Competitive Workers' Compensation Task Force Meeting

Ohio Bureau of Workers Compensation

Presentation of

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Good Morning and thank you, Senator Grendell, Director Hudson and members of the Competitive Workers' Compensation Task Force for the opportunity to appear before you today.

My name is Robert Hartwig and I am President and Economist for the Insurance Information Institute, a property/casualty insurance trade association based in New York City whose members account for nearly 70 percent of all property/casualty insurance premiums written in the United States.[1] Its primary mission is to improve understanding of the insurance industry and the key role it plays in the global economy. I am also a Chartered Property Casualty Underwriter (CPCU) and have worked on a wide variety of insurance issues during my 17 years in the property/casualty insurance and reinsurance industries. With respect to workers compensation insurance specifically, my experience includes service as Senior Economist and subsequently Director of Economic Research for the National Council on Compensation Insurance (NCCI), where I conducted research on a wide variety of workers compensation issues and testified on rate of return and cost of capital matters in many states. In the years since my time at NCCI, I have given many presentations and written many articles in the area of workers compensation.

I have been asked by the Task Force to present on the issue of monopoly in insurance markets, specifically in the area workers compensation as it pertains to the current situation in Ohio. In order properly address this issue my presentation today will focus on the following key issues:

(i) The traditional economic rationale and criteria for monopoly and whether those rationale/criteria apply in the case of the Ohio workers compensation market;
(ii) The origin, history and evolution of the monopolistic state fund structure in the United States and in Ohio specifically;
(iii) The potential benefits and concerns associated with alternative competitive market structures in the Ohio workers compensation market, including the examination of experience in other states, and

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(iv) The importance of establishing a level playing field for any and all participants in the event private insurers are given the opportunity to compete in the state.

What is a Monopoly and Why Do They Exist?

A "monopoly" is a market in which there is only one seller, and the seller can determine the price of the product or service. Monopolies arise and persist because other potential sellers cannot enter the market to challenge the monopoly. They cannot enter because they cannot overcome certain cost or legal barriers to entry. Barriers to market entry take one of four main forms:

1. One firm owns all of a key resource (such as a key mineral or energy source, but could also occur in situations involving complete ownership of intellectual of financial capital).

2. A firm owns an exclusive patent or process to produce a good or service (such as with a drug or certain manufacturing processes).

3. The cost of production makes a single producer more efficient than a large number of producers (as might be the case when very high fixed costs are required to produce a product or service, such as electricity). This situation is commonly referred to as a *natural monopoly*.

4. A government:
   a. gives one firm the exclusive right to produce and sell a specific good/service (e.g., such as food vendor at a national or state park), or
   b. monopolistically provides the good/service itself as a government function (such as national defense at the federal level or workers compensation coverage in the state of Ohio or trash collection at the local level).

The Standard Critique of Monopoly

A basic proposition in economics is that when compared to a competitive market, a private firm with monopoly control over a good or service results in too little of the item produced at too high a price.[2] Indeed, American history is littered with famous examples of monopolies (and near monopolies) in industries as diverse as oil (Standard Oil), steel (Carnegie Steel), railroads, telecommunications (AT&T) and even computer software (Microsoft). Some of the wealthiest people the world has ever known have been associated with the exercise of monopoly power: John D. Rockefeller, J.P. Morgan, Andrew Carnegie and Bill Gates, to name a few. Before 1890 and the enactment of the Sherman Antitrust Act, monopolies were not illegal in the United States.

Government Monopolies

Governments do not create or sanction monopolies for the purpose of wealth creation. Instead, governments create monopolies when they believe that doing so is in the public interest, such as when a government believes that a service wouldn't otherwise be available to all who need it or its cost might be beyond some buyers' ability to pay.[3] A government might create a monopoly for a service that consumers cannot avoid (e.g., a toll road) and, for a number of reasons, it might also require consumers to buy the service from the monopolist provider.

Any level of government can create a monopoly: federal, state and local. Sometimes, a government grants a private firm a monopoly for a particular good or service.[4] In other cases, the government operates the monopoly itself.

However, a monopoly can produce an inferior product or service. This is because the monopolist has no market-based incentive to provide a high-quality service or to

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[2] This assumes no government subsidy or price constraint that might lower the price to—or below—what it would be in a competitive market.

[3] Of course, government can subsidize individual buyers whose ability to pay is limited without distorting prices for the entire market.

[4] For example, when a pharmaceutical company discovers a new drug, it can apply to the government for a patent. If the patent is granted, the firm has the exclusive right to produce and sell the drug for a set number of years. The drug firm can charge higher prices for its patented product than it could without the patent protection and, in turn, earn higher profits than otherwise. With these higher profits, the firm can pay back the high cost of the research and development for the patented drug and can finance risky and costly research for new and better drugs.

improve; its "market share" and finances are guaranteed or supported (and in some cases subsidized) by the government, and it has no external benchmark for performance. In comparison, competition drives sellers to improve/innovate or lose market share. The quality-of-product argument is one of the most frequently leveled criticisms against government monopolies in areas as diverse as trash collection and education to motor vehicle registration and public safety.

Government Monopolies and Property-Casualty Insurance

Government monopolies in the property-casualty insurance sector are rare and account for only a very small fraction of premiums written in the United States on an annual basis. This suggests that the traditional economic justifications for the existence of government monopolies generally do not apply in the property-casualty insurance industry. There are a small number of exceptions, including the National Flood Insurance Program and the federal government's programs to back large scale losses from acts of terrorism or accidents at nuclear power plants. Many states operate various plans for owners of high risk properties (e.g., in coastal areas) but none of these can be considered true monopolies.

