WHITE PAPER

Workers' Compensation: The Bubble is Bursting

In almost every industry, or industry grouping, eventually professionals begin to ask, "where or when is the next bubble?" Bubbles always happen. And, by definition, bubbles always burst.

"Bubble" has become a big scary word that is laden with ominousness and foregone cataclysm. We forget that bubbles occur in a predictable way: from a set of foreseeable circumstances, bad decisions, and really *really* bad decisions that should have never been allowed to happen.

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As we know, the blunders of the past become extraordinarily apparent to everyone after the fact:

"**Of course** the housing market was going to burst."

"**Obviously,** the stock market was set to explode."

"**Clearly** auto insurance prices couldn't stay so cheap for so long."

Similar mistakes have been made, and are still being made, in the workers' compensation arena. However, the bubble burst for WC isn't just a far-off prediction. It's imminent. To mix my metaphors, we could have smelled the smoke years ago, but now the basement and roof are both aflame – because, I guess, bubbles have basements… and roofs… and can catch fire…

Anyway. The WC bubble burst is looming and, finally, being commented on by governing bodies and WC publications. Take a look for yourself: this link is to the Google search for "workers' compensation rate increases."

In the past several months, carriers, brokerages, and financial analysis firms have decided workers' comp has gotten cheap enough and historical losses (taking place over the past 5-6 years) are unsustainable. This combination means that your clients are likely to face material rate increases sooner than later.

(It certainly would've been nice if someone had seen these signs on the horizon a couple of years ago. This is where I indulge in a little shameless self-promotion – take a look at this article from a couple years ago.)

Given that almost all parties agree that 7-9% rate increases are warranted immediately, it's safe to assume that rate increases will actually be more like 10-15%. And then in the next quarter, and again later in the year, those percentages will go up even more dramatically. This isn't over-extrapolation or assumption. That's exactly how egregious across-the-board rate increases behave. When almost every carrier raises rates at Q1, their problems aren't magically fixed by Q2.

Consider what happened not that long ago to the auto insurance market. It's not shocking now to hear about the "one client" who didn't take any auto losses, but their auto rates jumped 40% at renewal when that marketplace exploded. WC is no different.

Really, there's no room, nor will there be, for anyone to complain about WC rate increases coming back with a vengeance. Those same rates have dropped for about 30 quarters straight (in many cases). Rate drops just don't work like that. There's no Law of Arbitrarily Cheap Pricing that leads to infinite rate decreases forever. Bubbles are created, and bubbles burst, and the WC bubble is bursting right now.

THE PROBLEMS WITH THE WORKERS' COMPENSATION MARKET

There are a number of factors that left the WC market so vulnerable to a bubble being created.

First, over the past 5-7 years, carriers have aggressively entered, and then more-slowly exited the monoline workers' compensation space. Without naming names, just think of your standard carriers – weren't they fairly aggressive on your WC files about five years ago? What are they doing now? Not hungrily gobbling down your monoline WC construction files, that's for certain.

Carriers have jumped into the workers' comp space with both feet while rates were still crashing down and, as the rates continued to fall, many of those carriers realized their mistake(s). Again, without mentioning specific carriers by name, here are some real-world examples:

CARRIER A	Entered the space and exited two years later
CARRIER B	Entered the space and exited three years later
CARRIER C	Entered the space to focus on one class of business and exited the space later that year
CARRIER D	Drove the market down, starting 10 years ago, and continued for three to four years, then pulled back so far that their rates were no longer competitive. Carrier D forced themselves to no longer write in select states and territories due to their losses experienced a half-decade ago (losses that, of course, could have been mitigated by appropriate pricing).
CARRIER E	Was forced out of certain states due to poor underwriting practices that they have yet to acknowledge. They are in court and they are losing.
CARRIER F	Gave their paper to a large MGA ($150M or so in written premium) that had badly damaged their former carrier, and Carrier F was subsequently pushed to the brink of a market exit 4-5 years later. (In fairness, Carrier F also attempted to aggressively enter the auto space four years ago and failed miserably as well.)

