Illinois Department of Insurance

PAT QUINN
Governor

MICHAEL T. McRAITH
Director

MEMORANDUM

TO: The Honorable Senate President John J. Cullerton
The Honorable Leader Christine Radogno
FROM: Michael T. McRaith, Director, Illinois Department of Insurance MTM
DATE: December 16, 2010
MATTER: Workers' Compensation Reform
RE: Status of Illinois Workers' Compensation Insurance Market

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Thank you for the opportunity to testify before the Special Committee regarding the workers' compensation insurance market in Illinois. Department testimony is intended to be factual and not an assessment of any opinion offered by any interested party or witness to the Special Committee. Pursuant to the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq*., the Federal government does not regulate the business of insurance because that responsibility is delegated to the states. Under the Illinois Insurance Code, 215 ILCS 5/1 *et seq.,* the Illinois Department of Insurance is charged with supervision of all aspects of the business of insurance in Illinois. In collaboration with insurance regulators from other states, the Department actively supports and works with the National Association of Insurance Commissioners ("NAIC").

Self-insurance in Workers' Compensation

As of 2009, 275 large employers in Illinois have been certified by the Workers' Compensation Commission as sufficiently capitalized to satisfy workers' compensation standards without purchasing commercial insurance. While the Department does not regulate single employer self-insured plans, the Department does regulate 9 self-insured workers compensation "pools." A "pool" is a group of same industry employers ("homogenous risk characteristics") who combine funds to provide workers' compensation protection to those employees. Department authority over workers' compensation pools includes solvency, participant characteristics, and general administration.

By volume, 26% of workers' compensation benefits in Illinois are paid by self-insured pools or plans.

Illinois Workers' Compensation Insurance Market -- Size

In 2008, the commercial Illinois workers' compensation insurance market was the fourth-largest in the country, with $2.586 billion in earned premiums. Premium volume in the Illinois workers' compensation market was larger than the markets of Indiana, Iowa, and Missouri combined.[1]

Illinois Workers' Compensation Insurance -- Assigned Risk Pool

Due to risk characteristics or worker safety history, insurers may refuse to insure an employer. Employers that are unable to buy insurance in the voluntary, open market receive offers for coverage through the residual market, or the "assigned risk pool." Through a triennial request for procurement, private insurers bid to provide coverage in the assigned risk pool at premium levels higher than are available in the voluntary market. Losses in the assigned risk pool are proportionally divided among the insurers in the voluntary market according to the insurer's premium volume market share. In 2008, the assigned risk pool comprised 3.7% of the private market by premium volume.[2]

Due to insurers' investment of capital and commitment to the State, the Illinois workers' compensation market has increasingly extended voluntary coverage offers to employers. The size of the assigned risk pool as a percentage of the total market premium volume has declined since 2003. *See* Table 1.

Table 1: Relative Size of Assigned Risk Pool

Year	Percentage of market
2003	11.6%
2004	9.5%
2005	7.6%
2006	5.4%
2007	4.7%
2008 (preliminary)	3.7%

Source: *NCCI Annual Statistical Bulletin 2010 Edition*, exhibit XIII.

The Role of the National Council on Compensation Insurance

The National Council on Compensation Insurance ("NCCI") is an advisory organization providing workers' compensation rating information for at least 37 states. All companies that write Workers' Compensation insurance in Illinois are members of NCCI and report data to NCCI on the frequency and severity of injuries in employee classes. Based on this information, NCCI issues advisory rates.

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[1] *Report on Profitability by Line by State in 2008*, NAIC (2009) pp. 127-28.
[2] *NCCI Annual Statistical Bulletin 2010 Edition*, NCCI (2010), exhibit XIII.

NCCI divides workers into 440 national classifications (which might not be used in every state) and 413 "state special" classifications (which might be used in more than one state). NCCI analyzes the incidence of workplace injuries and associated costs within each of those classes. Based on the collected data, NCCI calculates a loss cost (pure losses) and an advisory rate (losses plus expenses) in each classification. NCCI provides a single loss cost and advisory rate filing in Illinois in support of insurer pricing accuracy and to enhance insurer competition.

The customers of each individual insurer will likely be charged a rate that deviates from the NCCI advisory rate. Any one employer will be charged by an insurer based on past claims experience and other employer-specific factors.

Rate Changes

Workers' compensation covers classes of employees in the State with different premium rates based on the risk and projected cost of injury. Some jobs, like auditors, attorneys, and architects, have a low risk of being injured on the job, and consequently workers' compensation rates for those professions are low. In contrast, ironworkers and loggers are more likely to be injured and more expensive to insure.

The experience of any individual employer with workers' compensation may be very sensitive to rate movement in a single employee job classification and not reflective of aggregate statistics. In 2010, NCCI advisory rates are, on average, 17.45% higher than 2004 rates. Assigned risk market rates are, on average, 28.07% higher than 2004 rates. *See* Table 2.

