



ASPEN OPINION

WORKERS' COMPENSATION: THE SEVERITY GAP



Hugh Murphy, Casualty Underwriter with Aspen Re, comments on the gap between improving insurance and deteriorating reinsurance results that is now visible in the U.S. workers' compensation

business line. While overall loss frequency has trended downwards, he cautions against unbridled optimism, since these results mask a trend towards higher severity and a higher frequency of the largest losses that tend to have a greater impact on excess-of-loss reinsurers.

Construction Boom

Prior to the natural catastrophes of 2017-18, the U.S. had already been experiencing a construction boom, which was underpinned by optimism concerning President Trump's infrastructure plan. Hurricanes Harvey, Irma, Maria and Florence, as well as the 2017 and 2018 wildfires, caused widespread devastation and spurred further construction growth in many states including Florida, Texas and California.

This boom in construction has resulted in a labor shortage and, more particularly, a shortage in experienced skilled labor due to many workers taking the decision following the 2008 recession to leave the industry for good. Seasonally-adjusted

data shows average job openings in 2018 up 5 percent on the 2017 average and 8 percent above the 2016 average. According to the latest Commercial Construction Index report, the fourth quarter of 2018 marked the seventh successive quarter in which the availability and skill of workers was a chronic concern for construction managers. Indeed, since the fourth quarter of 2017 (when the majority of natural disaster damage occurred), a growing number of construction managers have indicated that finding skilled workers had worsened in the previous six months.¹ With a continued strong pipeline of work, the construction manager's challenge is how to do more with less.

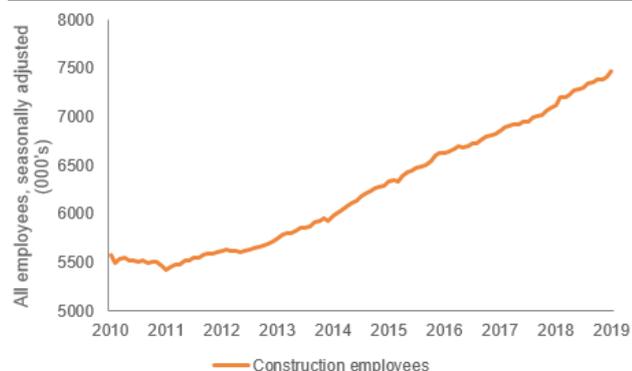
In many instances, this challenge is being met through the hiring of unskilled workers with less provision being made for supervision and having less regard for safety precautions. The risk exposure has increased but more particularly for excess-of-loss reinsurers. According to cedants, catastrophic falls from height comprise one of the largest workers' compensation loss categories, usually from a single or two-storey building, and in the vast majority of cases, concern a worker who has been in the job for less than six months.

The most recent data from the National Council on Compensation Insurance confirms that there was an uptick in the number of mega-claims (actual or estimated in excess of US\$10 million) in the accident-year 2016 with more evaluated at 24 months than in the previous 15 accident-years at a comparable maturity.² The analysis shows that more than two-fifths of losses are from the construction industry and falls from height are the cause of injury in almost a third of cases.³ The carpentry sector reported the most mega-claims in the period 2001-2015, with roofing ranked third in this list.⁴ Anecdotal

Continued overleaf



CHART 1: SEASONALLY-ADJUSTED EMPLOYMENT



Source: <https://data.bls.gov>

evidence suggests that carpenters have expanded their remit and have taken on occasional roofing work but lack sufficient knowledge of safety procedures and best practice. Indeed, inadequate fall-protection in construction is the most common U.S. safety violation across the entire workforce.⁵

The majority of mega-claims include damage to the central nervous system, which requires round-the-clock medical care. High medical care costs are compounded by long life expectancy due to many of the casualties being in their twenties or thirties at the time of the accident.