Another notable exception is workers compensation insurance, where four states currently operate monopolistic state funds: North Dakota, Washington, Wyoming and, of course, Ohio.

A logical question to ask is why these four states maintain anomalous monopolistic structures when 46 states allow private insurers to compete for business. Indeed, in 2009 there were 764 different insurance companies writing workers compensation in one or more of these 46 states, suggesting few economic barriers to entry to these markets. A review of the traditional economic criteria used to explain the existence of monopolies indicates that none apply in 2010, as displayed in Figure 1. No firm owns a critical resource necessary for the "production" of workers compensation insurance; no patents, exclusive processes or expertise are required and no large scale fixed costs make a single producer the only way to offer workers compensation insurance at a reasonable cost.

Given that none of the traditional economic criteria apply, the only possible reason why workers compensation markets in these four states maintain monopolistic structures is because state government has determined that it is an essential function of government—a function that cannot be provided at comparable cost or quality in the private sector.

Protecting injured workers from the financial costs associated with workplace injuries is essential, but whether in 2010 it is an essential function of government seems doubtful, given that hundreds of insurers sell workers compensation coverage to millions of businesses in 46 of the 50 states. But what about in 1910—when workers compensation was new? As it turns out history—not economics—provides the best insight as to why Ohio continues to maintain its monopolistic workers compensation structure.

Economic Tests that Could Be Used to Rationalize the Existence of Monopoly in Workers Compensation	**Do the Criteria Apply?**	**Observations**
Does any insurer have exclusive ownership of a resource, expertise or capital necessary to write workers compensation coverage?	No	• 46 states allow private sector competition • 764 private insurers wrote workers comp insurance in these 46 states in 2009
Do any insurers have an exclusive patent or process necessary to write workers compensation insurance?	No	• 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
Do high fixed costs render the cost of providing workers compensation too high unless there is just a single provider of coverage?	No	• The marginal cost of offering workers comp in Ohio is relatively low, especially for insurers already offering the coverage in other states

An Objective Measure of Competitiveness in Workers Compensation Markets[5]

Competitiveness in markets can be measured objectively using the Herfindahl-Hirschman Index, a commonly accepted measure of market concentration. It is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. For example, for a market consisting of four firms with shares of 30, 30, 20 and 20 percent, the HHI is 2600, calculated as follows: ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). In the case of a pure monopoly, with just one firm producing a good or service for the entire market, the HHI Index value would be equal to 10,000 (which is equal to 100^2).

The HHI takes into account the relative size and distribution of the firms in a market and approaches zero when a market consists of a large number of firms of relatively equal size. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases.

Markets with index values below 1000 are considered to be unconcentrated (highly competitive). Markets in which the HHI is between 1000 and 1800 points are considered to be moderately concentrated, and those in which the HHI is in excess of 1800 points are considered to be concentrated.

Figure 2 shows that the HHI Index for workers compensation insurance markets in a number states near to or economically similar to Ohio. Nevada is included because that state converted from a monopolistic state fund structure to a competitive structure in 1999. All states with the exception of Kentucky fit the U.S. Department of Justice's definition of "highly competitive." Kentucky's market is still categorized as competitive despite a somewhat higher degree of concentration.

The competitive nature of workers compensation markets is ubiquitous, existing in every state that is not a monopolistic fund state. As Figure 3 shows, large numbers of firms typically compete for business in every state, assuring—as displayed in Figure 4—that no single firm or group of firms exercises market control over pricing or any other important market function (such as underwriting).

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[5] Portions of this section are drawn from the US Department of Justice discussion of the HHI index found at: http://www.justice.gov/atr/public/testimony/hhi.htm

Why States Created Monopolistic Workers Compensation Funds

In 1912—just when many states were implementing modern workers compensation programs—38 percent of the nation's workers were employed in construction, manufacturing, mining, and transportation, with farming constituting another 30 percent.[6] The work was hazardous: of the nation's 38 million workers that year, between 18,000 and 23,000 were fatally injured on the job.[7] Approximately 4.7 million or 12 percent of the workforce had a nonfatal illness or injury.[8]

A Rising Awareness of the Toll of Occupational Injury

Throughout the late nineteenth and early twentieth century the country was becoming increasingly aware of the steep toll the rapid industrialization of the country was taking on workers and their families. The National Safety Council was formed in 1912 amid a widespread belief that workplace safety needed major improvement. Injured workers or their survivors could rarely obtain compensation for their losses. They had to sue employers to obtain compensation for the effects of workplace injuries, illnesses, or deaths. Few workers had the resources to successfully sue their employers and meet the stringent burden of proof necessary to establish employer negligence.

[6] Statistical Abstract of the United States, Series D-62-76.

