Aon Global Risk Consulting
Actuarial & Analytics

California Workers Compensation
Aon Advisory Bulletin – July 2018

State of the Market

Frequency

Indemnity claim frequency remains flat

- *Smooth Sailing:* After bottoming out in 2009, frequency rebounded somewhat but has remained in a tight range for the last several years.
- *What about 2018*? We expect it to remain flat as the state's economic growth continues.
- *Differences by region*: While the Bay Area is lowest and heading lower (44% lower than statewide average), other regions are near or above the average and holding steady.

Loss Severity

Slow growth in indemnity severity

- *Moderating trends*: After a 6.4% jump in 2014 due to SB 863, indemnity severity is up only a **total** of 4.7% in the three years since, more closely tracking with wage inflation.
- *What's going on*? Increases in PD benefits put in place under SB 863 have mostly worked their way through the system.

Predicted medical severity increase finally arrives?

- *Delayed effect*: A **5.6%** increase is currently estimated for 2017, although this could moderate over time as more data is collected (as did the estimate for 2016 eventually).
- *What's changed*? Medical cost savings from SB 863 have mostly run their course, which could herald an increase to more traditional medical inflation rates.
- *Some good news*: Pharmaceutical costs continue to decrease due to new drug formulary and better opioid controls. Although still a major concern, the recent decline in opioid use may be attributed to both fewer newer claims for which they were prescribed and a reduction in use on claims with chronic opioid use.

Expense Severity

Claims handling expenses continue to rise

- *The beat goes on*: ALAE increases post-SB 863 show no signs of moderating, as 2017 ALAE severity on indemnity claims is projected to be **8.4%** over 2016 levels.
- *What's driving this?* As reform bills are implemented, ALAE increases as claimants challenge more unfavorable terms, etc. Recent increased focus on settlement efforts associated with SB 1160 / AB 1244 lien reforms could also be playing a role.

Rates

Advisory Pure Premium rates continue to decrease

- *How much?* The proposed advisory rate in the 7/1/2018 filing ($1.80 per $100/payroll) represents a **7.2%** decrease from the average approved January 1, 2018 rate. It's the **seventh consecutive** decrease since 2015, totaling a **34.5%** reduction.
- *Are insurers passing on savings to employers?* Insurers are now on average applying pure premium rates ($2.22 per $100/payroll) that are 23.3% higher than the indicated rate (although it should be noted that combined ratios remain in the 90% range).
- *What's driving it*? Lower indemnity frequency and loss development, continued acceleration of claim settlement rates, and declining lien filings.

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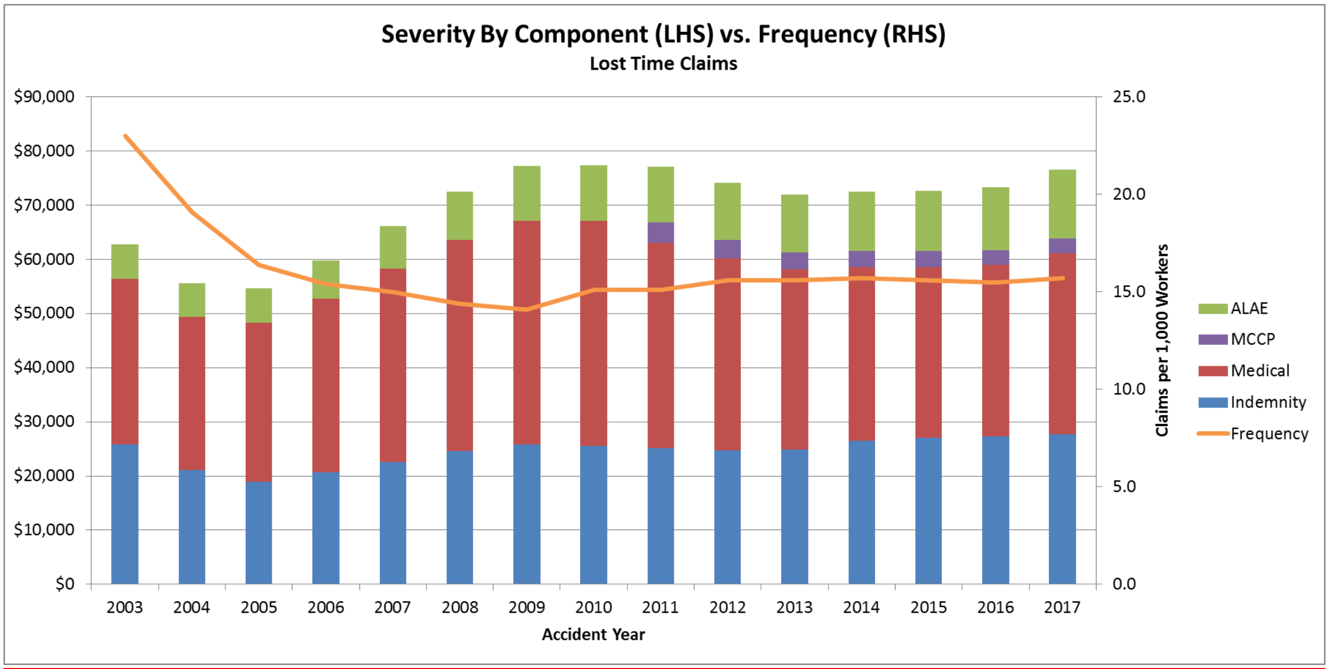


