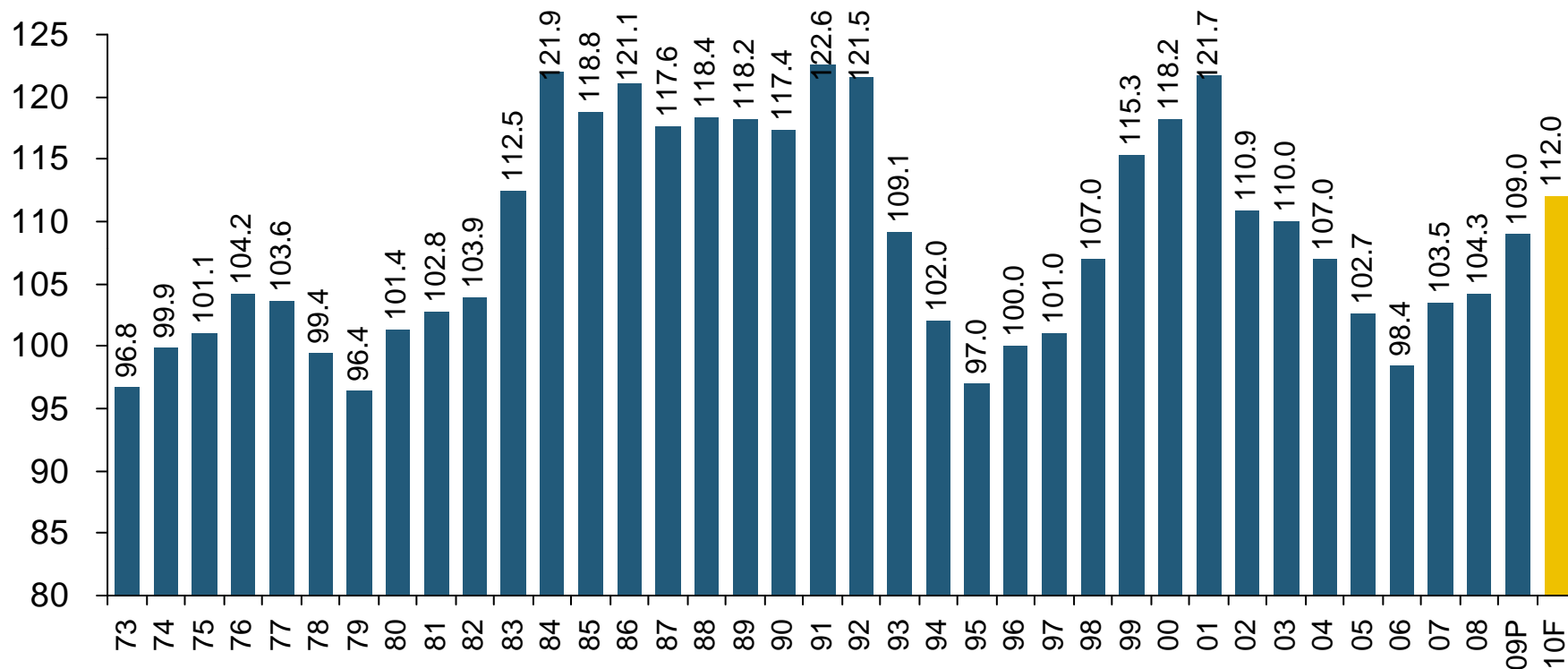
Comparison of State WC rates

Ohio's 2008 rate, \$3.32 per \$100 payroll was third highest in the country, behind Alaska and Montana. It is markedly higher than surrounding Midwestern states.



Indiana's rate, by contrast, is 49th. Only North Dakota is lower.