[7] "National Safety Council data estimate that in 1912, 18,000-21,000 workers died from work-related injuries (not limited to manufacturing). In 1913 the Bureau of Labor Statistics documented approximately 23,000 industrial deaths among a workforce of 38 million, equivalent to a death rate of 61 deaths per 100,000 workers." Source: http://www.cdc.gov/mmwr/preview/mmwrhtml/mm4822a1.htm

[8] Mark Aldrich, "History of Workplace Safety in the United States, 1880-1970," at http://eh.net/encyclopedia/article/aldrich.safety.workplace.us The illness/injury data probably understate the occupational injury/illness problem, because they exclude work injuries that required medical treatment but did not result in a full day away from work, and usually exclude the effects of occupational illnesses. Many of these data deficiencies weren't addressed until 1970 (see http://www.bls.gov/iif/oshhist.htm). Using data from the Statistical Abstract and the data Aldrich provides, the average worker worked about 54 hours per week (54.2 in 1912 and 53.8 in 1913); if there were 38 million workers, then there were 10,670 units of ten million manhours worked, and multiplying by the steel industry injury rate of 441 per ten million manhours yields an estimate of the number of workplace injuries/illnesses at 4.7 million.
For perspective, just before the current recession started (in December 2007) there were 139.1 million people working. This is about 3.6 times the number employed in 1912-13. Of course, the distribution of workers among industries is quite different today. Nevertheless, if workplace death and injury rates had remained the same as they were in 1912, we would currently experience 75,600 workplace deaths annually and nearly 17 million workplace injuries. The actual numbers for 2008—the latest data currently available—were 5,071 fatalities and 3.7 million illnesses/injuries.

Until the early twentieth century, a worker hurt on the job could only recover damages by suing the employer. Even then, the common law seemed stacked against the worker. The employer had three powerful defenses (rules), any of which would defeat employee allegations of negligence on the part of the employer:

- **Contributory Negligence Rule**: The employee was partly at fault;
- **Assumed Risk Rule:** By taking the job, the employee understood the hazards involved;
- **Fellow Servant Rule:** A fellow worker, not the employer, caused the accident, so the employer was not at fault.

Today these rules may seem harsh. But as America first flexed its industrial muscle in the 1860s, they were seen as necessary protection for important but dangerous enterprises like mining, construction and railroading. One author notes these were the very industries:

> *". . .whose prosperity was intimately associated in the public mind with the seemingly fabulous growth of the economy and general welfare in the Victorian Age. Who but one indifferent to the very success of private enterprise would not shrink from imposing upon too heavy a burden such as would undoubtedly be involved if it were exposed to the bracing wind of an unmitigated duty of care?*"[9]

Over time, though, the common law softened. States began passing laws to broaden workers rights in the most dangerous industries. By the 1890s judges and juries had become more sympathetic to the workers' situation by finding ways to bypass the traditional barriers in tort. And the plaintiff's bar began to emerge, starting to accept cases on contingency, an action that opened the tort system up to the low-wage workingman.

[9] J.G. Fleming, *An Introduction to the Law of Torts*, (Oxford: Clarendon Press, 1970), pp. 5-6, as cited by Andrew D. Racine, *On the origins of workers compensation: Beyond the distributional consequences,* dissertation New York University, 1987.

The impetus to provide assistance to workers injured on the job also drew strength and a sense of urgency from the fact that in the early 1900s the financial security "safety net" that we rely on but take for granted today simply didn't exist. There were no Social Security disability or survivors benefits, no employer-sponsored life or disability insurance programs, no health insurance programs (government, employer-sponsored, or individual), and few states had Workers Compensation laws. Injured workers and their families all too often wound up destitute.

At the same time, the idea of liability insurance began to spread. Before the late 1800s, most non-life insurance protected against property loss – covering a business that burned or a cargo stolen by pirates. Now insurers were beginning to indemnify businesses for inadvertent errors. In the workplace, these indemnifications became the first employer liability policies.

Even with the changes, the system did not seem effective to workers. A study of accidents in Cleveland between 1905 and 1910 showed the typical death payment received by a worker's family was $345. Nearly two-thirds of claimants received nothing.[10]

These problems were recognized not just in Ohio or the United States, but in Europe, too. Germany passed the first workers compensation law in 1884. England followed up in 1897. The laws eliminated the standard employer defenses but also put a limit on how much the injured worker could recover.

In the United States, employers and labor organizations were both ambivalent. Employers tended to win cases, but many were concerned about the uncertainty employee lawsuits brought to earnings. Many labor groups liked that workers would definitely recover under workers compensation programs, but other groups saw the sacrifice of the right to sue as diminishing the dignity of the craftsman/professional.

[10] E.J. Sealy, *A History and Synopsis of the Workmen's Compensation Law of Ohio*, The Annals of the Society of Chartered Property and Casualty Underwriters, Vol. 7, No. 1 (March 1955), p. 69.

But in 1910, the publication of *Work-Accidents and the Law,* by Crystal Eastman, made workers compensation a hot political issue. Eastman studied industrial accidents at rail yards, coal mines and steel mills, documenting how working families suffered. To fix the problem, she proposed, in essence, a workers compensation system. Workers would receive one benefit to pay for medical costs caused by the injury. They would receive a second benefit for lost wages while recovering.

Eastman helped draft the first rigorous workers compensation law, for New York, which passed in 1910. As one historian notes:

> *"In the months after the publication of Eastman's study, commentators described the progress of workmen's compensation with phrases like "prairie fire" and "whirlwind. . . ." As one Wisconsin study described it, compensation statutes had arrived with a kind of "magical rapidity."*[11]

Figure 5 shows how quickly workers compensation spread. In the 10 years after New York's law passed, 42 other states enacted similar laws. Ohio was one of the first, with its General Assembly passing the *Workers Compensation Act* in 1911. Ohio's early and progressive response to one of the most important social and economic problems of the early twentieth century helps explain much of what makes Ohio unusual in how its workers compensation law operates to this day, nearly a century later.

