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A Closer Look

State Workers' Comp Funds Wary of Shrinking Premiums

By Sean P. Carr

State-backed workers' compensation insurers share the same challenges as their private-carrier counterparts: rising ratios, falling premiums, higher medical costs. Like some insurers, state funds also have an uneasy, and sometimes hostile, business relationship with a partner — in their case, state government itself.

The approximately 20 state funds operating in the United States take many forms. Generally, they are the insurer of "last resort," the guaranteed issuer, and often compete in the private market as well. In a few states, they are monopoly writers. Some funds consider themselves fully independent, others are hanging on to tax breaks and other considerations and still others have moved toward going fully private.

"If you've seen one state fund, you've seen one state fund," said John Leonard, president and chief executive officer of Maine Employers' Mutual Insurance Co. of their unique nature.

State funds write approximately 25% of the workers' compensation market, according to an analysis prepared by Conning Research & Consulting (*BestWire*, Oct. 5, 2009). Despite double-digit drops in net premiums written, the state funds of California and New York ranked as the sixth- and seventh-largest writers in the United States, respectively, according to a September 2009 A.M. Best Statistical Study.

Preliminary net combined ratios for 2009 are 110 for private carriers, but 129 for state funds — up from 101 and 121, respectively in 2008 — according to a new report from the National Council on Compensation Insurance. Net written premiums continue a five-year decline to \$29.8 billion for private carriers and \$4.3 billion for state funds, according to preliminary NCCI data, from \$37.8 billion/\$10 billion in 2005.

Being a "one line, one state" insurer reinforces the need to maintain underwriting discipline even while competing, said Roger Fries, president and CEO Kentucky Employers' Mutual Insurance. "If we price it and we get it, that's fine. If we price it and we don't get it, that's fine. We're not going to chase price," he said.

The rapid 57% fall in premiums since 2005 has hindered funds' ability to keep expenses in line with premium revenue, said NCCI Chief Actuary Dennis Mealy. Another reason for state funds having higher combined

Workers' Comp Fund Key Dates

- 1999: The Florida Workers' Compensation Fund, a self-insurance fund, went into liquidation.
- 2000: Nevada privatized the State Industrial Insurance System, one year after opening the workers' compensation market to competition. The mutual insurer transitioned to a publicly traded company, Employers Holdings Inc., in 2006.
- 2001: A Minnesota law allowed for all directors of the 18-year-old SFM Mutual Insurance Co. to be elected by policyholders. The company later renamed itself SFM - The Work Comp Experts.
- 2006: West Virginia's money-losing Workers' Compensation Commission became BrickStreet Mutual Insurance Co. The state market opened to private competition in 2008. BrickStreet paid off its financial obligations to the state in 2009.
- 2013: SCF Arizona is scheduled to become an independent mutual insurance company.

Sources: News reports

ratios is that they generally run higher ratios of reserves to premium than the private carriers, Mealy said. This allows them to have a better bottom line than private carriers for a given combined ratio: state funds have a pretax operating gain of 3.5% while private carriers have a 1.6% pretax operating gain.

"Very Tempting"

The relative health of state funds makes their reserves "very tempting" for cash-strapped state governments, said Laurence Hubbard, president and CEO of the Montana State Fund. "As long as there's a political affiliation, they could become a target," said Hubbard, also the new president of the American Association of State Compensation Insurance Funds.

Some recent examples:

- Maryland Gov. Martin O'Malley proposed taking \$20 million in surplus from the Injured Workers' Compensation Fund to help balance the state's budget as part of a

■ See WORKERS' COMP, Pages 2

Webcast to Explore Changing State Funds

A.M. Best Co. will present a webcast titled, "State-Run Workers' Compensation Funds: Their Role in the Competitive Marketplace" on Wednesday, May 19, from 2 p.m. to 3 p.m. EDT. Registration is free online at <http://www.ambest.com/statefunds10>. The editors of *Best's Review* will explore how state workers' compensation funds are changing and how for-profit workers' compensation insurers can compete against them.



WORKERS' COMPENSATION

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measure that would advance the fund toward privatization. The plan was dropped.

- California Gov. Arnold Schwarzenegger sought to sell a \$1 billion share of the State Compensation Insurance Fund's book of business to help close a budget gap. The SCIF board opposed the sale and Insurance Commissioner Steve Poizner filed a lawsuit to block it. Court dates are pending. Meanwhile, SCIF nearly doubled its net income in 2009.

- Colorado lawmakers sought to siphon \$500 million from Pinnacle Assurance's \$650 million surplus in 2009. State Solicitor General Dan Domenico said such an action would be unconstitutional and the funds "are not assets of the state."

- While not demanding assets for the state, Kentucky Senators sought to force the KEMI Board of Directors to distribute 40% of its \$154 million surplus in the form of rebates to customers. That bill failed in the state House of Representatives; KEMI subsequently announced a \$30.8 million dividend, its first.

"You have the ever-present risk of Big Brother hanging out there," said Leonard, who is also chairman of the NCCI Board of Directors.