Workers Compensation Combined Ratio: 1973–2010F



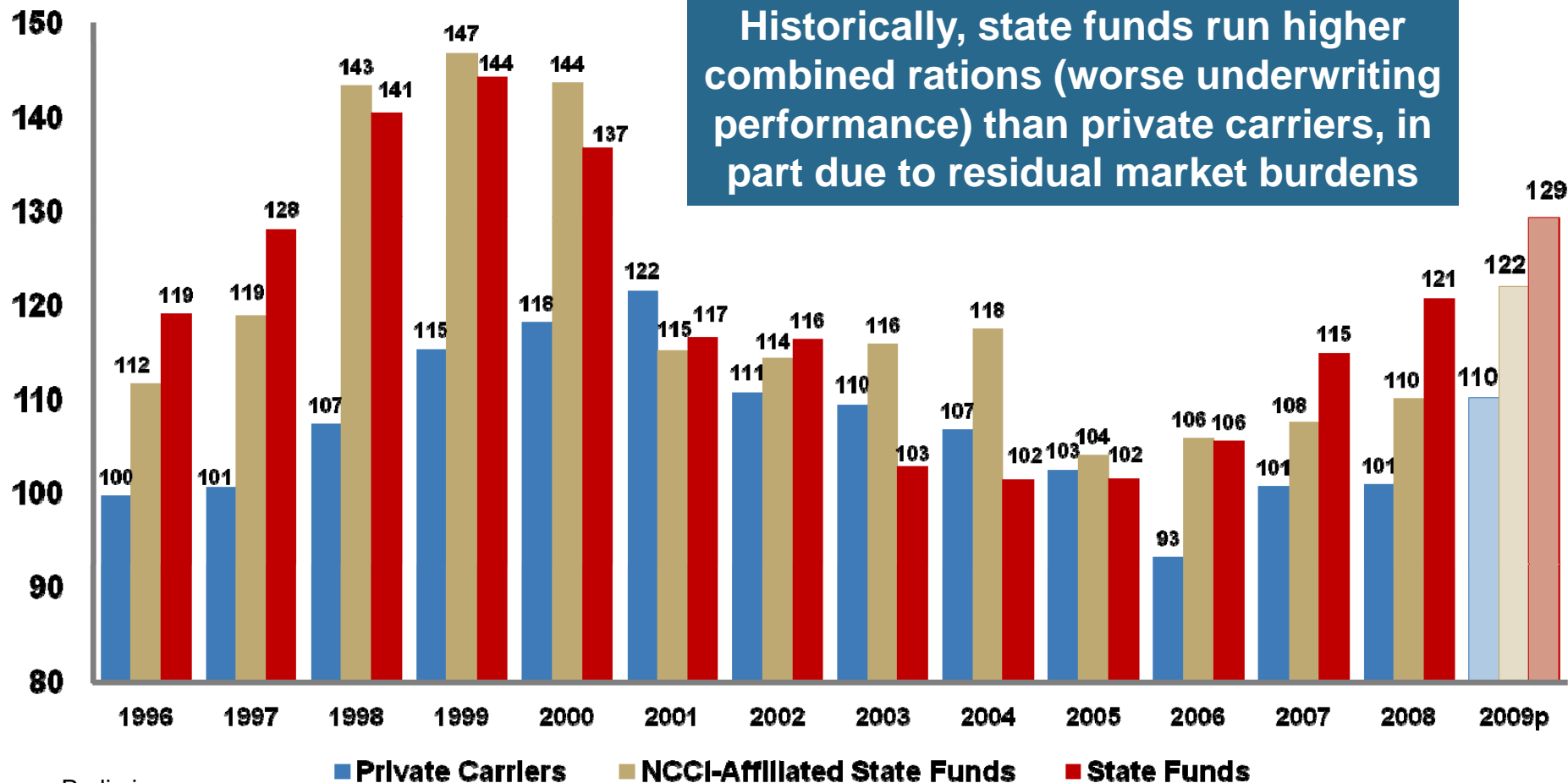
Workers Comp Results Are Cyclical

Workers Compensation Calendar Year Net Combined Ratios

Percent

Private Carriers and State Funds

Historically, state funds run higher combined ratios (worse underwriting performance) than private carriers, in part due to residual market burdens