Conceptually, the idea of mandating compensation for injured workers on a scheduled basis without regard to proving employer fault (i.e., no-fault basis) was appealing, both to workers and employers. For the latter, it brought a level of predictability to workplace accident/illness costs and lessened the ill will between employers and employees from the previously adversarial approach. Moreover, there was no compelling reason to exclude any employer or employee from a workers compensation regime. As a practical matter, however, this did not initially appear to be a risk that private insurers could handle,

[11] John Fabian Witt, *The Accidental Republic: Crippled Working Men, Destitute Widows, and the Remaking of American Law,* (Cambridge, Mass., and London: Harvard University Press, 2004), p. 127.

especially if they had to insure every employer. In order to ensure the availability of workers compensation coverage to every employer, the Ohio Industrial Commission in 1912 began to operate the state's workers compensation system as a monopolistic state fund, about the same time that many other state funds were being formed—some as monopolies, some not.

A Brief History of Workers Compensation in the United States

Ohio adopted its workers compensation system nearly 100 years ago as part of a concerted nationwide effort designed to help workers in an increasingly dangerous industrial age. As shown in Figure 5, Ohio was one of the first ten states in the country to enact a workers compensation law. As the next section reveals, the turbulent early history of workers compensation in Ohio, not the realities of modern day insurance markets or economics, remains the principal reason why Ohio maintains a monopolistic fund structure to this day.

The Origins of Workers Compensation Insurance in Ohio

Even as the an increasing number of states passed workers compensation laws in the early 1910s, many people, including their advocates, believed the laws could be ruled unconstitutional, particularly if the state required an employer to purchase coverage.

Figure 6 illustrates in a timeline how what happened in Ohio reflected what was going on in the rest of the country. The events below the timeline were key dates in Ohio's adoption of workers compensation. The events above the timeline occurred elsewhere.

The table shows that as New York was drafting its law, the Ohio General Assembly in 1910 authorized the governor to appoint a commission to look into a workers compensation law. The commission reported back in January 1911.

The state passed its workers compensation law four months later. By then, however, New York's law had been ruled unconstitutional—the court ruling that the compulsory nature of coverage took away the employers' property rights without due process.[12] Laws in Maryland, Massachusetts and Montana were also rescinded.[13] Though well intended, widespread adoption of workers compensation protections for workers was off to a rocky start and with an uncertain future.

Reacting to multiple court findings that mandates were unconstitutional, Ohio's first (1911) workers compensation law was a voluntary one. It also established the state workers compensation fund. Coverage was only available to employers of five or more persons, and employers paid 90 percent of the cost, with the employee paying the rest.

The Ohio law was immediately but unsuccessfully challenged, with the courts affirming the law's constitutionality in 1912. Yet despite the victory in court, the law simply was not achieving its objectives. Few employers bought coverage, "preferring to purchase employers liability insurance and to fight claims brought by injured employees."[14] To many, the only way employers would join a workers compensation system was if they were compelled to do so. But the mandate, many believed, might make the law unconstitutional.

Rather than fight in the courts, supporters of the new system tapped the Ohio Constitutional Convention of 1912, which offered several amendments in referendum that fall. One allowed the state to create a workers compensation fund, and it passed easily. Thus enshrined in the state constitution, the original 1911 law was made mandatory in 1913, with an option for employers to self-insure. Self-insurers lost the key tort-law defenses.

Ohio employers were now compelled by law to purchase workers compensation insurance and the state had a state workers compensation fund so that every employer

[12] *Court Invalidates New Liability Law*, New York Times, March 25, 1911, p. 3.
[13] Robert A. Bregman, et al., *The Workers Compensation Guide*, (Dallas: International Risk Management Institute, 2nd edition 1997), p. 3.
[14] Sealy, p. 70. The voluntary law survived a court challenge in February 1912, but it was clear that a compulsory law would be ruled unconstitutional. And Wisconsin's 1911 law became the first to survive a challenge. In Wisconsin, the employer could opt out of the workers compensation system, but it lost the three standard defenses.

was guaranteed access to coverage. However, private insurance companies argued that nothing prohibited them from providing workers compensation coverage.

The idea was hardly radical. At the time, through today, states have provided workers comp in three ways:

- Monopolistic systems, in which the state is the sole provider, as Ohio is today.
- Private systems, where only private insurers provide coverage, as is the case in most of the United States.
- Competitive fund systems, where the state and private insurers compete.

And by 1911, nine states other than Ohio had passed workers compensation laws. Only one, Washington, was monopolistic. Six had private systems, including Illinois and Wisconsin. New York and California had competitive funds, which is what private insurers sought in Ohio. But the state's powerful labor unions objected strenuously.

Almost a century later, it's hard to capture the disdain the unions held for private insurance companies. Here is Paul Kennedy in 1913, representing the American Association for Labor Legislation before the Republican Club in New York:

> *"We do not care to turn loose on the community an army of solicitors. We oppose casualty companies . . . because it is to the interest of these companies to have a compensation indefinite and uncertain so that rates may be as high as the traffic will bear. Moreover, these private companies will not consent to a schedule of compensation such as we consider just. Prevention is better than cure, and these casualty companies have done little to prevent accidents. Finally, in elective insurance the employer is the only one who has any election at all.*[15]

[15] *Hotchkiss Doubtful of State Insurance,* New York Times, March 30, 1913, p. 14.

