ASSURED REPORT

Workers' Compensation: The Good Times are Rolling…For Now

Favorable workers' compensation news appears to be sweeping the nation. Positive data points include declining claim frequency, benign medical inflation, and most recently favorable news on opioid prescriptions.

But some of our earliest research led us to the conclusion that workers' compensation insurers efficiently discount relatively predictable costs into their rates. As the WC loss ratio reaches a 20-year low, WC rates are going down across the nation in response to that wave of positive data points.

And because of that, WC loss ratios are probably about as good as they'll get.

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Workers' Compensation: The Good Times are Rolling…for Now

Spring 2016 brings a bevy of good news which is quickly being discounted in rates.

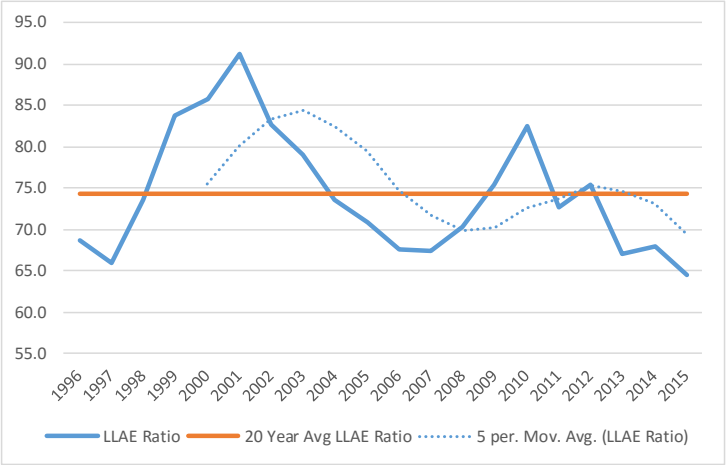
Some of our earliest work at Assured Research led us to the conclusion that workers' compensation (WC) insurers efficiently discount (by which we mean incorporate into their rates) relatively predictable costs. So, scheduled benefit changes or legislative and regulatory matters (pertaining to medical procedures, for instance) are fairly quickly passed through to the policyholder in the form of higher, or lower rates.

Our view has not changed. Across the nation, in fact, WC rates are generally going down in response to a wave of positive data points ranging from declining claim frequency to benign medical inflation. There are recent exceptions with we'll touch on, but the main point of this note will be to highlight some of the positive data points out over the past few months.

As good as it gets?

Figure 1 shows that the calendar year, national WC loss and loss adjustment expense (or, LLAE) ratio is as low as it has been in 20 years – not bad! And Figure 2 (next page) reveals that **WC insurers outperform the overall industry; producing higher returns on surplus and lower volatility**.

Figure 1 WC Calendar Year LLAE Ratio



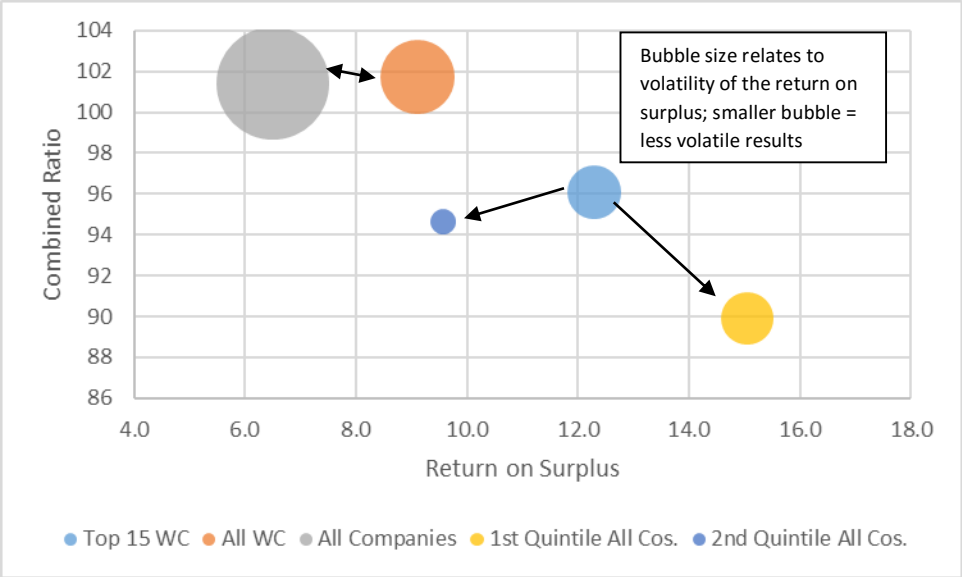
Source: SNL, Assured Research

The top 15 WC insures in our sample of more than 50 didn't perform quite as well as the top quintile of all insures using the dispersion analysis featured in several of our recent *Assured Briefings*, but Figure 2 shows that the top WC writers outperformed the 2nd quintile of all companies. Any reader with a professional memory dating back more than about 15 years may find themselves continually surprised (as we often are) whenever these statistics are displayed.

Is this as good as it gets? Probably. Despite the almost uniformly positive data points which we'll get to shortly, rates in WC are beginning to decline. Rates in NCCI states declined by 4% in 2015 and in California (some 21% of national premium) commissioner-approved rates are down 16% from their peak in January, 2015.