**Note: Medical includes Medical Cost Containment Programs (MCCP) through 2010.*

Additional Areas of Interest

Cumulative Injury Claims: Growth continues in Southern California

- Recent Bulletins discussed why these claims are so problematic (high attorney involvement, frequently reported post-termination, higher average costs).
- Approximately **17.9%** of Accident Year 2016 indemnity claims statewide are projected to involve cumulative injury, up from just 8.3% in 2005.
- Rates are highest in the Los Angeles basin and (to a lesser extent) San Diego, and below the statewide average in Northern/Central California.

Lien Reforms: Liens come back to earth (again)

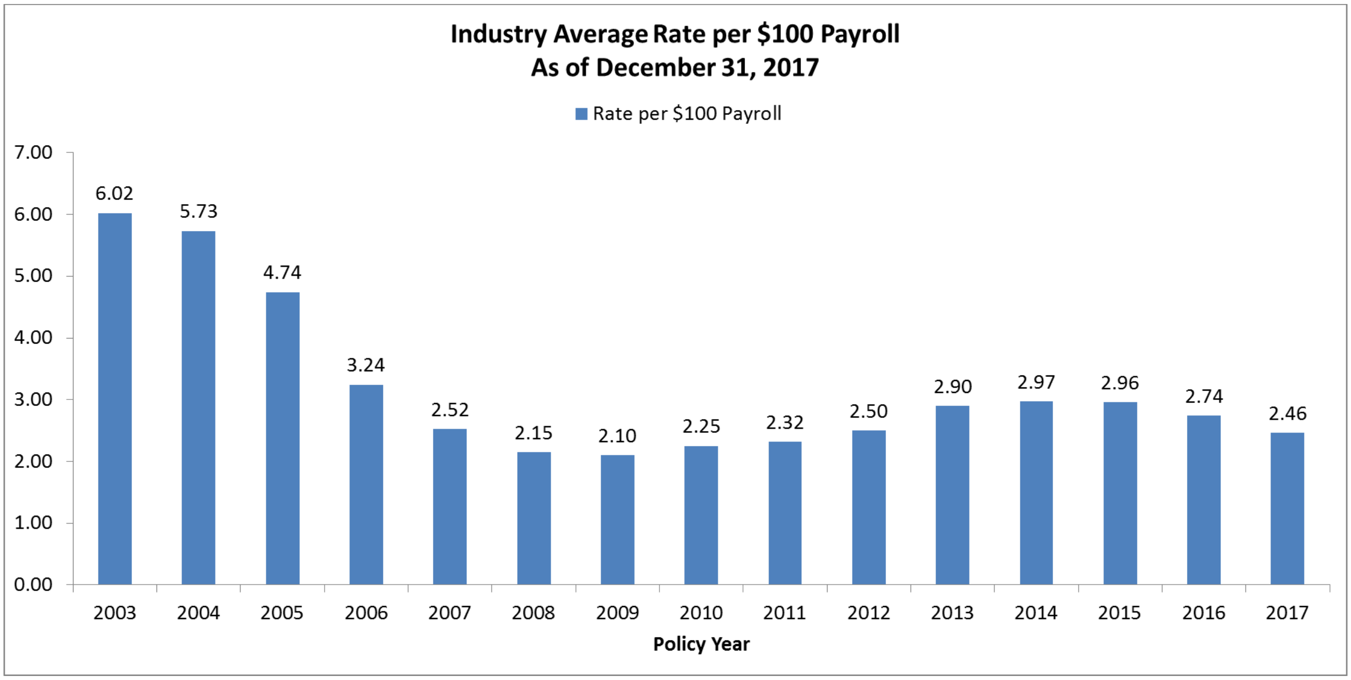
- WC liens spiked in 2012 in advance of SB 863, which imposed filing fees.
- They spiked again in 2016 in advance of SB 1160, which required sworn declarations for liens, as well as AB 1244, which enacted stricter provisions for liens by providers convicted of fraud.
- In July 2017, the DWC dismissed 292,000 outstanding liens that did not comply, comprising roughly 20-25% of outstanding lien demands in recent years.
- This may reduce ALAE costs and distort medical loss projections for several years.

