

## Will Reform Lure Carriers Back to Workers' Comp?

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When lawmakers passed the biggest workers' compensation package in a decade, they rejected rate regulation and bet that the reforms would spur vigorous competition and lower premiums.

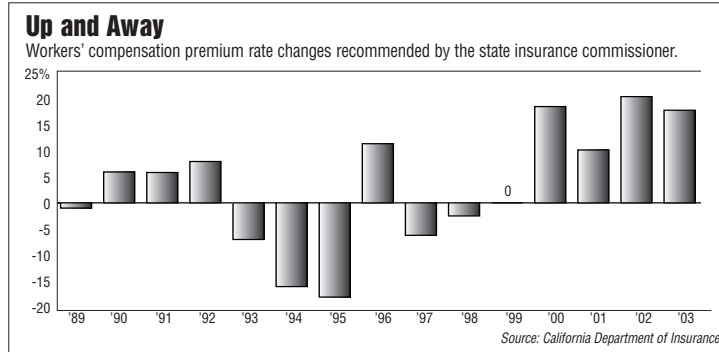
The question now is whether carriers are willing to take the gamble. Specifically, they will be looking for stable and predictable costs that allow them to accurately price their premiums.

"That has been the big problem for carriers in the state," said Nicole Mahrt, spokeswoman for the Western region of the American Insurance Association, a trade group. "Everybody's goal was to improve competition, but we really need to look at what this bill does."

It's too soon to tell if carriers will jump back into the \$20 billion market, but there are indications the reforms could bring some competition back – though it could take time.

First, state officials must write the regulations that will put many of the law's provisions in place. Then there is the question of how these reforms play out in the market, which is dominated by the State Compensation Insurance Fund, a public insurer whose past financial problems have given carriers pause.

Before new capital jumps into the marketplace through start-ups, and before big carriers such as **Liberty Mutual Group** increase their presence, the industry will closely evaluate the reform's effect on insurance writ-



ten under the new rules. That could take months or longer.

"A lot of companies are still on the sidelines and want to see the actual impact on loss cost," said Bob Farnam, an analyst with the **A.M. Best Co.** who covers the California marketplace.

### Once burned

When deregulation was implemented 10 years ago, the market looked like a winner. But a brutal price war broke out and ultimately drove more than two-dozen carriers out of business.

One area that was supposed to save money involved giving higher weight to the treating doctors' diagnosis. But costly legal battles ensued about whether that diagnosis was valid.

The latest reform package is supposed to remedy that and lower costs by allowing employers to set up an HMO-type panel offering employees a choice of doctors. But the regulation spelling out the kinds of doctors who will be allowed in is not yet written.

Another part of the reform is establishing a set of medical standards that would objectively determine the extent of a permanent disability. There's also a new requirement that insurers pay for

treatment immediately, before it's even proven that an injury is work-related. The concern is that workers seeking treatment for outside injuries might file bogus claims.

"How many of these cases will be filed frivolously? Historically it's been fewer than 1 percent," said Stanley Zax, chairman of **Zenith National Insurance Corp.**, one of the few companies that has been profitable with a big book of California business. "This is an extremely complicated system, and we are dealing with any extremely complicated set of changes."

Even so, Zax said one change could immediately lower rates – a provision that puts a two-year cap on temporary disability payments. But he added that other changes will await state rule-making and detailed analysis by experts.

The result will be that changes in rates and claims-loss history will gradually unfurl over months and years, and though it could lead to increased competition it could take time.

### 800-pound gorilla

Meanwhile, there is the state fund, which now has a 60 percent share of the market for companies that don't self-insure – up from 20

percent because so many private insurers got wiped out in the late 1990s.

State Insurance Commissioner John Garamendi traveled to New York earlier this year to convince big players such as **American International Group**, **St. Paul Travelers** and **Liberty Mutual** to increase their underwriting.

AIG, the largest insurer in the country, wrote only \$515 million worth of workers' compensation coverage in 2002, a 4.7 percent market share.

Garamendi said insurers told him that the size of the state fund, which wrote over \$5 billion in coverage in 2002, discouraged them from being more aggressive. If the fund were to fail, it would saddle existing market players with huge costs picking up the pieces.

Farnam said the fund appears to have increased its financial strength, reporting net income of \$712 million for 2003, up from \$26 million in 2002. That raised its surplus, a key indicator of an insurer's financial health, to \$2.1 billion from \$1.5 billion in 2002.

"Our market share is directly tied to the fact that some carriers did not charge enough and went insolvent," said Fund spokesman Jim Zalinski.

**Stan Long**, chairman of the workers compensation division at **Marsh Inc.**, the country's largest insurance broker, believes the fund may have to deliberately "shed business" for true competition to be restored. "It has the business now and you have to take it from them," he said.