THE WORKERS' COMPENSATION CRISIS: ADDRESSING THE REAL PROBLEM (REBUTTAL TO RICHARD A. HOFMANN'S ARTICLE IN THE FALL 1991 *FORUM*)

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THE WORKERS COMPENSATION CRISIS: ADDRESSING THE REAL PROBLEM

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For seven years workers compensation insurance has been in a state of crisis, with combined ratios averaging nearly 120%, a residual market share that has grown from less than 10% to 24% of the total market, and a number of state systems teetering on the verge of catastrophe. Only adequate rates, workers compensation system reforms resulting in cost reductions, or a combination of both will restore this system.

Early in 1991 the workers compensation insurance industry described activities which will identify specific causes for rising workers compensation costs in 12 initial target states and the development of legislative or administrative cost containment proposals to stem the rise in workers compensation costs. I strongly believe that this approach when coupled with adequate rates, will provide the real solution to the current problems of the workers compensation system.

Some proposals and criticisms of the insurance industry miss the mark by addressing only the **symptoms** of a troubled workers compensation system rather than its root causes. Mandated rate reductions and interference in the ratemaking process are short sighted and destructive. Such actions will not resolve the workers compensation crisis. Insurers must be free to charge adequate rates for employers with both good and bad safety records and the voluntary market subsidy of the residual market should be reduced. The formation of self-insurers and group self-insurers will not solve rate inadequacy problems--it merely shifts those costs to other people. Such proposals evade the real problem in workers compensation by creating the appearance that something is being done to bring down costs and rates. There are many reasons, which vary from state to state, for the current workers compensation insurance crisis. The problems and solutions must be addressed by each state individually.

THE RESIDUAL MARKET

The workers compensation reinsurance pools operated by NCCI now provide coverage to over 600,000 policyholders who are unable to find coverage in the voluntary market. The residual, or involuntary, market now accounts for 24% of the workers compensation insurance market - - - - up from less than 10% only six years ago. This unprecedented growth has put a strain on the entire system. NCCI and its members have been laboring to correct the problem of the residual market by implementing higher carrier performance standards, providing more information and assistance to insurance agents who use the residual market, reducing fraud, and tightening rules and procedures.

I believe that **consumers are best served in a competitive voluntary market where they may choose among carriers competing to provide the programs, prices and services they need.** This can best be accomplished by the adoption of adequate rates in both the voluntary and residual markets. The residual market must also be redefined as the true market of last resort.

Criticism of the current residual market attacks a mechanism that is not the problem; the growing residual market is merely a reflection of the problem. Changing the delivery system for the product is mere "window-dressing" and a costly one at that. The problem of the residual market is that it has grown far beyond what is healthy and manageable. The goal of reform should not be the building of a residual market mechanism that can service 600,000 employers. Rather, efforts must be directed to depopulate the residual market to a point where efficient and effective service is assured and rates that cover actual costs are allowed to be charged.

Proposals, such as group self-insurance plans, purport to offer the public a simple solution to the woes of the system. However, we are seldom told how such groups would be any more successful than the current system when inundated by 600,000 employers. The most significant flaw in such a proposal, however, is the basic premise that another mechanism would allow the regulator to approve a rate sufficient for the market to be self-supporting. In 1990, in most jurisdictions, the indicated rate differential needed to obtain a self-supporting residual market was between 40-50%. Very few regulators would or could approve a rate increase of that magnitude in today's economy. Thus, solutions must emphasize depopulation, loss control, cost containment, and adequate residual market rates.

Efforts are underway at NCCI to eliminate fraud in the system, provide a "single stream" application process, and develop standards and programs that will permit servicing carriers to aggressively manage and reduce the residual market loss costs.

We are already seeing results from these efforts. During the first quarter of 1991, NCCI introduced assigned risk investigative units to provide greater scrutiny of applications meeting specific criteria based on premium size, complexity of risk, or on suspected misrepresentation of application information. These units detect understated premium upon application and identify those employers who do not possess good faith entitlement to coverage. After only three months of this additional review, over 14.6 Million Dollars in annual premium has been identified as of July 1, 1991. The residual market uncollectible unit has generated an additional 1.5 Million Dollars in collected premium by refusing to settle open accounts without extensive review and negotiation with the client. These represent just a few of the administrative changes already under way within NCCI which have focused on employers who abandon their responsibilities to bear their fair share of the costs due to their own poor experience.