Nonetheless, in 1915, Ohio Insurance Commissioner Frank Taggert ruled that private insurers could compete with the state for workers compensation business. Private insurers quickly entered the market.

Taggert's ruling was challenged, but the state Supreme Court ruled in 1916 that Taggert was correct. In the end, though, union's powerful influence won out. A year later, House Bill 1 was enacted, banning private workers comp insurers from the state. The government canceled all outstanding policies.

So Ohio's constitution allows a state compensation fund but does not require one. And the constitution would allow private insurers, though state law prohibits them. But at by the start of the 1920s, Ohio had a single workers comp insurer, known today as the Bureau of Workers' Compensation.

After the countrywide flurry of legislation and litigation, six states joined Ohio in having a monopolistic state fund. They are listed in Figure 7, along with the year the funds were founded and their current status.

Three formerly monopolistic states, Oregon, Nevada and West Virginia, have turned to the private market. In 1980, Oregon reorganized the state carrier into SAIF, a not-for-profit, state-chartered company. SAIF competes in the market with private carriers and has approximately 40% market share in the state today.[16]

Nevada not only stopped acting as a monopolistic carrier, it left the market entirely, creating a private insurance market with no public competitive presence. At year-end 1999, it turned over its assets, liabilities, in-force policies and reserves to Employers Insurance Company of Nevada. That company has been folded into a larger group, the publicly traded Employers Holdings Co., which writes workers compensation in Nevada and 29 other states.[17]

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[16] http://www.saif.com/aboutsaif/aboutsaif_companyinfo.aspx

[17] Employers Holdings Inc. 2010 10-K, p. 6.

West Virginia's fund was privatized in 2006 as Brickstreet Mutual. The state opened up to private competition in 2008. That year, Brickstreet still held 87% of the state's workers compensation market.[18]

Washington remains a monopolistic state, but recently the Building Industry Association of Washington submitted 340,000 signatures in support of a November 2010 referendum on privatizing the market. Initiative 1082, a sit is known, would let private insurers compete with the Department of Labor and Industries by 2012.[19]

Much has changed in the century since Ohio established its monopoly. Back then, the workers compensation market was truly embryonic. Few insurers wrote the coverage and their experience in doing so was negligible. Today, the private insurance industry has nearly a century's worth of experience under its belt, successfully providing coverage to every conceivable type of business and occupational class over the extremes of state and national economic cycles. The coverage is well established has grown until, as Figure 8 shows, with an estimated $30.5 billion in net premiums written in 2010.

The Workers Compensation World Has Changed Significantly Over the Course of the Past Century

Over the course of the past century, much has changed regarding workers compensation insurance. Among the most important developments are the following:

- the development of the specialty of occupational medicine and rehabilitation and the promulgation of national workplace safety standards;
- the enormous drop in workplace injury, illnesses, and death rates;
- the development of an extensive financial and social "safety net;"
- the emergence of risk management programs aimed at reducing both the frequency and severity of workplace casualties, and

[18] *Workers' Compensation State Funds: Evolution of a Competitive Force 2009*, Conning Research and Consulting (Hartford, CT: 2009), p. 108.
[19] *Washington state: Group collects signatures for vote on WC reform*, Risk and Insurance, found at: http://www.riskandinsurance.com/story.jsp?storyId=497722662

- from a private insurer viewpoint, the decades of experience that insurers have acquired providing workers compensation insurance.

The spread of Workers Compensation laws and growing awareness of industrial accidents in the early part of the twentieth century helped improve workplace safety, but those effects were not permanent and continuing. It was reported that, in the decade of the 1960s, "disabling injuries increased 20 percent… and 14,000 workers were dying on the job each year."[20] To reverse this, President Nixon on December 29, 1970 signed the Occupational Safety and Health Act of 1970, which created the Occupational Health and Safety Administration (OSHA) to set and enforce safety standards and the National Institute for Occupational Safety and Health (NIOSH) to do research on ways to improve occupational safety. As an example of its effectiveness, the NIOSH "cotton dust" standard promulgated in mid-1978, when 12,000 cases of "brown lung" were reported, by the year 2000 had reduced reported cases to 700.

Over a similar time frame the nation's financial safety net has grown significantly. The disability insurance program was added to Social Security's retirement and survivor benefits in 1956. Medicare was added in 1965. Although these programs cover both workplace-related and other disabilities, they affected workers compensation benefit administration by establishing a framework that hadn't previously existed. For example, workers compensation programs began using Medicare's fee schedules in determining what to pay for medical costs of occupational injuries and illnesses; prior to that the standard was typically the "usual, customary, and reasonable" standard which was more variable and led to higher outlays for medical care.

Employers have come to recognize that improving workplace safety is valuable far beyond reductions they might achieve in workers compensation costs. Many employers now involve employees in safety-improvement programs, boosting morale and productivity and identifying improvements that might otherwise have been overlooked. They are more willing to invest in rehabilitation in order to shorten the time an employee needs to return to work.