Table 2: Rate Changes in Illinois 2005-2010

Voluntary Market Rate Changes				Assigned Risk Market Rate Changes			
Effective Date	**Average Advisory Rate Change**	**Cumulative Effect on 2004 Premium**	**Cumulative Change since 2004**	**Effective Date**	**Average Advisory Rate Change**	**Cumulative Effect on 2004 Premium**	**Cumulative Change since 2004**
2004		$100	0.00%	**2004**		$100	0.00%
1/1/2005	+0.1%	$100.10	0.10%	**1/1/2005**	+4.0%	$104.00	4.00%
1/1/2006	+6.3%	$106.46	6.46%	**1/1/2006**	+6.3%	$110.55	10.55%
1/1/2007	0.0%	$106.46	6.46%	**1/1/2007**	0.0%	$110.55	10.55%
1/1/2008	+4.0%	$110.71	10.71%	**1/1/2008**	+4.0%	$114.97	14.97%
1/1/2009	+3.5%	$114.59	14.59%	**1/1/2009**	+3.5%	$119.00	19.00%
4/1/2009	+2.5%	$117.45	17.45%	**4/1/2009**	+2.5%	$121.97	21.97%
1/1/2010	0.0%	$117.45	17.45%	**1/1/2010**	+5.0%	$128.07	28.07%

Source: NCCI, Illinois Market Rate Filings (2010).

Competition in the Illinois Market

In 2009, 311 licensed companies collected workers' compensation premiums in Illinois.[3] Accounting for the licensed entities that are subsidiaries of holding companies or other insurers, 110 companies compete for 99.9% of the marketplace.[4]

In Illinois in 2009, the largest workers' compensation insurer had a market share of 11.76%. The top five firms controlled 44.58% of the market, and the top ten firms 57.53%.[5] The Herfindahl-Hirschman Index ("HHI") is a standard measure of market concentration used by the Department of Justice and the Federal Trade Commission. A market with an index below 1000 is regarded as "unconcentrated" by those agencies, between 1000 and 1800 as "moderately concentrated" and above 1800, a market is regarded as "highly concentrated."[6] In 2009, the HHI for the Illinois workers' compensation insurance market was 496. By contrast, the Illinois health insurance market HHI for 2009 was 2171.

This level of market competition compares favorably with neighboring states. According to 2009 data compiled and analyzed by the NAIC, 101 companies were offering workers' compensation policies in Indiana, 94 in Iowa, and 88 in Missouri.[7]

Table 3: Competition in the Insurance Market

State	Firms	Top 5 Market Share	Top 10 Market Share	Herfindahl-Hirschman Index
Illinois	110	44.58%	57.43%	496
Indiana	101	38.78%	54.43%	487
Iowa	94	39.51%	59.07%	466
Missouri	88	52.38%	68.26%	680

Source: *2009 Market Share Reports for Property/Casualty Insurance Groups and Companies, Workers' Compensation and Excess Workers' Compensation*, NAIC (2010).

Loss Ratios

A "loss ratio" is the percentage of a premium dollar paid in benefits on behalf of or to an injured worker. For example, a loss ratio of .81 means that a company is paying out 81 cents in benefits for every dollar of premium. A study released in December, 2010 by NCCI examined loss ratios

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[3] *Market Share Report of Illinois Licensed Property & Casualty Companies by line of business – 2009*, Illinois Department of Insurance, http://insurance.illinois.gov/Reports/Market_Share/MarketShare2009.asp, (2010), pp. 115-29.
[4] *2009 Market Share Reports for Property/Casualty Insurance Groups and Companies, Workers' Compensation and Excess Workers' Compensation*, National Association of Insurance Commissioners (NAIC) (2010), p. 30.
[5] *Id.*
[6] *Horizontal Merger Guidelines*, U.S. Departmentof Justice and Federal Trade Commission, April 2, 1992. http://www.justice.gov/atr/public/guidelines/horiz_book/hmg1.html
[7] *Id.*

in the 37 states where NCCI serves as an advisory organization.[8] In 2008, of those 37 states, Illinois ranked second-highest in loss ratio, with an observed loss ratio of 0.830, behind only Connecticut, at 0.831. In 2007, Illinois led the 37 NCCI states in loss ratio with a figure of 0.808.

Table 4: Workers' Compensation Insurance Loss Ratio

State	2008 Loss Ratio	2007 Loss Ratio
Illinois	0.830	0.808
Iowa	0.751	0.722
Indiana	0.706	0.678
Missouri	0.619	0.574

Source: *Policy Year Underwriting Results Using Data Valued as of December 31, 2009*, NCCI (2010).