p Preliminary

Source: 1996–2008 Private Carriers, *Best's Aggregates & Averages*; 2009p, NCCI

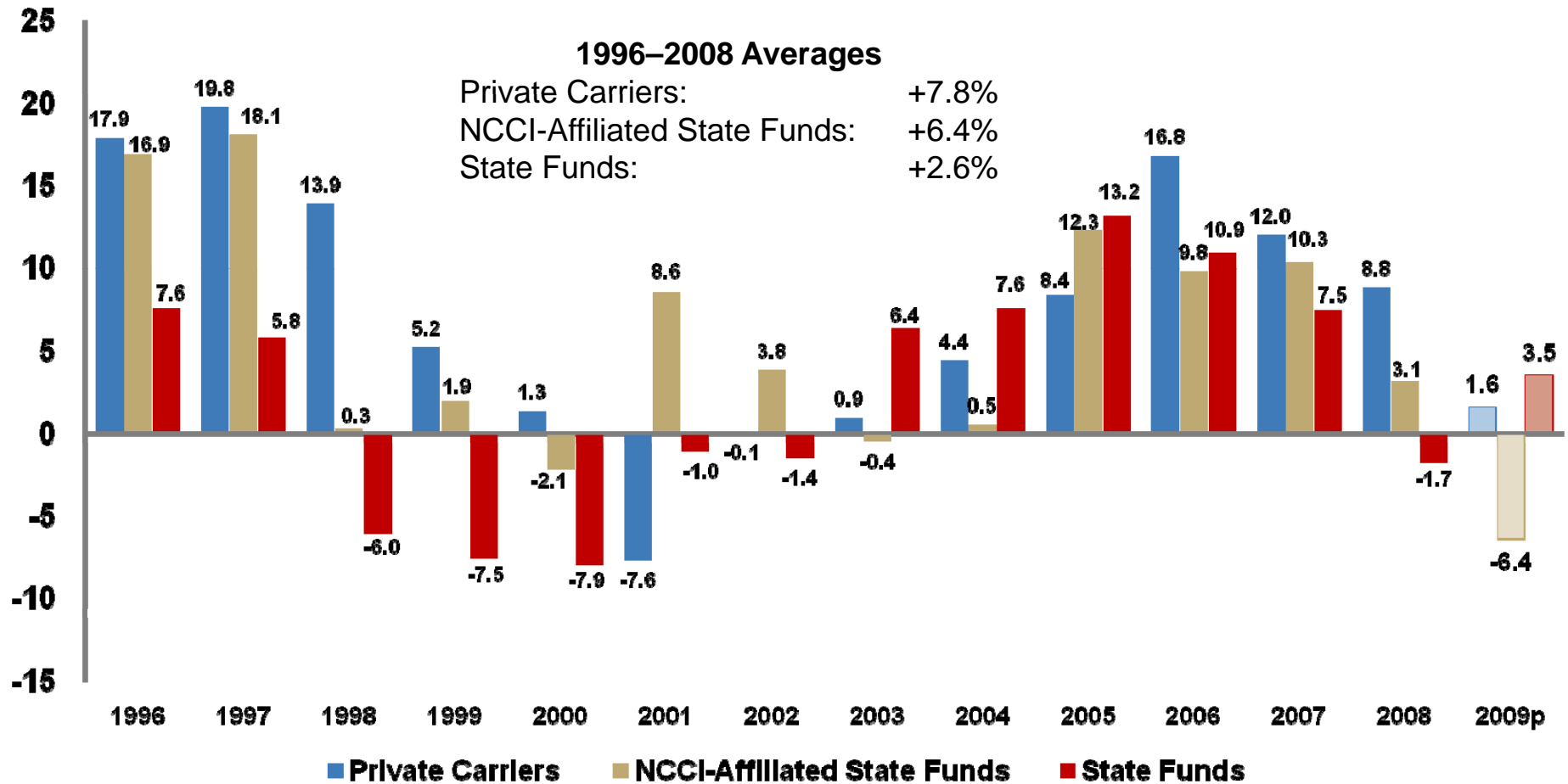
1996–2009p NCCI-Affiliated State Funds: AZ, CO, HI, ID, KY, LA, MO, MT, NM, OK, OR, RI, UT Annual Statements

1996–2009p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT Annual Statements

Workers Compensation Pre-Tax Operating Gain Ratios

Percent

Private Carriers and State Funds



p Preliminary

Operating Gain Equals 1.00 minus (Combined Ratio Less Investment Gain on Insurance Transactions and Other Income)

Source: 1996–2008 Private Carriers, *Best's Aggregates & Averages*; 2009p, NCCI

1996–2009p NCCI-Affiliated State Funds: AZ, CO, HI, ID, KY, LA, MO, MT, NM, OK, OR, RI, UT Annual Statements