[20] http://www.osha.gov/as/opa/osha-at-30.html

As a result of these and other developments, what was seen a century ago as a possibly uninsurable risk by private insurers is now clearly insurable. Private insurers now provide the vast majority of the nation's workers compensation insurance (as measured by premiums). In 2008, for example, one report said private insurers had 75% of net written premium ($45.24 billion vs. state funds $11.35 billion).[21] This percentage overstates the role of the state funds because it includes the four monopolistic funds and excludes private alternatives (e.g., captives/risk retention groups/self insurance).

The Ohio Department of Insurance is certainly capable of regulating insurers who write workers compensation insurance. We know this because they already do it, for Ohio-domiciled insurers who write workers compensation insurance in other states, and for insurers domiciled in other states that operate in Ohio that write workers compensation insurance outside of Ohio. The Department also regulates all other lines of insurance. State insurance departments in the 46 states with private sector insurance report no particular problem regulating this line of insurance.

The private market is quite competitive. Even in the 20 states in which state funds compete with private insurers, no state has more than 60 percent of the market, and in 9 states the state funds have a 30 percent or lower market share. This is despite advantages that state funds enjoy vis-à-vis private carriers (such as not paying taxes or having to earn a profit for the providers of its capital).[22]

Is Ohio's Workers Compensation Insurance Market Truly a Monopoly?

Ohio's workers compensation law allows employers to provide workers compensation programs through private alternatives (e.g., captives/risk retention groups/self insurance), so the state fund, as a practical matter, does not actually monopolize the entire workers compensation insurance market. The exception that allows alternative arrangements effectively makes the Ohio fund a competitive state fund, but it limits the types and sizes of employers that can opt for better, different or less expensive workers compensation

[21]Conning Research, "Workers Compensation State Funds: Evolution of a Competitive Force," 2009, p. 31.
[22]Op. cit., p. 38.

risk management alternatives. There is no economic reason for this restriction. It could be argued that if state-provided workers comp insurance were better for a business, the business would choose it in a competitive marketplace, and the lack of choice implies that at least some Ohio employers might not be able to select the best arrangement for themselves.

Workers compensation benefits are built around replacing lost wages and medical care and rehabilitation. As such, they do not completely eliminate employers' liability for the consequences of workplace-related accidents/illnesses. Typically, private workers compensation insurance policies contain two insuring agreements—one for workers compensation benefits as provided in state law, and the other for any other liability the employer might be required to pay for damages arising out of workplace-related accidents/illnesses. Because the Ohio state fund doesn't provide this latter protection, Ohio employers who want it must purchase a separate liability insurance policy. This is inefficient because the same incident might give rise to both workers comp benefits and an employer liability lawsuit and separate insuring arrangements would entail separate (and likely duplicative) claims evaluation and disposition.

No State Is a Monopolistic Insurer for Any Other Liability Insurance Line

With 46 of the 50 states allowing private sector competition in their workers compensation systems it is immediately obvious that the monopolistic structure in Ohio's workers compensation market is anomalous. The structure is anomalous in at least one other important respect: there is no other type of liability insurance anywhere in the United States where the state is the sole provider of coverage. This observation is instructive because in fact there are many other types of liability coverage that are universally mandated. The best known and by far the largest of these is automobile liability insurance. Ohio and every other state require people who own and drive cars and other vehicles to buy third-party liability insurance, and about a dozen states require purchase of personal insurance ("no-fault") protection. But no state has ever established a state-run agency for the sole purpose of providing that insurance to all drivers/vehicle owners. Instead, every state relies on the private insurance industry to do so—and since no state has even contemplated replacing this market structure with a monopolistic state insurer, we can safely infer that this arrangement is satisfactory and preferable to alternatives. The personal and commercial auto liability insurance markets are highly competitive in every state and give buyers many choices of companies which offer choices of price, service, and policy features. Other types of compulsory liability coverages that are entirely serviced (or nearly so) by private insurers include medical professional liability coverage, contractor liability and even coverage for offshore oil and gas drilling operations.

Advantages of Multi-Line and Multi-State Diversification

Almost all private insurers that write workers compensation insurance diversify their “book of business” by writing other lines of property-casualty insurance (see the below) and/or writing in other states. Doing this also enables these insurers to determine which types of risks—in workers compensation and other lines—they can specialize in within a given state.

Diversification by insurance line and territory also increases an insurer’s financial stability, since it is highly unlikely that losses in every line in every state will exceed expected levels all in the same year. Therefore, a smaller amount of capital is needed to provide a given level of financial soundness than would be needed by an insurer offering only one line of insurance in one state (such as a monopolistic workers comp fund). The smaller required capital generally translates into better prices for insurance buyers.

Table 1
2008 Largest Private WC Insurers, Workers Comp NWP as % of Total

Company	WC NWP ($ billions)	Total NWP ($ billions)	WC as % of Total
Liberty Mutual	$4.82	$22.25	21.7%
AIG	$4.70	$31.98	14.7%
Travelers	$2.49	$20.46	12.2%
Hartford	$2.41	$10.21	23.6%
Zurich	$1.05	$4.93	21.3%
CNA	$0.93	$6.14	15.2%
Chubb	$0.78	$9.47	8.3%

Source: Conning Research, *Workers' Compensation State Funds: Evolution of a Competitive Force, 2009*, p. 19.

