

August 2013

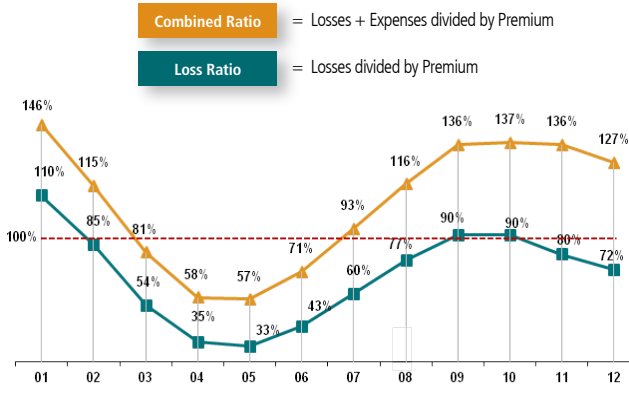
California Workers' Compensation Update

By Darren Cartwright

The workers' compensation insurance market is a dynamic force with many moving parts. The market drivers impacting today's rates are largely about the costs associated with treating and getting an injured worker back to work. It's been six months since SB863 took effect so it's a good time to look at where the market stands, how we got here and where it's headed.

A LOOK BACK

Insurance companies writing workers' compensation policies in California have not turned a profit since 2007. The chart below outlines the combined loss ratios and is based on Workers' Compensation Insurance Rating Bureau (WCIRB) data as of 12/31/2012. It illustrates that for every \$1 of premium charged, insurance companies are paying out an average \$1.27 in losses and expenses (calendar year 2012 projected result). This is not an ideal business model.



Although this downward trend is an improvement over the past three years, the trend is occurring in large part due to increased premiums, which are offsetting losses but still not enough to show an underwriting profit.

A LOOK AT TODAY

Written premiums were up by 15.8% in 2012 from 2011. However, paid losses reached \$8 billion last year (66.6% of the industry's \$12.1 billion in earned premiums) – the highest industry total since 2007. According to the Oregon Workers' Compensation Premium Rate Ranking list, California now comes in as the third most expensive state for workers' compensation insurance.

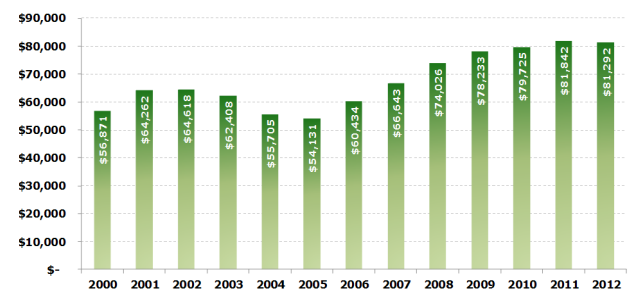
Oregon's Workers' Compensation Premium Rate Ranking (2012 Study)

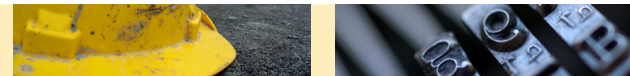
Workers' Compensation Premium Rate Ranking					
2012 Ranking	2010 Ranking	State	Index Rate	Percent of Study Median	Effective Date
1	2	Alaska	3.01	160%	January 1, 2012
2	6	Connecticut	2.99	159%	January 1, 2012
3	5	California	2.92	155%	January 1, 2012
4	3	Illinois	2.83	151%	January 1, 2012
5	13	New York	2.82	150%	October 1, 2011
...					
38	12	Texas	1.60	85%	June 1, 2011
39	41	Oregon	1.58	84%	January 1, 2012
40	35	West Virginia	1.55 82%	82%	November 1, 2011

Source: Information Technology and Research Section in the Oregon Department of Consumer and Business Services (10/2012).

What's driving the increase in premiums? In a word: losses. A few key drivers are at play.

The projected ultimate cost of indemnity claims is at a historic high according to the WCIRB. The estimated average cost of a lost-time claim for 2012 is projected to reach \$81,292, which represents a \$27,000 increase, or 50%, since the full implementation of the reforms that took effect in 2005.



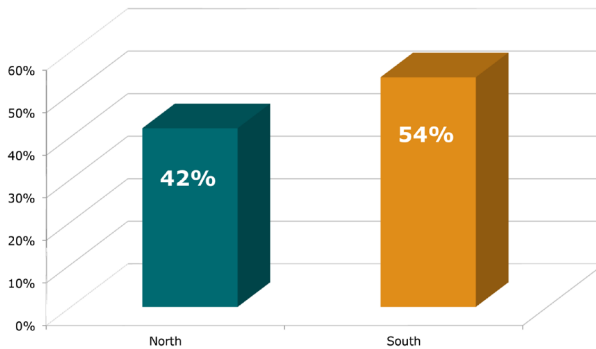


The average claim cost represents medical, indemnity (lost time and permanent disability) and expense totals. Note that litigation consistently drives the ultimate cost of a claim. In fact, claims that become litigated are, on average, six times more expensive. The California Workers' Compensation Institute (CWCI) released a study that examined numerous cost drivers and their impact to the system. Not surprisingly, attorney involvement was the number one cost driver identified in the study.