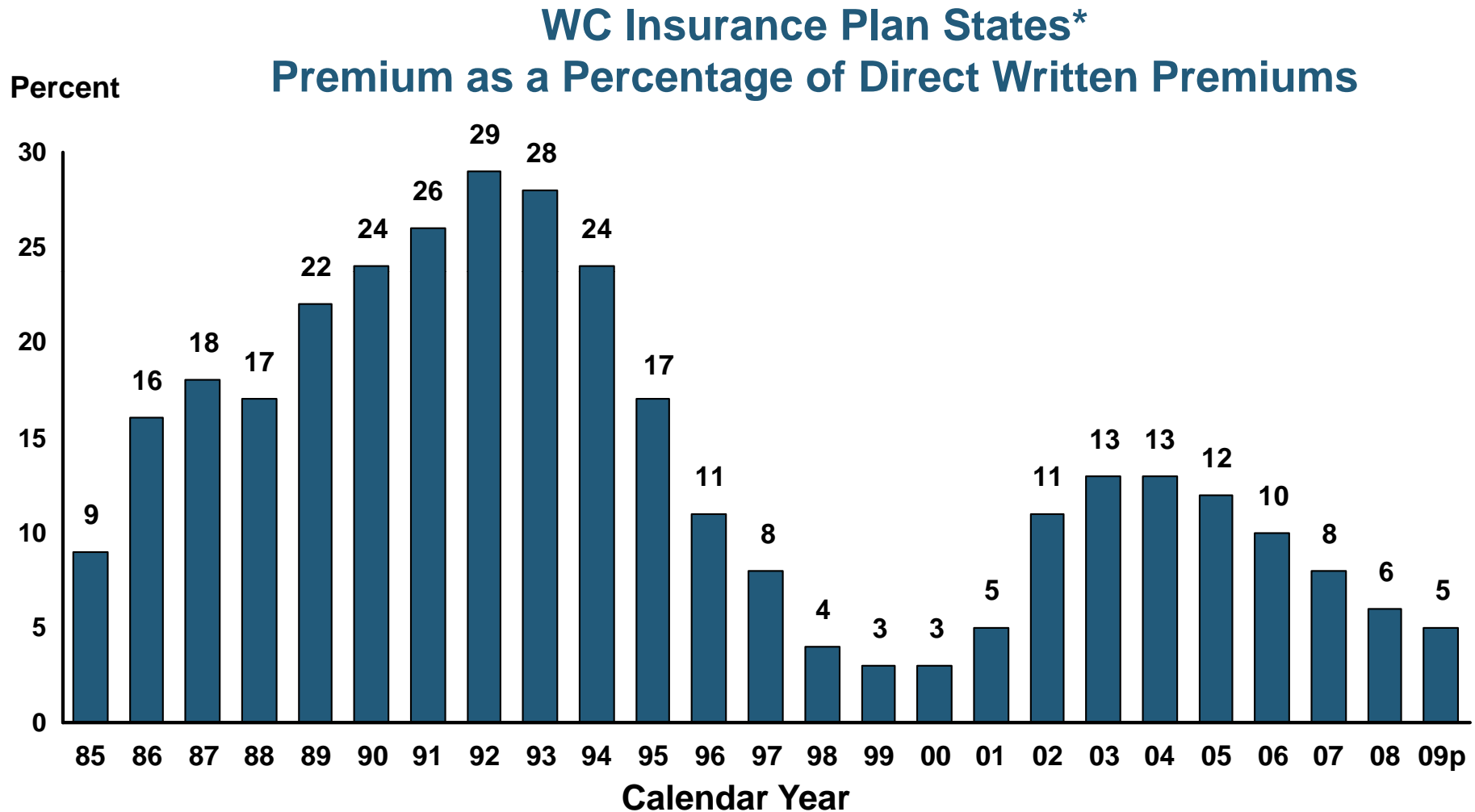
1996–2009p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT Annual Statements