NCCI continues to review the application process to arrive at a more efficient and streamlined system to better address the concerns of consumers, agents and servicing carriers while also providing the necessary information and verification to assure eligibility for coverage under the Plan. NCCI has developed system specifications and identified automation enhancements, including image processing, designed to streamline the current system. We expect to conclude the necessary programming changes this year. We have also sponsored educational workshops to improve communication channels with insurance agents who frequently use the plan.

Equally important, NCCI recognizes that if the residual market is to survive, the underlying costs of the system must be aggressively managed and controlled. We are reviewing such programs as fraud detection in claim handling, disability management, and medical and legal cost management. All are critical to the survival of the market because they directly impact the health of the overall system.

Our current activities acknowledge that the residual market can be improved. However, the growth and expansion of the residual market is only a symptom of a much larger crisis. Once this fact is accepted, the weaknesses in our critics' arguments are exposed. Alternatives to the residual market delivery system only address the symptom and ignore the depth and complexity of a troubled workers compensation system. Regulators, legislators and consumers must recognize that there are no easy solutions to the problems facing the workers compensation system. On the other hand, these problems are not insurmountable either. The insurance industry is focusing its extensive efforts on a multi-faceted reform package to bring the workers compensation system back into balance.

LOSS COSTS RATING

Some industry critics advocate deregulating workers compensation pricing and prohibiting collective pricing activities. This issue is under review by the National Association of Insurance Commissioners, which is expected to approve model workers compensation loss costs legislation for introduction in 1994. Under a loss cost rating system, the rating organization prepares prospective loss costs for workers compensation classifications. These loss costs use data on historical losses and loss adjustment expenses, developed to an ultimate basis and trended. Provisions for other carrier expenses and profit are not included. Insurance companies factor in anticipated expenses and profit to develop their own final rates. Many states have already adopted loss cost rating programs. NCCI's Board of Directors pledged in 1990 to assist states that wish to move to a loss cost approach or to respond to any alternative rating approach that is legislatively or regulatorily selected.

However, regulators, legislators and consumers must be reminded that loss cost rating does not have any effect on rapidly rising system costs. As a result, loss costs rating will not directly address the industry's severe rate inadequacy problem.

THE QUEST FOR WORKERS COMPENSATION DATA

Everyone wants to know what's driving workers compensation costs. Some have suggested that a new data base be created and administered by a new state statistical data collection agency. It has been suggested that such a new data base would better monitor the performance of workers compensation systems, allow legislatures to quantify expected cost impacts of reforms sooner, improve the performance of the systems, and help produce long-term cost savings for the benefit delivery systems.

The intention of these recommendations are desirable. However, advocates of "new" data systems may overlook the wealth of workers compensation statistics which already exists. The collection of workers compensation data is a costly, complicated and time-consuming task. Several disciplines, including claims evaluation, computer programming, statistical analysis and data base management are required to collect, collate and analyze this information.

While rating organizations such as NCCI do not currently collect self-insurance data (because self-insurers are not members), with few exceptions, 100% of the workers compensation insurance company experience is reported to the authorized rating organization. This data base, therefore, provides a highly credible source of statistics for ratemaking, law evaluations, and research. In addition, every state has an industrial commission, bureau or accident board that administers, monitors and collects data on its workers compensation system.

Several different kinds of data are now collected and assembled into NCCI's vast statistical data base. For determining the overall change in state rate level, financial experience in the form of policy year aggregates, calendar year aggregates and calendar/accident year aggregates are reported for each state.

Another important and critical form of data received by NCCI on a policy-by-policy basis is Unit Statistical Plan data. Here, detailed information on all transactions on insured employers are reported. These data are used to determine the classification relativities by state for approximately 600 classes, to calculate the Experience Rating Plan modifier for individual employers, and to evaluate the price or cost effect of workers compensation law changes.

A third form of data collected by NCCI, is Detailed Claim Information (DCI). The DCI system obtains data on a sampling basis for research purposes. The DCI data base, with oversight by the National Association of Insurance Commissioners, is being expanded to cover all states in 1992. Clearly there are sufficient data being collected (presently at a significant cost) that can identify underlying system costs without the expense and unknown value of a new data base. What is important, is that system reform must occur now, (with information we now have), to bring the system back in balance.

CONCLUSION

I invite regulators, legislators, and consumers to join with the workers compensation insurance industry in resolving the real problems of the workers compensation system. I know that rate increases are difficult to approve, and accept in today's economy . However, I also know that only rate adequacy coupled with effective cost containment efforts will restore a long overdue balance in the workers compensation system.

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