

STATE OF THE SYSTEM

WCIRB REPORT ON THE STATE OF THE CALIFORNIA WORKERS' COMPENSATION INSURANCE SYSTEM

Introduction

The workers' compensation insurance system in California is over 100 years old. It provides workers' compensation insurance coverage to more than 500,000 employers while delivering medical and wage replacement benefits to almost 800,000 injured workers annually. The Workers' Compensation Insurance Rating Bureau of California (WCIRB) is a licensed rating organization and the California Insurance Commissioner's designated statistical agent. As such, the WCIRB monitors the health of the workers' compensation system and makes its data and analysis available to system stakeholders and public policymakers.

This report summarizes the state of the California workers' compensation insurance system as of mid-2015. The report is based on the experience of insured employers and does not reflect public or private self-insured employer data. In the report, we summarize the cost of workers' compensation insurance based on premiums paid by California insured employers, show how those premium dollars are distributed among various system cost components, and detail the key cost drivers in the system, such as the frequency of workers' compensation claims and the average cost of claims. We also provide a brief summary on how post-Senate Bill No. 863 (SB 863) costs are emerging compared to initial projections as well as a summary of insurer combined loss and expense ratios and returns on equity over time. When appropriate, throughout the report, we have included comparisons of components of the California system to the systems in other states. (Information regarding the sources of data used in our charts can be found on page 29.)

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EXECUTIVE SUMMARY

The WCIRB's 2015 State of the System Report summarizes the key components of the California workers' compensation insurance system as of mid-2015. Principal findings include:

- Written premiums in California continue to grow at a double-digit annual rate due to higher premium rates and to growth in insured payroll resulting from economic expansion and wage level increases.
- California has the highest premium rates in the country. California's high rates are largely driven by the highest frequency of permanent disability claims in the country, high medical costs per claim driven by a more prolonged pattern of medical treatments, and much higher-than-average costs of handling claims and delivering benefits.
- In both 2013 and 2014, 83% of total system costs were for indemnity and medical benefits incurred on behalf of injured workers and the cost of delivering those benefits.
- Recent increases in indemnity claim frequency that are counter to trends in other states are largely driven by increases in the Los Angeles Basin area.
- Even after adjusting for regional differences in wage levels and industrial composition, indemnity claim frequency in the Los Angeles Basin and San Joaquin Valley areas were approximately one-fifth higher than the statewide average and indemnity claim frequency in the Bay Area was approximately one-third lower.
- The average California medical benefit per claim is among the highest in the country with costs more than 90% above the countrywide median. However, recent favorable trends in California medical severities suggest that the differential will moderate.
- The high cost of medical benefits in California relative to other states is not driven by treatment costs early in the life of a claim, but rather by the length of time a claim remains open and medical benefits are paid.
- California has the highest ratio of loss adjustment expenses to losses in the country.
- While the cost of medical cost containment programs in California has grown and is among the highest in the country, average annual medical inflation in California workers' compensation since 2001 has been well below that of other systems, reducing total medical costs by billions from what they otherwise could have been.
- Senate Bill No. 863 impacts have generally been emerging consistent with initial WCIRB projections with potentially greater-than-projected savings in medical cost reductions offset in part by less-than-projected savings in reduced frictional costs.
- In recent years, California workers' compensation combined ratios have generally been higher and returns on net worth lower than countrywide averages.

EMPLOYER COSTS

“The cost of workers’ compensation benefits provided to injured workers is funded by over 500,000 insured employers conducting business in California.”

The cost of workers’ compensation benefits provided to injured workers is funded by insurance premiums paid by over 500,000 insured employers conducting business in California. Generally, all California businesses with employees must either purchase a workers’ compensation insurance policy from a licensed insurance company or be legally self-insured under the regulation and oversight of the California Department of Industrial Relations Office of Self Insurance Plans.

Insurance premiums paid by employers who purchase a workers’ compensation policy fund the cost of claims incurred during the policy period and related insurer expenses. Chart 1 shows the total premium generated by workers’ compensation insurance policies in California over time. (The premiums shown below do not reflect premium credits for policies that include deductibles.) Workers’ compensation premiums have grown by double-digit percentages over the last five years, increasing 11% from 2013 to 2014.

Chart 1: Reported Written Premium (Gross of Deductible Credits)

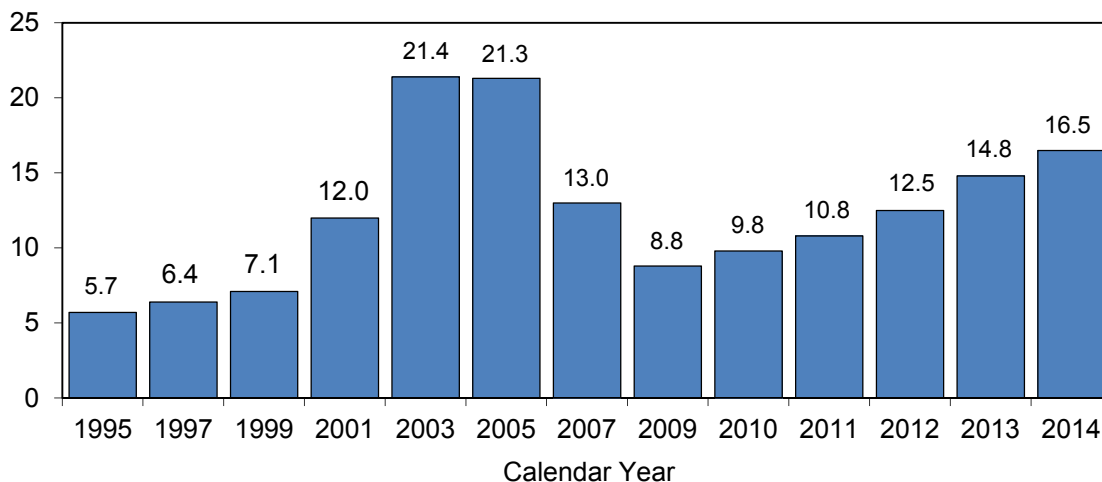


Chart 2 shows that California premium comprised more than one quarter of countrywide premium in 2014, which is up significantly from that of five years ago. In contrast, California workers make up about 12% of the countrywide workforce.