Workers Compensation Residual Market Overview

Residual Markets Have Been Shrinking

WC Residual Market Shares Continue to Decline



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

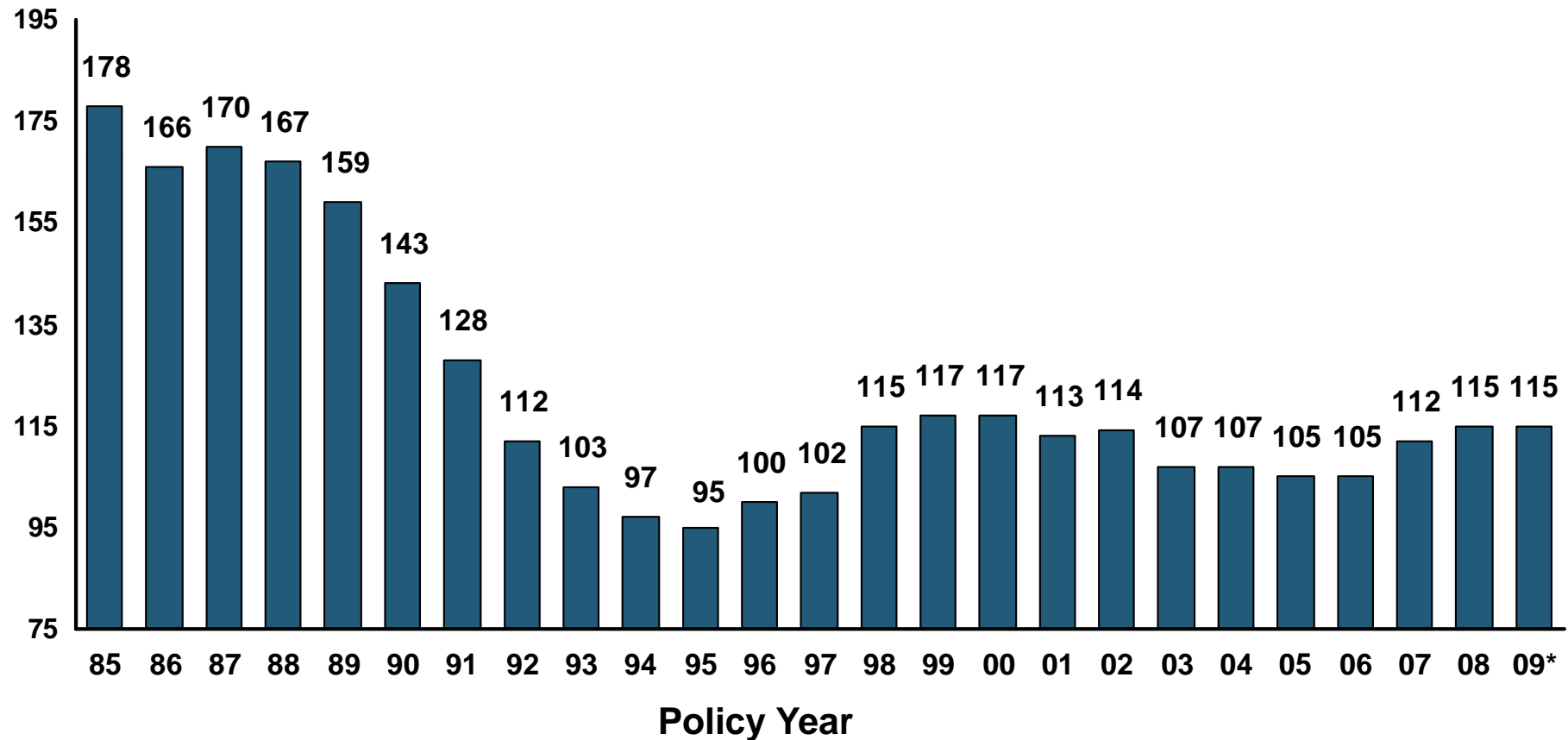
p: Preliminary

Source: NCCI.