The Importance of Competition on a Level Playing Field

As Ohio considers the future direction of its workers compensation system, the basic principles of establishing a system that embraces the concept of free, open and fair competition is paramount. Should the state decide, now or at some point in the future, to open its market to competition insurers that meet the department's standards of financial integrity, it is critical to ensure that the competitive structure provides opportunities for all insurers to compete—large and small. Indeed, Ohio is home to a number of insurers, many of them small-to-mid-sized companies, that write workers compensation in other other states. These companies must not in any way be disadvantaged by virtue of their size in the event that the Ohio workers compensation market. No large carrier, by virtue of its multistate market presence or market share in other commercial lines in Ohio should be afforded any particular advantage in competitive market environment.

Thank you for your time and the opportunity to address the Task Force today. I would be happy to respond to any questions you may have.

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

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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	• 46 states allow private sector competition • 764 private insurers wrote workers comp insurance in these 46 states in 2009	Possibly	• 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	• 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	• 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	• 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)	• Creating a WC product and distribution system would have been costly

Source: Insurance Information Institute

Figure 2: WC Market Concentration* by HHI in Selected States, 2009

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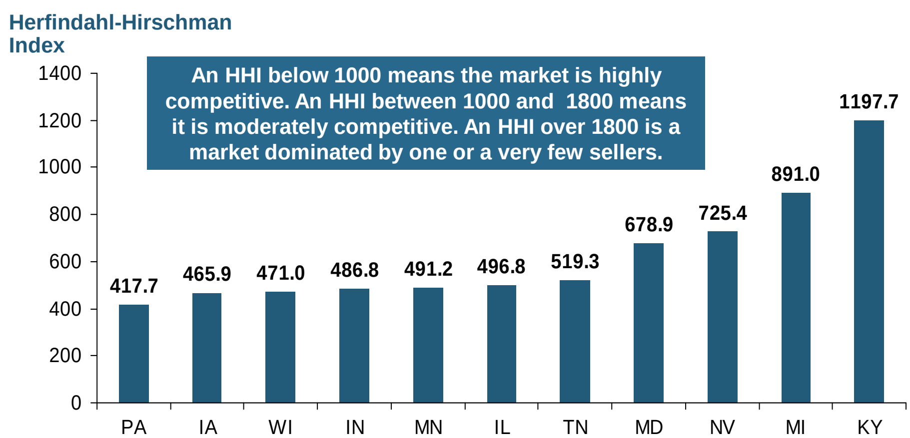

In every state near Ohio and with similar economies, the private market for Workers Compensation insurance is highly competitive

*private insurers only

Sources: SNL Financial, U.S. Department of Justice; I.I.I.

Figure 3: WC Market Share of Top 5 Insurers in Selected States, 2009

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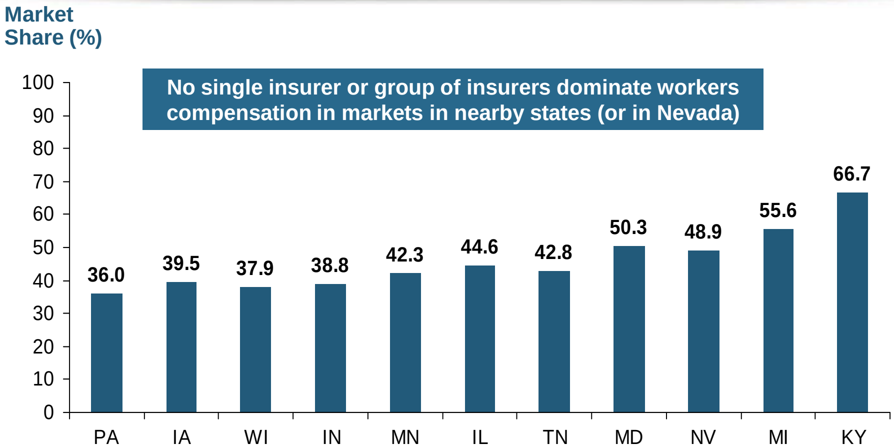

In every state near Ohio and with similar economies, the private market for Workers Compensation insurance is highly competitive

*private insurers only

Sources: SNL Financial; I.I.I.

3

Figure 4: Number of Insurers in the WC Market in Selected States, 2009

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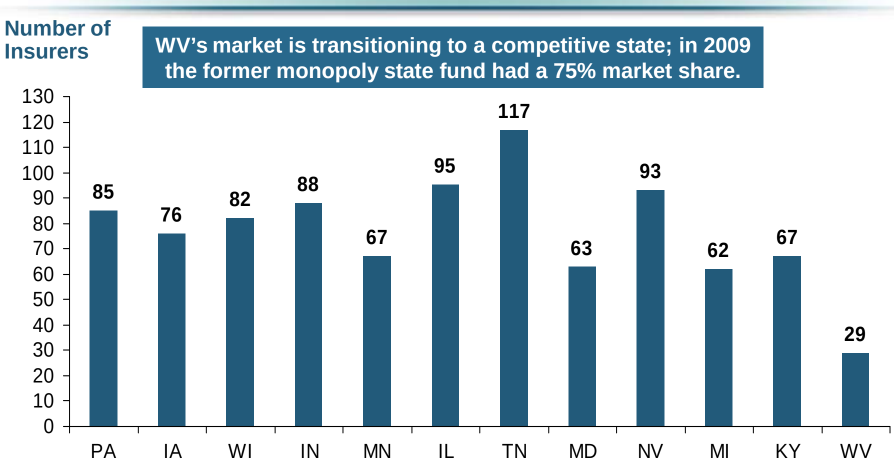