All of these instances occurred over about 30 quarters while rates dropped *every single quarter.*

Second, almost every actuarial study that I have read on workers' compensation (again, over the past five years) displays the loss portfolio of an entire industry and/or line of business, but *completely ignores* loss development. Workers' Compensation loss development has an incredibly long tail, is unpredictable client-to-client, and can be assumed as automatic. That is, WC losses develop, IBNR claims occur on all files – these are facts of life. We know that a 50% loss ratio on the current year for *any* account isn't actually 50%.

Even reports that have been released over the past two months that acknowledge the ominous signs for the upcoming year, and recommend rate increases, have nonetheless commented that 2020 has been profitable for WC. This doesn't make any sense. Here are some examples, from reputable reports, that are frustrating due to how they mislead us, their target audience.

"Segment loss reserves have also exhibited unusual strength with favourable prior-year development of 15% of calendar year"

Here, the report analyzes the current year, and prior year losses. But two years of loss data could not be further from a useful analytical device.

"Reports are showing that claims frequency is down significantly, tied likely to the slowdown in economic activity, with sharp reductions in employee time spent at the work space."

Carriers having fewer employees in the workplace is, in fact, a *negative* thing for everyone! (I explain this in more detail below.) So, the implication that this downturn is a positive for WC is grossly inaccurate.

"Pandemic-related long term or catastrophic claims have also been limited to date."

Claims from the current pandemic could not have materialized to measurable predictable levels in less than one year. (Which, again, I will explain below.)

Dive into the California or NY marketplace, for example. We are looking at, on average, development factors of 3x. Thus, in these states, when a client is paying $100k in premium and their current year's losses are at $40k – it's a bad year. We can equivocate on that interpretation because "every file is different" and "losses develop differently." But we can't get away from the fact that development factor projections are based on the *average* of the given search criterion over the life of *all* the claims in question.

Third, typically, the workers' compensation marketplace is somewhat inverted relative to other lines of coverage. That is, when other lines are soft, WC rates are hard and *vice versa*. I specialize in WC, but I don't recall hearing any of my retail partners talk about how much they're saving their clients on GL or Professional Liability right now.

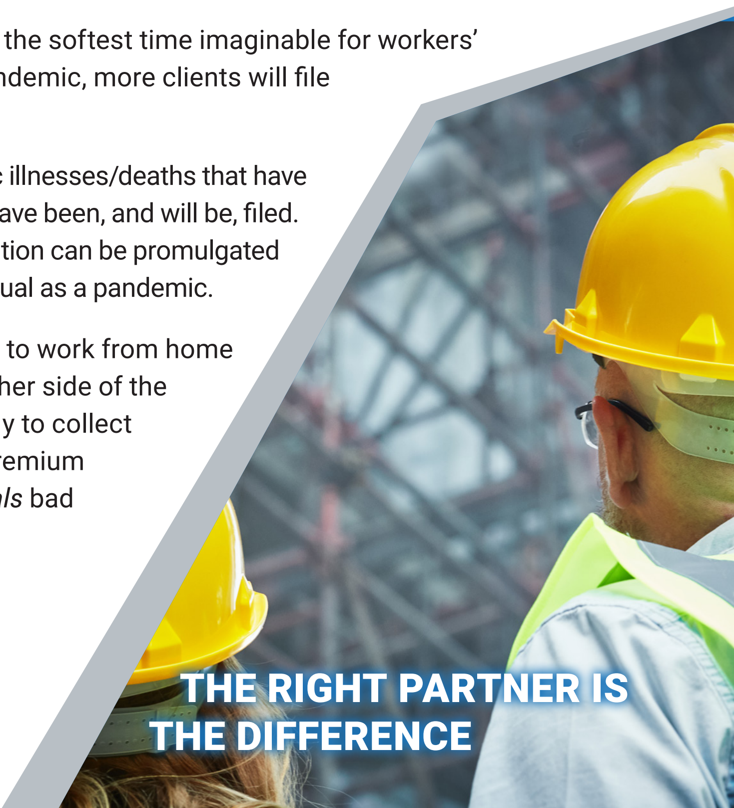
No retail brokers are having an "easy" time placing excess, so whether it be General Liability, Professional Liability, Property, Auto, Umbrella, etc., clients have mostly likely been given the bad news that their prices are going up.

