NATIONAL UNDERWRITER

MarketStance

WC Insurers Need Lasers To Target Markets

BY FREDERICK YOHN

MarketStance isn't in the business of predicting election results. Phew! Early in 2000, however, we opined that the workers' compensation market was in recovery, but that it would be a slow, uneven one due to cooling economic conditions in many if not all parts of the United States.

The good news is that we were premature in forecasting a marked economic deceleration—the U.S. economy to date has shown a surprising degree of resilience. The bad news is that the outlook for the workers' comp markets in various states is, if anything, even more complex than we were expecting at the beginning of the year.

We should have listened to former U.S. Congressman Tip O'Neil. As with politics, workers' comp markets are, indeed, local. That is, while the tenor of the national economy undeniably has had an impact, it's the local politics—in this case, the by-class composition of each state's workers' comp exposures and loss experience—that has predominated in the determination of each state's exposure growth, pricing and market conditions.

For carriers looking to enter new states or to increase their writings in a target state, the compositional specifics of state workers' comp markets are all the more important.

Take Arizona and Nevada, for example. Payroll growth for 2000 and 2001 in both states is forecast to be at or near the top of the list—that's to say, annual rates of 7-plus percent. In terms of exposure growth, however, both states' rankings slip appreciably, albeit remaining within the top tier.

This performance disparity is due to the fact that these two states are experiencing deceleration in construction activity, which, in turn, is restraining total workers' comp exposure growth.

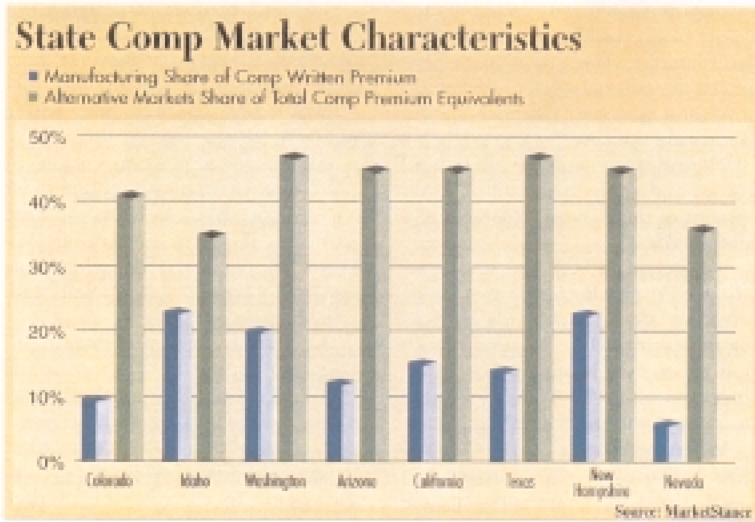
Indeed, much of the strength in these states' forecasted payroll growth is concentrated in "plain vanilla" workers' comp classes, which tend to have much lower workers' comp rates—and, unfortunately, much more intense competition for the business. (Whoever would have predicted that carpal tunnel syndrome among croupiers could become a major issue in a state's workers' comp market?)

When ranked based upon forecast workers' comp exposure growth, Colorado and Idaho top the list with forecasted annual exposure growth of 7 percent or better for 2000-01.

You guessed it, much of this top-of-the-top-tier growth outlook is due to the continued strong outlook for construction activity in these states and their construction-related workers' comp classes.

All told, MarketStance estimates that construction workers' comp classes such as concrete work (Class 5215) and carpentry (Class 5403) account for 28 to 34 percent of these states' written workers' comp premium in 1999—from 4 to 10 percentage points above the national proportion.

In contrast with Arizona and Nevada, Washington, California, Texas and New Hampshire all have been pulled up in MarketStance's growth outlook by the acceleration in construction activity forecast for each of these states.



State Comp Market Characteristics

While this is certainly good news for carriers that focus on construction-related exposures, it could be problematic with respect to these states' loss cost outlooks since rapidly expanding construction activity tends to be one of the drivers of a run-up in loss costs and adverse reserving adjustments.

At the other end of the spectrum, Ohio, Maine, Mississippi and West Virginia owe their bottom-tier rankings—that is, with respect to workers' comp exposure growth—to the pronounced deceleration in these states' construction activity projected for this year and next by MarketStance.

The situation could be worse, however. These states already have below-average shares of their workers' comp exposures in construction classes, thereby muting to some extent the impact of the slowing in construction activity. (One moral here is to watch out for Nevada with its exceptionally high percentage of workers' comp premium in construction—39 percent—should this state's construction industry ever seriously decline.)

