Eight Straight Years of Workers Comp Profits:
What Could Go Wrong

Carrier Management

**Executive Summary: Workers compensation produced a combined ratio of 87 across the industry in 2022, Fitch Ratings Analyst James Auden reports in this summary of key drivers of underwriting profit for the line. Here, he notes that lower reported reserve redundancies and more market competition will likely reduce underwriting profits in 2023 and 2024. But it would take more pronounced price softening together with an unfavorable shift in loss costs to push the combined ratios above 95.
All eyes are on loss severity trends, particularly medical, while carriers continue to benefit from frequency declines which persist even though the pandemic has subsided.**

Chart 1

Top 10 Workers Compensation Insurance Writers

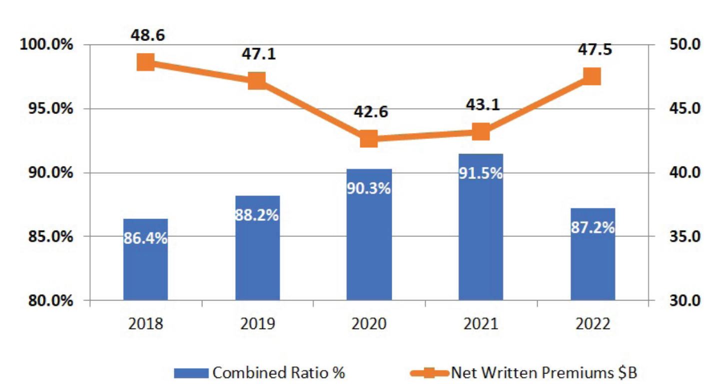
Rank	Company	NWP 2022 ($ Mil.)	NWP Change from Prior Year (%)	Market Share (%)
1	Travelers Companies, Inc.	3,445	6.8%	7.3%
2	Hartford Financial Serivces, Inc.	3,429	10.6%	7.2%
3	Chubb Ltd.	2,252	9.6%	4.7%
4	Berkshire Hathaway	2,065	6.4%	4.3%
5	Liberty Mutual Group	1,826	10.3%	3.8%
6	Amtrust Financial Services	1,740	30.3%	3.7%
7	Accident Fund Group	1,557	-4.9%	3.3%
8	W.R. Berkley Corp.	1,203	6.0%	2.5%
9	State Compensation Insurance Fund	1,165	-4.6%	2.5%
10	American Financial Group	1,155	8.3%	2.4%
	Industry	**47,510**	**10.1%**	

Note: NWP = Net Written Premiums
Source: Fitch Ratings, S&P Global Market Intelligence.

In contrast to personal lines and other major commercial insurance products, the top 10 workers comp carriers hold only 42 percent of the market. Market share is less concentrated for this line.

Chart 2

Workers Compensation Underwriting Performance



Source: S&P Global Market Intelligence. P/C Industry Aggregate

Recent increases in medical claims severity that may continue in a more fragile economic environment represent the greatest threat to future segment performance if left unchecked by a corresponding pricing response.

By James B. Auden

Workers compensation insurance stands out as the most profitable major U.S. commercial insurance product line over the last five years, bolstered by relative claims stability and enduring loss reserve strength.

Segment results remain persistently favorable despite recent negative pricing trends that run counter to a broader U.S. commercial lines hardening market cycle for the last four years.

Recent increases in medical claims severity that may continue in a more fragile economic environment represent the greatest threat to future segment performance if left unchecked by a corresponding pricing response.

Workers compensation is one of the largest individual commercial product lines in U.S. P/C insurance, with over $47 billion in 2022 net written premiums. The product is offered by a large number of insurers, and segment market share is less concentrated than personal lines or most other major commercial products as the top 10 carriers hold only 42 percent of 2022 market share led by large multiline writers: Travelers (7.3 percent market share), Hartford (7.2 percent) and Chubb (4.7 percent).

Benefits from prior market reforms and shifts in underwriting practices, combined with a long-term trend of claims frequency improvement related to advances in safety and risk management, contributed to the workers compensation line reporting an underwriting profit for eight consecutive years. The segment's average combined ratio was a stellar 91 from 2015-2022. (Chart 2, prior page)

While underwriting results were anticipated to decline moderately in 2022, the segment posted a highly profitable 87 combined ratio in 2022, with 10 percent growth in industry net written premiums fueled by insured exposure growth from favorable labor market conditions and wage growth.