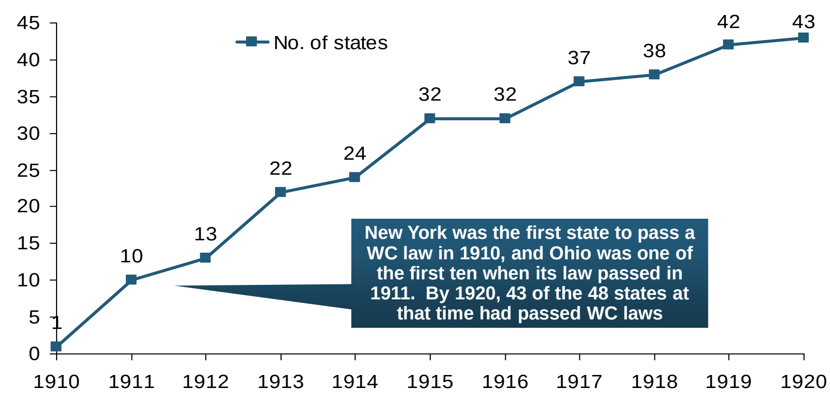
In every state near Ohio and with similar economies, the private market for Workers Compensation insurance is highly competitive

*private insurers only

Sources: SNL Financial; I.I.I.

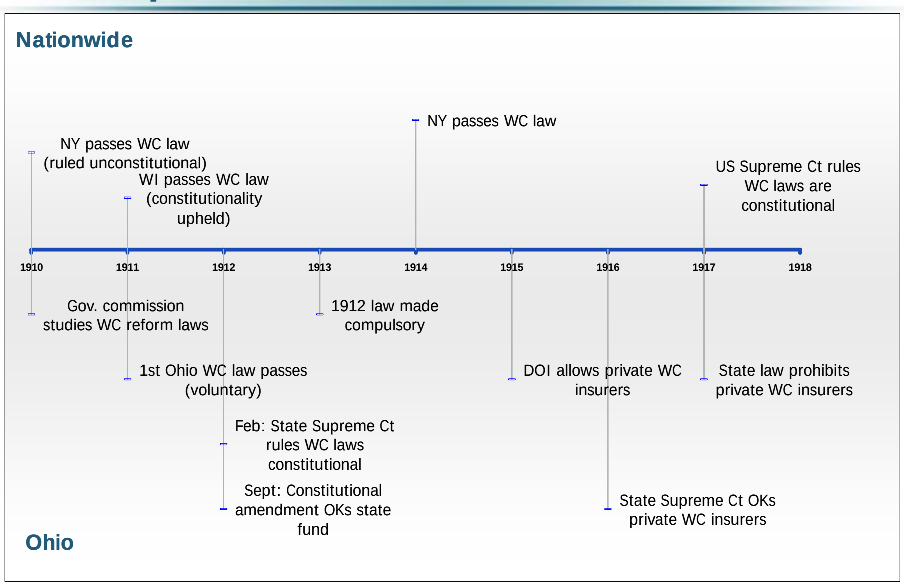
4

Figure 5: Cumulative Number of WC Laws Passed, 1910-1920



Source: http://eh.net/encyclopedia/article/fishback.workers.compensation; Insurance Information Institute.

Figure 6: Key Workers Compensation Developments in the 1910s



Source: Insurance Information Institute.

Figure 7: Monopolistic State Funds: Where Are they Today?

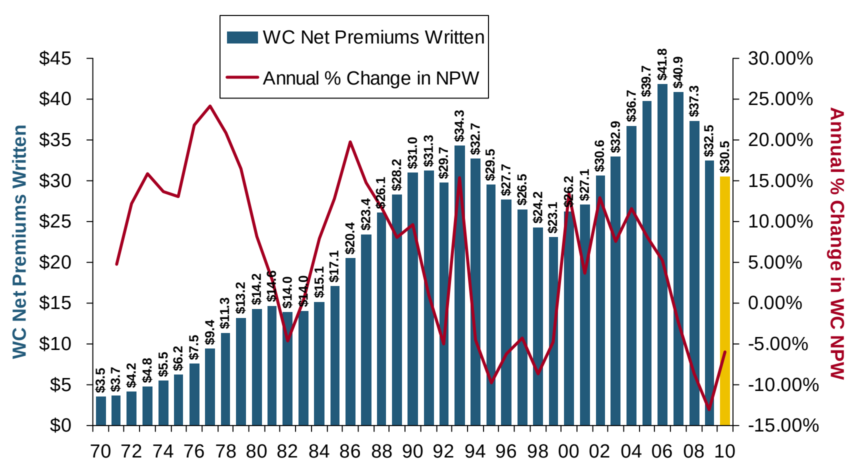
State	Date started	Status
Ohio	1911	Still monopolistic
Washington	1911	Monopolistic; referendum sought in 2010
Nevada	1913	State fund privatized in 1999
Oregon	1913	Allowed competition in 1980
West Virginia	1913	Allowed competition in 2008
Wyoming	1915	Still monopolistic
North Dakota	1919	Still monopolistic

Source: Economic History Association, http://eh.net/encyclopedia/article/fishback.workers.compensation, Insurance Information Institute research.

7

Figure 8: Workers Compensation Net Premiums Written and Annual Growth Rates: 1970-2010P

($ Billions)



Sources: A.M. Best (1973-2009); Insurance Information Institute calculations and estimates for 2010.

8