Exposure growth forecasts are all well and good, but how is a carrier, broker or agency to choose among the group of top-tier growth prospects in selecting expansion states?

Well, Tip's local politics maxim—that is, digging deeper into each state's workers' comp market characteristics—likely is a good start.

Carriers focusing exclusively on small-commercial accounts may want to steer clear of Nevada since less than 40 percent of its workers' comp exposures are in the small-commercial market size segment (the second lowest small-commercial share in the United States). On this basis, Idaho and New Hampshire both look considerably more attractive.

Do you have expertise in writing workers' comp for manufacturing risks? You may want to set your sights on Idaho, Washington and New Hampshire since manufacturing risks account for better than 20 percent of each state's total workers' comp premiums.

In addition, are you interested in writing larger, more complex accounts and working on alternative risk transfer? Then Washington and New Hampshire should be the most attractive, since MarketStance estimates that more than 45 percent of workers' comp premium equivalents in these states were handled via alternative markets last year.

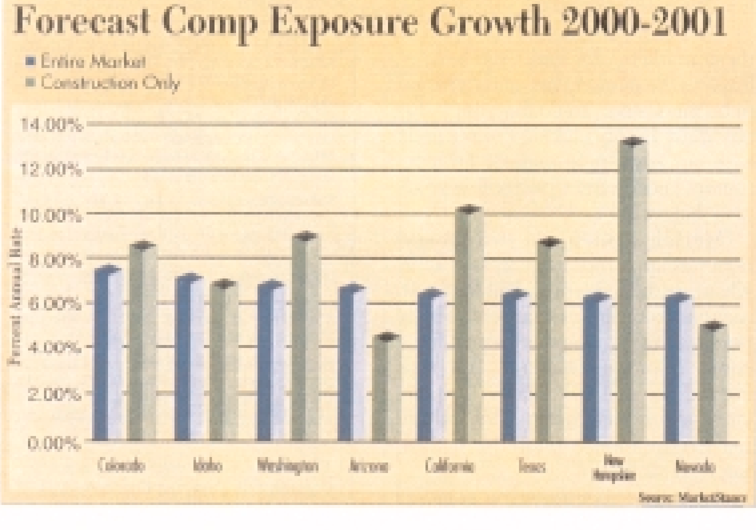
The by-class composition of these states' workers' comp exposures can be an important issue in other respects—ones that can temper the siren call of fast growth.

For carriers, the similarity of one state's expanding workers' comp business to the rest of the United States can be a major determinant of the extent to which key competitive technologies such as loss control, pricing and reserving practices are readily transferable.

From this perspective, Idaho, Washington and Nevada give some cause for concern since the top 20 national workers' comp classes account for distinctly less-than-typical shares of these states' total workers' comp exposures.

Managing general agents and carriers that focus on a limited set of risk classes within each state likely would

(continued on page 22)



Forecast Comp Exposure Growth 2000-2001

FREDERICK YOHN IS THE PRESIDENT OF INTELLISTANCE LLC IN MIDDLETOWN, CONN., AND THE DEVELOPER OF "MARKETSTANCE," A PRECISION MARKET ANALYSIS TOOL FOR THE U.S. COMMERCIAL PROPERTY-CASUALTY INSURANCE MARKET AND A REGISTERED TRADEMARK OF INTELLISTANCE.

MARKETSTANCE

WC Insurers Need Lasers To Target Markets

(continued from page 3)

find each of these top-tier states to be conducive to specialization. All eight have within-state concentration ratios above the national average—that is, the top 20 workers' comp classes in each state account for more than 32 percent of the state's total workers' comp exposures.

However, these states still are below the concentration ratios of some East Coast states such as New York (41 percent) and Delaware (41 percent). By the way, one state to watch out for on this basis is Oregon—its within-state concentration ratio is only 23 percent.

Figures never lie, but liars know how to figure. Did Tip O'Neill say that, too? Well, in any event, he certainly was street-smart enough to know that even the best election forecasts provide only a part of the story.

Limited and imperfect as they may be, state-specific workers' comp market forecasts and market composition data can be invaluable. This is all the more so because they provide carriers and agencies with the basis for a discipline of proactive, state-specific coordination of activities in their various commercial lines marketplaces.

If Tip were here, he'd almost certainly agree that only dummies forget to look at pre-election polling figures until after the final election results are in. But isn't that essentially what the insurance industry long has been accustomed to doing?

By the way, we've avoided mention of Florida in this analysis since even MarketStance is having trouble making sense of the figures coming out of that state. NU