WC Residual Market Shares Continue to Decline

NCCI-Serviced WC Residual Market Plans as of December 31, 2009

Percent



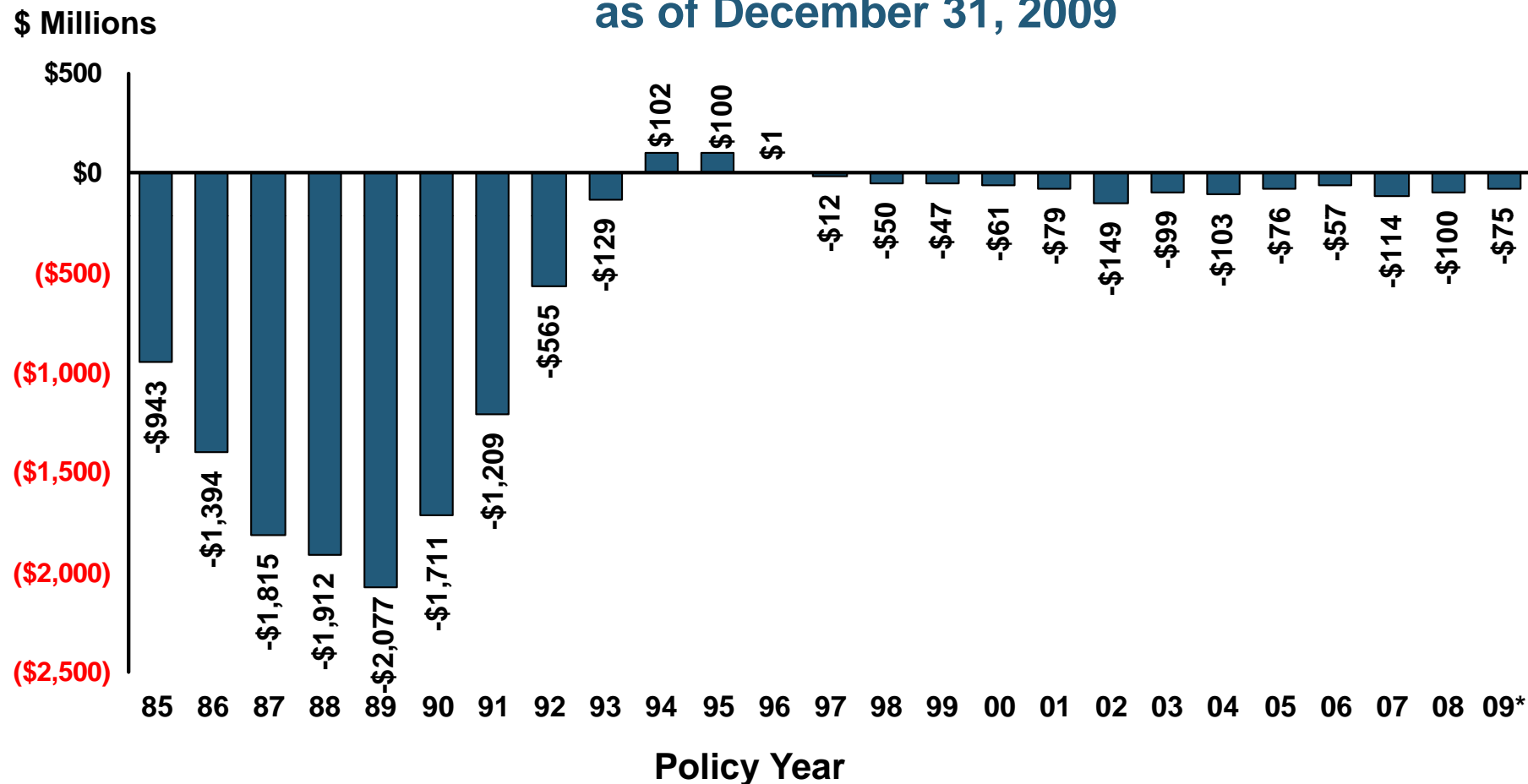
*NCCI Plan states plus DE, IN, MA MI, NJ, NC

p: Preliminary

Source: NCCI.

Workers Compensation Residual Market Underwriting Results

NCCI-Serviced WC Residual Market Plans as of December 31, 2009



*Incomplete policy year projected to ultimate.

Source: NCCI.