Potential for large long-term workers compensation losses materializing from the coronavirus pandemic is proving to be less than initial projections. However, the pandemic did materially affect the workers compensation market in other ways. Changes in workplace dynamics and economic activity contributed to a sharp reduction in claims activity, and claims volumes remained down significantly as the pandemic subsided. Information in statutory filings shows industry workers compensation reported claims were still down 19 percent in 2022 from 2019 levels. A slower recovery in claims volume overall has a positive effect on year-to-year changes in incurred claims losses. (Chart 3)

The long period of strong workers compensation profitability coincides with an extended period of highly favorable loss reserve experience. On a calendar-year basis, prior period favorable reserve development averaged nearly 14 percent of earned premiums for the last six years (2017-2022). For the same period, all lines combined for the property/casualty industry reported average favorable development of 1.2 percent of earned premium. In 2022, workers compensation favorable development was down slightly to 12.6 percent of earned premium. (Chart 4)

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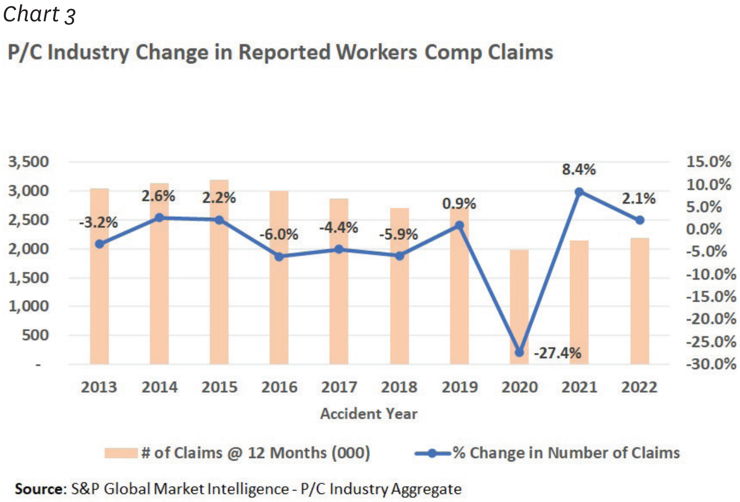
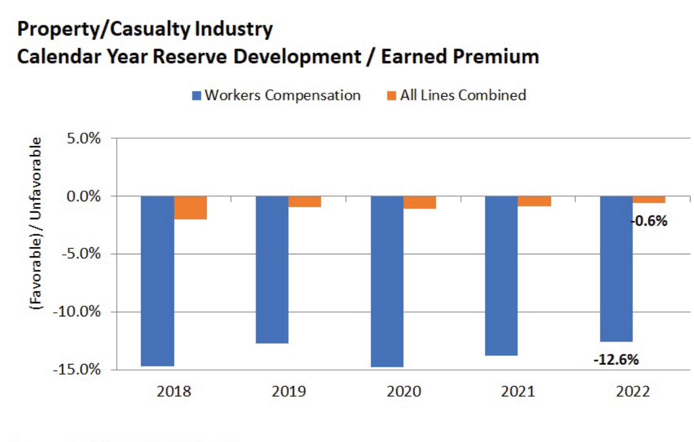
Chart 3



Pandemic impact and beyond: Accident-year claims volume in 2022 remained 19 percent lower than 2019.

Chart 4



Workers comp driving industry reserve redundancy. Prior-period favorable reserve development averaged nearly 14 percent of earned premiums for calendar years 2017-2022. In the same years, the P/C industry reported average favorable development of just 1.2 percent of earned premium.

Outside of workers compensation, the industry reported $1.2 billion of adverse development in 2022 for all other lines.

On an accident-year basis, workers compensation carriers continue to report initial loss and loss adjustment expense ratios that prove redundant as loss experience ultimately emerges. In particular, accident years 2014-2017 have each generated over 11 percentage points of favorable development from original loss estimates. Accident years 2018-2021 have also experienced more modest redundancies since inception that may continue over time. (Chart 5)

Year-end 2022 industry workers compensation loss reserves are anticipated to generate future significant redundancies, but perhaps at a reduced magnitude from past highly favorable results. Analysis of industry figures shows items including incurred but not reported levels relative to total incurred losses and reserves held per outstanding claim at marginally less robust levels for the 2022 accident year versus the recent past.