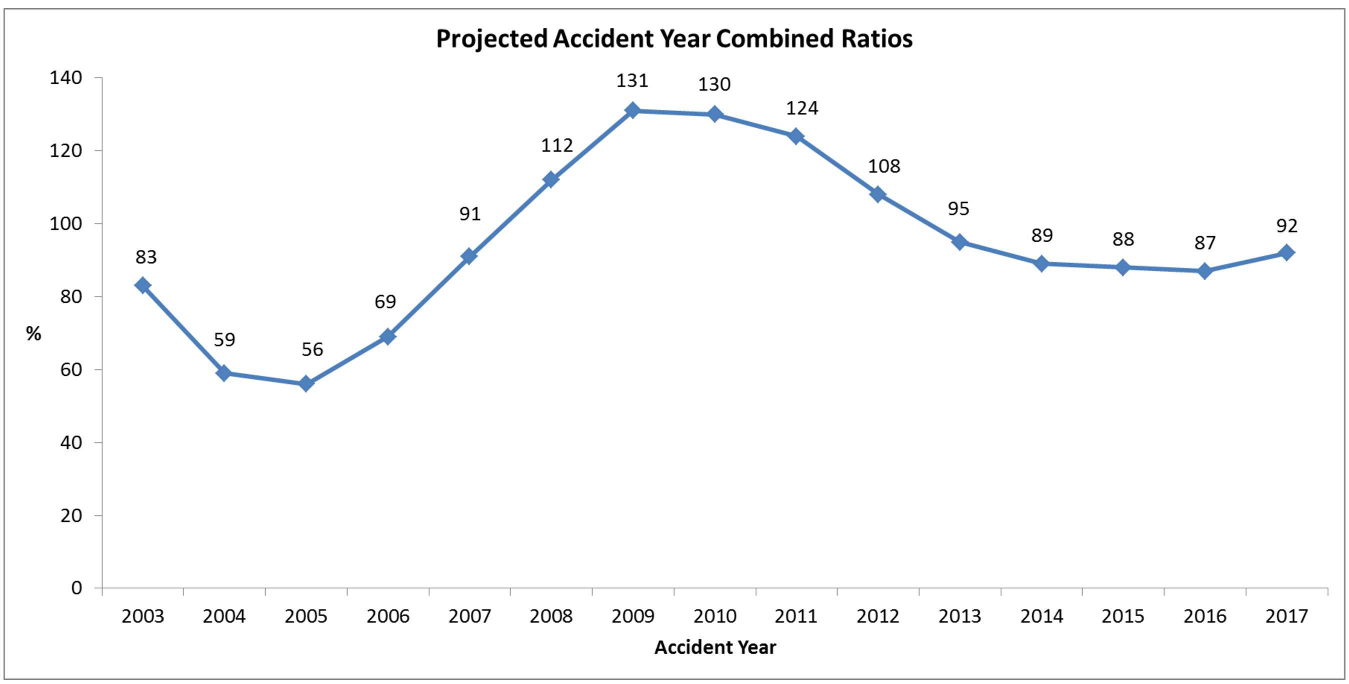
New Drug Formulary: Bending the curve

- Pharmaceutical costs per claim have decreased significantly in recent years (70% from 2012 to 2017)
- Reductions driven by a series of reforms (SB 863, followed by Medi-Cal reimbursement reform)
- New drug formulary effective 1/1/2018 (AB 1124) expected to generate a 10.5% reduction in overall medical costs

Changes to Experience Rating Plan: Effective January 1, 2019

- WCIRB will eliminate the first $250 of every claim in the experience rating calculation to eliminate the incentive to not report small medical only claims.
- Actual “excess” losses also excluded from formula, tempering the impact of large claims.
- 2017 Experience Mod changes were implemented with “premium-neutral” impact (per the WCIRB).


Industry Average Rate per $100 Payroll
As of December 31, 2017
Rate per $100 Payroll
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
6.02
5.73
4.74
3.24
2.52
2.15
2.10
2.25
2.32
2.50
2.90
2.97
2.96
2.74
2.46
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
Policy Year


Projected Accident Year Combined Ratios
140
120
100
80
60
40
20
0
%
83
59
56
69
91
112
131
130
124
108
95
89
88
87
92
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
Accident Year

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