Bottom line: WC insurers efficiently discount rates for predictable and measurable changes in loss trends.

Figure 2 Dispersion Analysis: ROE (X axis), Combined Ratio (Y axis) and Volatility (Bubble Size)



Our sample of all WC writers bested the industry on return and volatility while top WC writers were between the 1st and 2nd quintile of all insurers.

Source: SNL, Assured Research

Positive data points keep rolling in

It seems a steady stream of positive data points have surfaced in recent months. We'd characterize the research, summarized below, as documentation of the positive trends that have already contributed to the favorable results shown in Figures 1 and 2, but then we're not suggesting that they'll abate anytime soon either.

Positive #1: Opioid use is down

The Workers Compensation Research Institute (or, WCRI) published their third edition of *Interstate Variation in Use of Opioids* in June. It's amazing to us that opioid prescribing is as high as it is (some 65-80% of lost-time claims with at least one pain medicine prescribed) but the good news is that the trend is almost uniformly down.

The report is available for purchase so we'll only hit the highlights here:

- Across 25 states the WCRI studied nearly 340,000 nonsurgical, lost-time claims with at least one pain medicine prescribed.

- Over the earliest and latest study periods (2010/2012 to 2012/2014) the percentage of such claims that included opioids was down or unchanged in 21 of the 25 states. Where **the frequency of opioid prescriptions was down** the decline was generally small, say 1-3%.

- But importantly, **the amount of opioids prescribed per claim was down materially** – oftentimes 20% or more in 21 of the 25 states.

- The variation in prescribing patterns was surprising to us and worth further study by any WC professional. For instance, **the amount of opioids prescribed per claim was some 2x the study group median in PA, NY, and LA**. And for professionals with interests in PA and NY – the opioid intensity per claim is some 3x that of neighboring NJ. Think WC policy, rules and regulations don't matter? Think again.

We're not aware of studies linking opioid prescribing patterns to claim duration or cost, but intuition suggests they are related; as in more opioids = more expensive and longer-lasting claims. And using data from the WCIRB (California) we can work out that **while opiates represent about 27% of total pharmaceutical costs in that state, they are "only" about 2.5% of total medical spend or about 1.5% of total medical and indemnity expenditure**.

But here we are inclined to go with our gut – declining opioid use in claims where pain medicines are prescribed surely translates into lower costs and more quickly resolved claims (and less actuarial tail risk).

Positive #2 News from the WCIRB (California) is (almost) all positive

The Workers' Compensation Insurance Rating Bureau of California recently released their financial summary of 2015 results. Available at this link, the report shows that premiums were up 7% in 2015 while costs rose just 5%.

Underneath the covers, their data shows declining claim frequency (-1%) and slowly rising claim severity (+3%) on the back of flat medical costs. The main concern for California writers is the rapid rise of ALAE costs per claim (+11%). Since so many of the rising ALAE costs pertain to medical cost containment measures, it seems fairer to think of a rising medical trend where the medical $/claim are flattish with a rapidly-rising medical administrative expense per claim.

But as we described at the outset of this note, **California writers have been discounting these positive trends in their rates since the beginning of 2015**. The average approved rate for policies incepting after 7/1/2016 is $2.30 per hundred dollars of payroll, some 16% below its peak at January 1st, 2015. "Filed and approved" rates in CA are for carrier guidance, but data from the WCIRB shows that average rates charged to California businesses (about 12% higher than filed rates) are following the same general pattern.

Positive #3 NCCI State of the Line Address conveys same positive trends

The NCCI's annual state of the line was presented this spring and by now you can guess the story. WC premium rose across much of the country in 2015, but that was on the back of rising payrolls (+4.8) offset by declining rates (-4.0%). Meanwhile, the calendar year 2015 combined ratio of 94% (in NCCI states) was the second-lowest year of the past 25 years.

Among the drivers of claims, frequency of lost-time claims was down 3% while indemnity costs on lost-time claims was up just 1%. Nationwide medical costs were down 1% even though prescription drug costs are rising some 6-7% per annum.

Conclusion

Back in 2013 (and following on research by the WCRI) we studied the disparate types of fee regulation governing the reimbursement rates paid by WC insurers to hospitals for common surgeries reimbursed by WC. In some states the reimbursement rates paid by WC insurers were twice that paid by Group Health writers (knee or shoulder surgeries are examples).

But our work showed that type-of-fee regulation didn't affect insurer's longer-term loss ratios. We concluded that **insurers are efficient at passing relatively predictable costs onto their policyholders**. That scenario is playing out in Florida right now. An April, 2016 court decision obliterating the WC attorney fee schedule was quickly followed by a 17.1% proposed rate hike by the NCCI. Whatever the final outcome, it's likely that policyholders will bear the brunt of any system-wide cost increases in the Sunshine state.

But the trend works in reverse too, and that is what is playing out nationally as WC insurers lower rates. WC cost drivers are nearly all trending in favorable directions, but rate decreases are close behind. And because of that WC loss ratios are probably about as good as they'll get.