If we look at the state's geographic differences, Southern California remains one of the more difficult places to run a business when it comes to workers' compensation. As illustrated below, litigation rates are 12% higher in the southern versus northern part of the state.

Claim Characteristics:

Attorney Involvement Rates on Indemnity Claims by Region
Northern CA vs. Southern CA

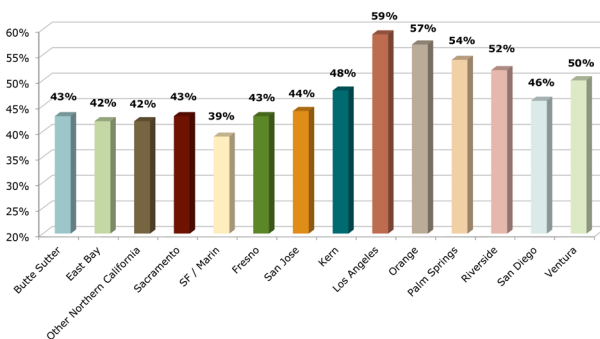


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When we look at specific regional differences in litigation rates, Los Angeles and Orange Counties stand out as the trouble spots.

Claim Characteristics:

Attorney Involvement Rates on Indemnity Claims Northern CA

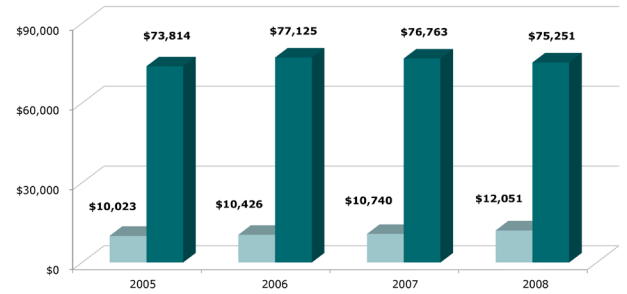


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Another difficult trend that the data seems to validate is the number of lost-time days that occur when attorney involvement takes place on a case. The average number of lost-time days can be five times that of claims with no attorney involvement, as seen in the chart below.

Average Adjusted Paid Temp Disability Days:

Indemnity Claims With & Without Attorney Involvement
AY 2005 - 2008



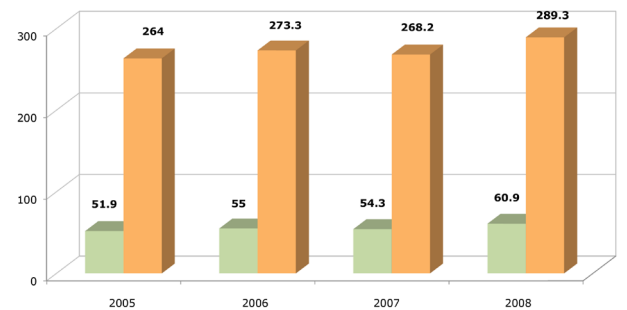
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Making matters worse, the weekly temporary disability (TD) rate continues to rise and is set to increase from the current \$1,066 per week to \$1,074 in 2014. Keep in mind that this is a tax-free benefit, so it is a challenge to try to return injured workers back to the job when they are essentially netting the same amount sitting at home collecting TD as they were working on the job with benefits and taxes being deducted.

And with higher litigation and increased lost-time days charged to a case, the overall cost of the claim can skyrocket to excessive levels. As seen in the illustration below, attorney involvement is increasing the costs of a lost-time claim by sixfold.

Average Adjusted Paid Temp Disability Days:

Indemnity Claims With & Without Attorney Involvement
AY 2005 - 2008



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WHAT'S AHEAD

Rates have not yet stabilized in California and we continue to see increases on risks with excellent loss experience in the range of 3%-5%, to 5%-15% on average loss risks, and as much as 20%-50% on risks with poor loss experience. And with a handful of carriers making upward adjustments on the July 1 renewal cycle, it's important as ever to make sure you're working closely with your broker to understand the market and prepare for your renewal.

In addition to starting the renewal process early and in an ongoing effort to mitigate losses, **your internal best practices are more important now than ever. Here are 10 Must-Dos for 2013:**

1. Have a plan for safety and continue to build a culture around it.
2. Establish a relationship with an occupational clinic.
3. Report injuries immediately.
4. Train your staff and managers on the basics of claim identification and response.
5. Keep in contact with your injured workers after an injury occurs.
6. Have policy or guidelines around return to work and be sure to treat both occupational and non-occupational disabilities the same.
7. Have physical job descriptions – keep them current and share with occupational physician for return to work efforts.
8. Know your adjusting team: adjusters, nurses, investigators & attorneys.
9. Do regular claim reviews.
10. Keep good records and document your case files.

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