Using the data reported by insurance companies to state regulators, the NAIC analyzed the aggregate loss ratios of the workers' compensation markets across all fifty states, plus the District of Columbia. The NAIC found that Illinois had the fifth-highest loss ratio in the country for 2008.[9] (See Appendix A for the full ranking).

Profitability

The NAIC will release the most recent report on estimated profitability of the Illinois workers' compensation insurance market in December, 2010. The 2009 NAIC profitability report (based on 2008 figures) ranked Illinois as the 45th most-profitable state for workers' compensation insurers, finding that that workers' compensation insurance was one of the least profitable lines of property/casualty insurance in the State.[10] Compared to neighboring states, workers' compensation insurance in Illinois was less profitable than in Indiana, Missouri, and Wisconsin, and as profitable as in Iowa. (See Appendix B for the full ranking).

We will be pleased to provide copies of any cited material. Please do not hesitate to contact me if you have additional questions or if the Department can be of further assistance.

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[8] *Policy Year Underwriting Results Using Data Valued as of December 31, 2009*, NCCI (2010).
[9] *Report on Profitability by Line by State in 2008*, NAIC (2009).
[10] *Report on Profitability by Line by State in 2008*, NAIC (2009) pp. 54, 127-28.

Appendix A: Loss Ratio of Workers' Compensation Line of Business – 2008

Rank	State	Loss Ratio
1	Ohio *	148.1
2	Washington	97.9
3	Arizona	85.4
4	Oregon	80.5
5	Illinois	77.6
6	Oklahoma	76.2
7	Iowa	75.6
8	New York	73.0
9	Maryland	72.7
10	Connecticut	72.4
11	South Dakota	72.0
12	Virginia	71.6
13	Idaho	71.2
14	Georgia	71.0
15	New Mexico	70.9
15	Montana	70.9
17	Minnesota	68.8
18	Delaware	68.0
19	North Carolina	65.9
20	Wisconsin	65.5
21	Massachusetts	65.4
22	New Jersey	65.3
23	New Hampshire	64.7
24	Tennessee	64.6
25	Pennsylvania	64.4
26	Vermont	64.1
26	Indiana	64.1
28	Michigan	63.1
29	Nebraska	61.6
29	Kentucky	61.6
31	Kansas	61.0
32	Missouri	60.9
32	Maine	60.9
34	Mississippi	60.1
35	Alabama	59.2
36	South Carolina	58.9
37	Utah	58.3
37	California	58.3
39	Colorado	55.4
40	Rhode Island	54.2
40	West Virginia	54.2
42	Louisiana	52.3
43	Arkansas	50.5
44	Texas	46.8
45	Florida	43.7
46	Wyoming	40.4
47	Nevada	40.2
48	Hawaii	38.4
49	District of Columbia	36.5
50	Alaska	34.8
51	North Dakota	21.0

* Results for Ohio do not take into account the large, State-run workers' compensation fund.

Source: *Report on Profitability by Line by State in 2008*, NAIC (2009), pp 127-28.

Appendix B: Profit on Workers' Compensation Insurance Transactions Line of Business as a Percentage of Earned Premium – 2008

Rank	State	Profit on Insurance Transactions
1	Ohio *	-59.7
2	Washington	-12.9
3	Oklahoma	-6.9
4	Georgia	-6.7
5	Arizona	-5.4
6	Illinois	-3.9
6	Iowa	-3.9
8	Idaho	-2.6
9	New York	-2.4
10	Wisconsin	-0.4
11	South Dakota	-0.2
12	New Mexico	0.1
13	Virginia	1.3
14	Delaware	1.4
15	Maryland	1.6
16	Connecticut	2.0
17	Colorado	3.2
18	Tennessee	3.3
19	New Hampshire	4.1
20	Minnesota	4.2
20	South Carolina	4.2
22	North Carolina	4.3
23	Massachusetts	4.7
23	Montana	4.7
25	New Jersey	4.9
26	Vermont	5.2
27	Oregon	5.4
28	Indiana	5.7
29	Mississippi	6.0
30	Kansas	6.2
31	Michigan	6.4
32	Pennsylvania	6.7
33	Utah	7.0
34	Louisiana	7.1
35	Rhode Island	7.6
36	Missouri	8.5
37	Nebraska	8.6
38	Maine	9.0
39	Alabama	10.3
40	West Virginia	11.5
41	California	12.2
42	Kentucky	13.4
43	Arkansas	14.3
44	Texas	14.8
45	Florida	14.9
46	District of Columbia	21.5
47	Hawaii	23.2
48	Wyoming	25.0
49	Alaska	25.7
50	Nevada	28.7
51	North Dakota	36.4

* Results for Ohio do not take into account the large, State-run workers' compensation fund.

Source: *Report on Profitability by Line by State in 2008*, NAIC (2009), pp. 127-28.