The Importance of Free, Open and Fair Competition

**Any Changes to Ohio's System Should
Fair Competition, Level Playing Field**

Considerations for a Competitive Workers Compensation Environment in Ohio

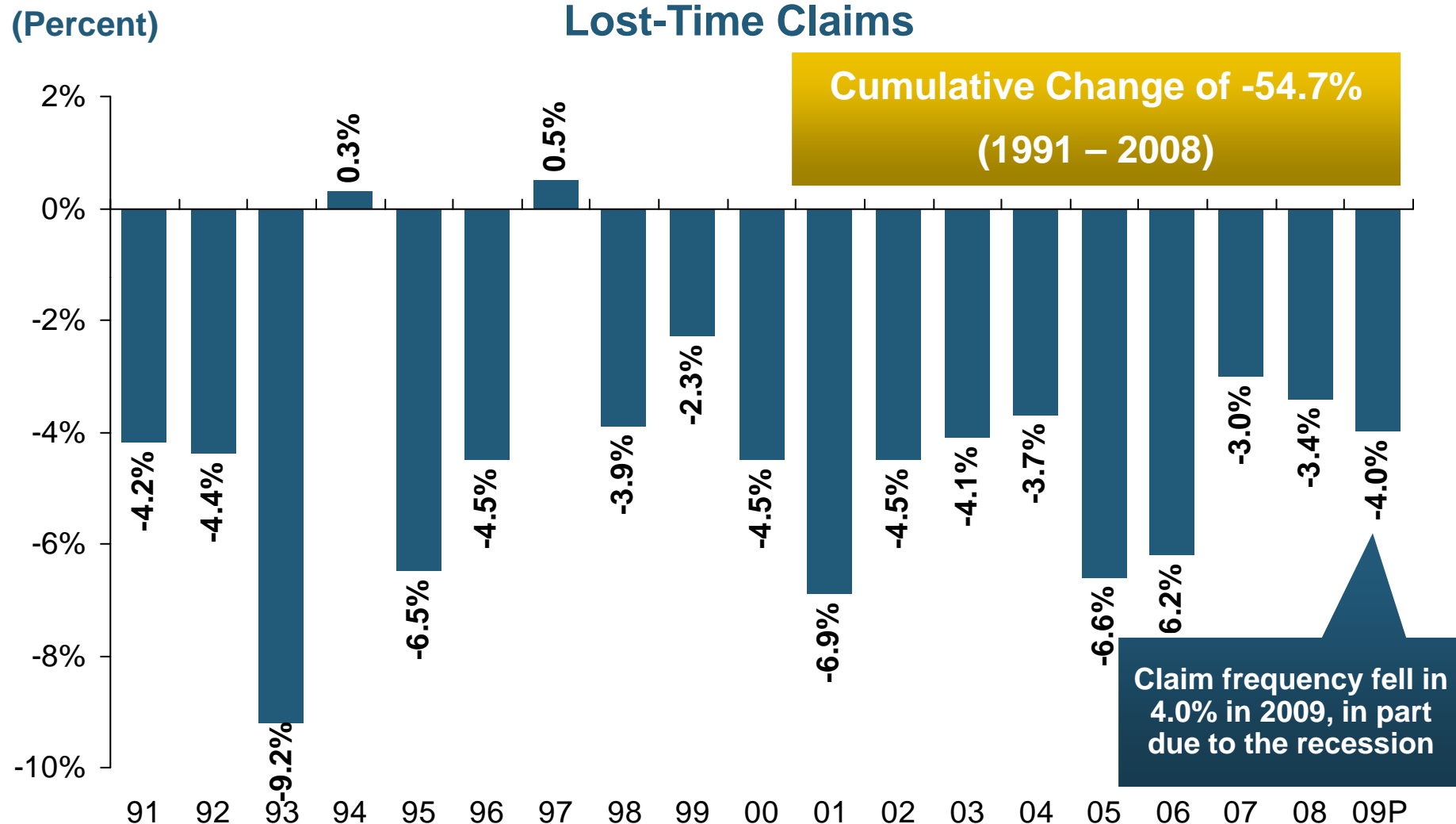
- **Any Competitive Structure Under Consideration (Now or in the Future) Should Be Designed to Maximize Free, Open and Fair Competition**
- **Advantages of Competition**
 - ◆ Maximizes policyholder choice/options
 - ◆ Enhances product quality
 - ◆ Enhanced array of risk management tools, analytics, solutions
 - ◆ Increased (insurer) diversification across states and other p/c lines
- **All Insurers, Large and Small, Must Operate on a Level Playing Field**
- **Most of the Insurers that Would Enter the Market Would be Small, But Collectively Would Account for 40% – 60%→Very Critical to Success**
 - ◆ Opening of the market should not disadvantage them due to size, distribution network
 - ◆ Large carriers, by virtue of their multistate market presence or market share in other commercial lines in Ohio should not be allowed any particular advantage



Workplace Safety is the Paramount Concern

**Workplace Safety Continues to
Improve, in No Small Part Due to the
Efforts of Workers Comp Insurers**

Workers Compensation Lost-Time Claim Frequency Continues to Decline*



2009p: Preliminary based on data valued as of 12/31/2009;

1991-2008: Based on data through 12/31/2008, developed to ultimate

Based on the states where NCCI provides ratemaking services including state funds; Excludes the effects of deductible policies

*Frequency is defined as the number of lost-time claims per 100,000 workers.