Luckily, you've also been able to give them the "good" news about their work comp rates, right? Well, sorry to burst that bubble…

Fourth, we need to touch on COVID briefly. The pandemic hit at the softest time imaginable for workers' compensation. Additionally, as deaths are growing from the pandemic, more clients will file claims, and fewer premiums will be paid, for two reasons.

a. The WC marketplace has yet to realize the losses of pandemic illnesses/deaths that have already occurred, let alone those to come. Yes, those claims have been, and will be, filed. COVID-19 has been in our lives less than a year. No loss derivation can be promulgated from that time period, especially when the situation is as unusual as a pandemic.

b. Insureds are paying lower premiums for workers being able to work from home as clerical staff, or even furloughed. The carrier is on the other side of the equation holding the bag of horrible coronavirus claims, only to collect a lower premium number due to those job changes. Less premium collected *plus* higher frequency/severity COVID losses *equals* bad fallout for markets.



Overall, here's how the workers' compensation market has been functioning:

- About 7 years of decreasing rates every quarter
- Rate decreases based on limited studies that looked at only the previous/current year losses when 4-8 years are needed for any accuracy – and four years will only rarely give an accurate depiction
- Carriers are entering and exiting the marketplace in the same two- to four-year span because they realize that they can't sustain the rates needed to compete at the risk of their own survival
- Current studies are now (finally – not two years ago) saying that rate increases are imminent across the board
- The worst pandemic in decades (if not a century) hit at exactly the worst time when the market couldn't absorb the impact

HOW WE CAN HELP

On average, assets are priced where they are worth. However, bubbles occur when, more or less, one part of the system either prices or buys at a number simply because "everyone else is doing it."

I know this is a bit reductionist, but it seems to be true for WC. Prices go low in workers' comp because Tom, Dick, and Jane decided their carrier can be okay doing it and the rest of the marketplace said "well, those three have to know what they're doing, so let's do it, too." Markets may have also known that they were writing to a loss and just didn't care so long as they maintained market volume. Welcome to the bubble.

My sincere hope is that you and your clients remain as untouched as possible by the pop of this bubble. But, please don't make the mistake of thinking the pop isn't inevitable. To mix my metaphors again, all you can do at this point is batten down the hatches (inside the burning bubble house).

Let us help.

We can benefit all parties. Too many carriers have been getting too little premium for accounts that haven't been fully contemplated until right now. Some of those carriers have left the marketspace, but many are still on this downward freefall leading to their bursting bubble.

You need someone you trust to know these things about workers' comp; who is aware of the bubble and what its consequences will be; who has carrier relations that aren't going to detonate; and who can, and will, do the best job possible to find a mitigating equitable solution for all.

More specifically:

Our books perform remarkably well and will continue to make our carriers money. We routinely maintain the best brokerage loss ratios for our carriers – no carrier relationships are “blown up” for short term gain.

We work, and understand, our files. Many MGAs/wholesalers will auto-enter their accounts online to block the markets with their ACORD 130 and will wait for a target. Not that there’s anything wrong with that, but we will be busy analyzing the client, loss-picking the insured, giving our markets a heads-up of what is coming down the proverbial pipe, and asking you, our client, about the situation and what your needs are.

We go the extra mile. For example, sometimes detailed WC on complex files can be almost impossible to understand. Sometimes loss control programs need to be designed. Sometimes you just need another voice to help you with a client. I have assisted my agents in all of these arenas, direct with the insured, and even walked them through new loss control programs that I personally designed (which I always have the carrier sign off on).

I can promise that an effort will be made to help you and your client. This may not result in a 50% WC rate decrease, but you will have an expert that is working hard to solve the problems facing both the client and carrier.

Call us. Email us. Reach out today.
We can get you through this bubble burst, if you take the first step.

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