Costs of Medical Care

The good news is that considerable advances in medical technology, as well as procedures for such trauma cases, and burns injuries, have considerably enhanced survival rates in the last decade. The costs, however, for the reinsurer can be considerable. Deaths from burns have decreased by almost a quarter in the U.S. in the 15-year period to 2015.⁶ Those victims with 40-50 total body surface area (TBSA) burns have a 70 percent survival rate, while those with 90-100 percent TBSA burn injuries have an 11 percent survival rate.⁷ Claims can quickly spiral: at US\$100,000, the average cost of a burns-related hospital stay is more than twice that of a non-burns-related stay.⁸ Indeed, a stay at a center of excellence for burns treatment can cost as much as US\$100,000 per day.⁹

Trauma cases echo a similar story; rapid response times and the quality of hospital and home care can lead to a greater life expectancy for a casualty with paralysis than an able-bodied individual. The daily financial outlay in terms of lost time, medical and pharmaceutical costs may well be considerable.

Opioid Use

The complications around these claims can significantly increase in cost over time. Opioid use and abuse can add a layer of complexity which makes the claim difficult to close and may result in losses extending over many years, potentially totaling in excess of US\$1 million. Opioids can be prescribed

for fairly minor afflictions but can quickly lead to addiction. Such dependence may, therefore, extend recovery periods, delay the worker's return to work and diminish focus on non-pharmaceutical treatments such as rehabilitation. This may result in increased pharmaceutical costs, spiraling lost time payments and medical costs from treatment for comorbidities. While overall spending on opioids has reduced in the workers' compensation sector in the past five years, claims involving opioids use are more expensive and on average take twice as long to settle, thus reflecting the trend towards lower frequency and higher severity which has been observed in workers' compensation claims.¹⁰

The use of marijuana for both recreational and medicinal purposes is another emerging drug-related issue driving severity in workers' compensation. It is currently legalized for medicinal and recreational use in 33 states and 10 states, respectively. The key workers' compensation issue concerns auto accidents which are the biggest single cause of mega-claims. Catastrophic injuries from auto accidents are not limited to the heavier hazard group classes and are, therefore, harder to price – an office worker has the same chance of suffering a car crash as a demolition expert. With regard to marijuana, road accidents are as much as 6 percent higher in states that have legalized marijuana than in neighboring states where it is prohibited.¹¹ Unlike alcohol, testing is tricky as the amount of tetrahydrocannabinol (THC), the primary psychoactive component of cannabis, does not necessarily correlate with impairment (i.e. impairment may be high, while THC levels are low and vice-versa). Additionally, legal precedent is mixed with respect to marijuana use; some appeals courts have ruled that workers who have tested positive for marijuana following an accident are entitled to workers' compensation benefits, while others have allowed companies to terminate the employment of such workers.

Optimistic Outlook

The disparity between improving primary results and increased volatility is a challenge for reinsurers. Increasing employment, a scarcity of skilled labor, more advanced and more costly medical care, as well as the impact of both medical and recreational drugs, have all played a part in the increasing frequency and severity of larger workers' compensation claims. It is important to hold the line on reinsurance rates, particularly in the face of declining subject premiums. In the first instance, real importance and scrutiny should be placed on the employers' risk management measures, e.g. training, safety measures and hiring procedures. Reinsurers should also look for cedants with a proactive claims department that has a responsive attitude to reserving. This should encompass an assiduous cost management approach which seeks to address the costs of medical and pharmaceutical billings in particular.

A thriving construction sector, increased life expectancy and the accessibility of drugs to manage chronic pain are all reasons to be optimistic. So long as an appropriate approach is taken to these emerging trends, reinsurers should be able to share in this optimism.

¹ www.uschamber.com

² www.ncci.com

³ *ibid*

⁴ *ibid*

⁵ www.osha.gov

⁶ <http://www.dupont.com>

⁷ *ibid*

⁸ *ibid*

⁹ <https://www.researchamerica.org>

¹⁰ <https://www.irmi.com>

¹¹ www.iihs.org