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Get ready for rising comp rates

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On paper, it looks as though workers' compensation insurance rates will go down next year after several years of recommended increases.

But the deeper trends suggest insurers have been paying out more than they are taking in, all without the kind of investment portfolio performance that would normally cover the difference. Despite competitive pressures to keep costs to employers down, insurers will have to given in sooner or later and raise rates, experts say.

"There's no doubt they've got to go up. It's just a question of when," said Judy Diaz, managing member with TWIW Insurance Services.

Workers' compensation rates are set in large part by the recommendation of the Workers' Compensation Insurance Rating Bureau. The bureau acts as a clearinghouse for statewide information and an actuary. Because no single insurer pays out enough claims to generate a reliable dataset, insurers across the state pool their information together to get a clearer picture of what they can expect their costs to be and what they should charge.

The bureau uses that data to come up with what's called its pure premium rate filing. The rate filing is expressed in premium dollars charged per $100 of payroll — on average, it was $2.37 during the first half of this year, for example. Insurance companies use that figure as a baseline. They add all other costs — overhead, claims litigation, profits — on top of that rate to decide what to charge businesses.

The bureau's rate filing made big headlines going into the 2010 policy year because it recommended a whopping 40 percent increase. The state's insurance commissioner declined to approve those increases, as he had several double-digit increases in previous years. This year, the bureau is recommending a 1.8 percent decrease in its rate filing — down to $2.33 — because the yardstick against which an increase or decrease should happen has changed.

In the past, the bureau's "increase" was measured against its previous recommendations. So, if an insurance commissioner didn't grant an increase one year, the bureau would tack on the next year's needed increase to the previous year's unapproved increases. The result was a rocket-launch in recommended rates.

"There was a disconnect between what the bureau was filing and what was happening in the marketplace. It wasn't based on what insurers were charging," said Jerry Azevedo, a spokesman for the Workers' Compensation Action Network, a Sacramento group that advocates for employers' interests at the Capitol. "The bureau kept coming out with double-digit increases."

The insurance commissioner — an elected position in California — of course declined many of those increases for political reasons. But the system has been changed. The bureau's recommendation is now based on an average of the actual rates filed by insurers across the state. "What [the old system] created was a huge pressure. There wasn't any relief valve," Avezedo said. The new system "is trying to create more of a linkage between what the bureau is projecting for costs and actual rates in California."

For now, rates are set to go down. But insurers have increasingly been paying out more than they are taking in, as measured by a number called the "accident year loss and expense ratio." This number tells how much money insurers spent for every premium dollar they took in.

In 1999, insurers had recently been deregulated to allow them to compete for premium dollars. Companies rushed to advertise lower rates to attract customers, but by 1999 they were paying $1.84 out for every dollar they took in. Firms went bust, and employers were ultimately left on the hook.

By 2003, in anticipation of workers' compensation reform legislation, insurers went right-side-up. They paid out less than they took in between 2003 and 2007. But beginning in 2008, the trend reversed again. In 2009 and 2010, insurers spent $1.28 for every premium dollar they took in.

In good times, the returns from an insurance firm's investment portfolio would cover the difference. But times have not been good. Diaz said she believes carriers probably feel the need to raise rates but are reluctant to scare away customers during tough times.

"I think you have to be on the lookout for a catastrophic event," Diaz said. "A couple of little Department of Insurance seizures — something like that might scare some of the carriers, and they'll pull back. That could cause rates to rise."

Workers' compensation payments are divided into two portions: payments for medical bills, and compensation for the employee not being able to work like he or she could before. Avezedo, the lobbyist, said that rising medical costs, an issue much broader than workers' compensation insurance, are pushing up payouts.

"More and more, the California workers' compensation system is becoming a medical benefit delivery system and is not in any way immune from your core cost drivers in health care," he said. "It hasn't reached a crisis point, and each insurer is different, so you can't make a sweeping generalization. But the fact they're paying out much more than they're taking in would suggest additional rate increases in the future."