Lower reported reserve redundancies and heightened market competition will likely reduce underwriting profitability in 2023 and 2024. However, a more pronounced market price softening and an unfavorable shift in loss costs would be required to move the segment to a combined ratio above 95 or to a future underwriting loss. Overall segment financial performance will also see offsetting benefits to lower underwriting profits from higher portfolio yields that promote expansion of investment income.

Premium growth is anticipated to subside as an economic slowdown reduces the rate of exposure increases. Revenues will also be constrained by less favorable pricing trends. The Council of Insurance Agents & Brokers Quarterly Commercial Market Survey indicates that workers compensation renewal rate changes averaged approximately -1 percent for the last six quarters from third-quarter 2021 through fourth-quarter 2022. In the same period, Council survey data show overall commercial insurance rates increased by an average of 8 percent. (Chart 6)

Market pricing is anticipated to decline further. Large broker Willis Towers Watson's latest Marketplace Realities report projects marketwide workers compensation rate changes of between -5 percent and +2 percent for the remainder of 2023.

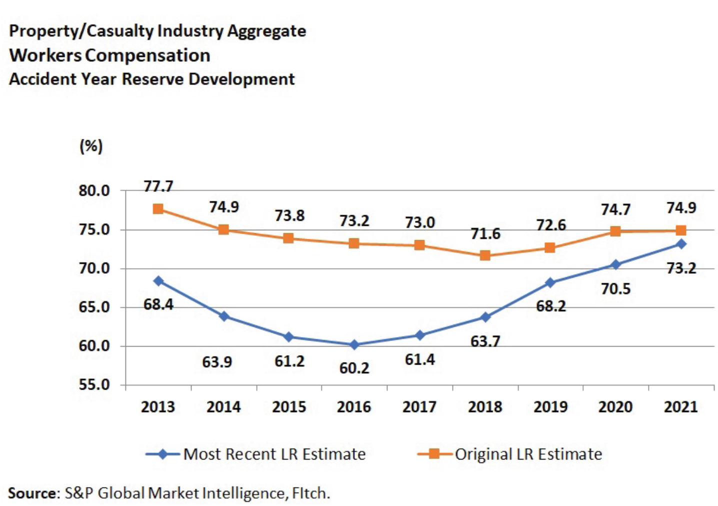
Past wider adverse swings in segment performance have coincided with persistent negative pricing trends combined with volatility in loss severity.

Workers compensation carriers are likely to continue benefitting from stable or favorable claims frequency trends. NCCI Holdings Inc.'s annual State of the Line report indicated lost-time claims frequency was down 4 percent in 2022. But a return of higher overall inflation that is proving more challenging to reverse for economic policymakers is now influencing workers compensation loss severity.

Indemnity claims severity increased by 6 percent in 2022 compared with -0.5 percent in the prior year, according to NCCI. Premium volume is more likely to offset indemnity changes as wage and payroll exposure bases also expand.

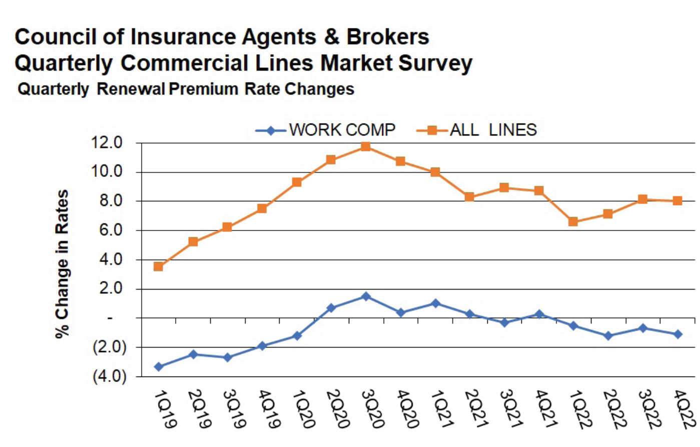
Changes in medical inflation are of greater concern as NCCI reports a projected 5 percent increase in 2022 medical severity, compared with a -1.5 percent change in 2021. Pressure on medical costs from sources including health care provider salaries, pharmaceutical costs, and usage of medical facilities and technology are likely to promote higher claims severity near term. CM

Chart 5



Accident years 2014-2017 have each developed more that 11 points favorably over time.

Chart 6



Workers comp pricing change was negative in four of the last five quarters.