From MEMIC's founding in 1993, it had full independence from the state, Leonard said. It pays the same taxes and fees private carriers do and NCCI tracks it as a private carrier, not a state fund, he said. "We look an awful lot more like Liberty Mutual than we do a state fund," he said.

"Bona Fide Privatization"

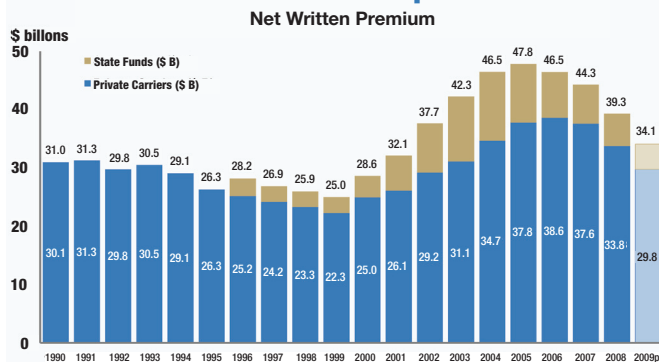
Lawmakers can also be liberators of state funds. In addition to "an interest in grabbing money from anywhere,"

American Association of State Insurance Compensation Insurance Funds

United States Members/Web Address	
SCF Arizona	www.scfaz.com
California - State Compensation Insurance Fund	www.statefundca.com
Colorado - Pinnacle Assurance	www.pinnacle.com
Hawaii Employers' Mutual Insurance	www.hemic.com
Idaho State Insurance Fund	www.idahosif.org
Kentucky Employers' Mutual Insurance	www.kemi.com
Louisiana Workers' Compensation Corp.	www.lwcc.com
Maine Employers' Mutual Insurance Co. (MEMIC)	www.memic.com
Maryland - Injured Workers' Insurance Fund	www.iwif
Minnesota - SFM Mutual Insurance Co.	www.sfmic.com
Missouri Employers Mutual Insurance	www.mem-ins.com
Montana State Fund	www.montanastatefund.com
New Mexico Mutual Group	www.newmexicomutual.com
New York State Insurance Fund	www.nysif.com
North Dakota - Workforce Safety and Insurance	www.WorkforceSafety.com
Ohio Bureau of Workers' Compensation	www.ohiobwc.com
Oklahoma - CompSource Oklahoma	www.compsourceok.com
Oregon - State Accident Insurance Fund (SAIF)	www.saif.com
Pennsylvania State Workers' Insurance Fund	www.dli.state.pa.us/swif
Puerto Rico State Insurance Fund Corp.	www.cfse.gov.pr
Rhode Island - Beacon Mutual Insurance Co.	www.beaconmutual.com
South Carolina State Accident Fund	www.saf.sc.gov
Texas Mutual Insurance Co.	www.texasmutual.com
Utah - Workers' Compensation Fund	www.wcgroup.com
Washington Department of Labor and Industries	www.lni.wa.gov
West Virginia - BrickStreet Insurance	www.brickstreet.com
Wyoming Division of Workers' Safety & Compensation	www.wydoe.state.wy.us

State Funds

Workers' Compensation Premium Continues Its Sharp Decline



p Preliminary
 Source: 1990-2008 Private Carriers, Best's Aggregates & Averages; 2009p, NCCI
 1996-2009p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OP, RI, TX, UT Annual Statements
 State Funds available for 1996 and subsequent.

states are showing an interest in privatizing their way out of the insurance business, said Bruce Wood, associate general counsel and director of workers' compensation for the American Insurance Association. In recent years, West Virginia's money-losing Workers' Compensation Commission transformed into BrickStreet Mutual Insurance Co.

Employers Holdings Inc. (NYSE: EIG), once Nevada's State Industrial Insurance System, had a long transition. Lawmakers opened the workers' compensation market to

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competition in 1999 and privatized the fund in 2000. The mutual holding company became a publicly traded company in 2006.

SCF Arizona, which began as the state's "insurer of last resort" in 1925, is on a course for mutualization under legislation signed by Gov. Jan Brewer. Details are left to next year's legislature, but the insurer will be in private hands, subject to the same taxes and regulations as any other insurer in the state, by Jan. 1, 2013.

The Arizona privatization plan won approval from insurers because it is a "bona fide privatization," Wood said. He denounced a plan advanced by Colorado's Pinnacle earlier this year as a "charade" because it would have maintained the carrier's residual market status and some tax breaks.

The insurer would have paid \$330 million — what some legislators called much too low — to separate and become a mutual insurance company. The plan died before bill language could be drafted, but backers intend to revisit the issue in 2011.

Oklahoma lawmakers considered privatizing CompSource Oklahoma, but pulled the bill in March saying it didn't have the votes to pass this session. That initiative will also likely return in 2011, Wood said.

A petition drive led by the Building Industry Association of Washington is looking to create competition. The campaign seeks to allow private insurers to compete with the state Department of Labor & Industries in offering workers' compensation coverage. Supporters are gathering signatures to get the initiative on the November ballot.