Frequency: 1926–2009

A Long-Term Drift Downward

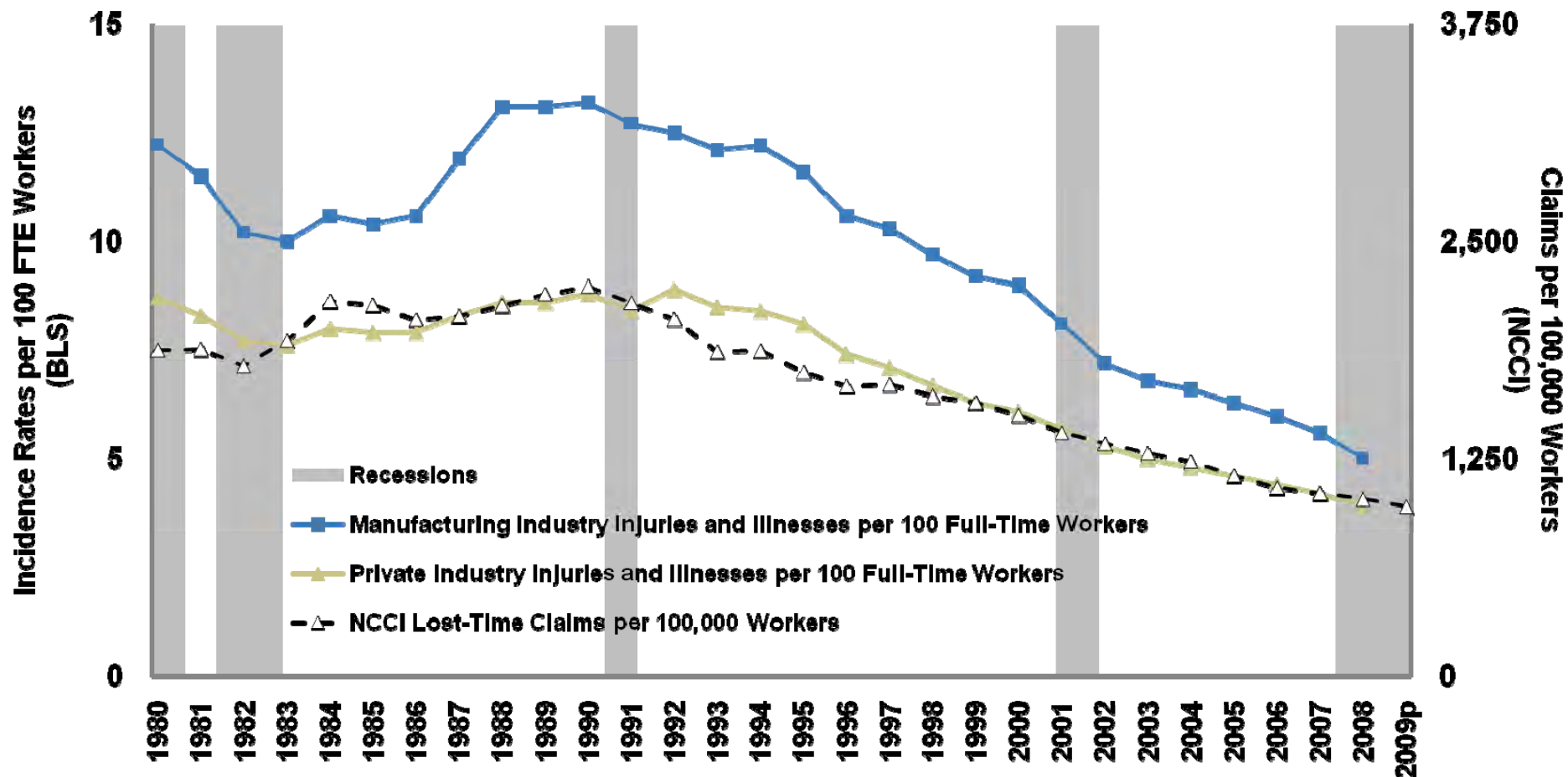
Manufacturing – Total Recordable Cases
Rate of Injury and Illness Cases per 100 Full-Time Workers



Note: Recessions indicated by gray bars.

Sources: NCCI from US Bureau of Labor Statistics; National Bureau of Economic Research.

Workplace Injury Incidence Rates Declined in Last Four Economic Downturns



Note: Recessions indicated by gray bars.

Sources: NCCI, US Bureau of Labor Statistics;

Insurance Information Institute Online:

www.iii.org

***Thank you for your time
and your attention!***

Twitter: twitter.com/bob_hartwig