Chart 2: California Written Premium as a Percentage of Countrywide Premium



Chart 3 shows the makeup of the California workers' compensation market by type of insurer. While the market is primarily comprised of insurers who write significant business in other states in addition to California, the market share of California-focused private insurers has grown over the last several years.

Chart 3: Distribution of Written Premium by Type of Insurer

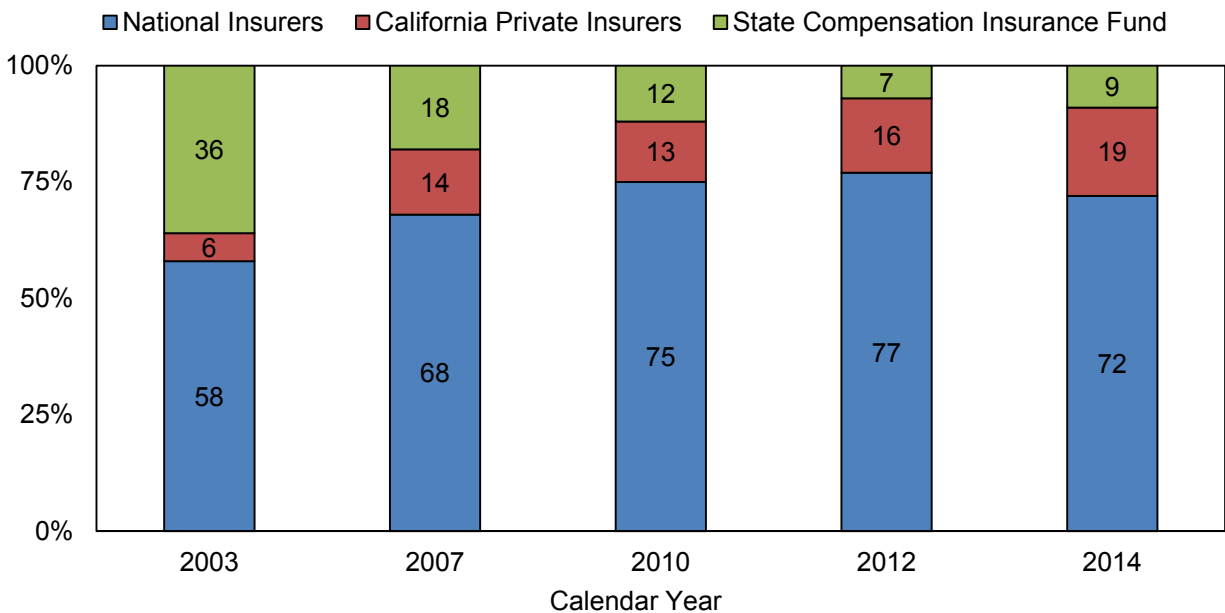


Chart 4 shows the amount of the 2012 through 2014 California premium increases attributable to insurer premium rate increases, economic expansion as reflected in both employment and wage level growth, and other contributing factors. Although the largest contributing factor to premium increases over the last couple of years has been increases in the rates charged by insurers, post-recession economic growth has become a relatively larger component of premium growth in 2014.

Chart 4: Components of Changes in Written Premium

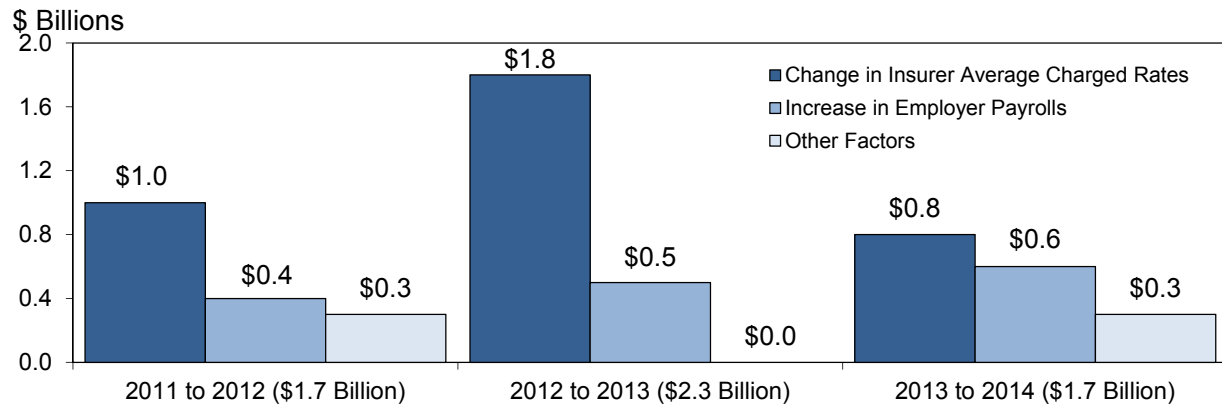
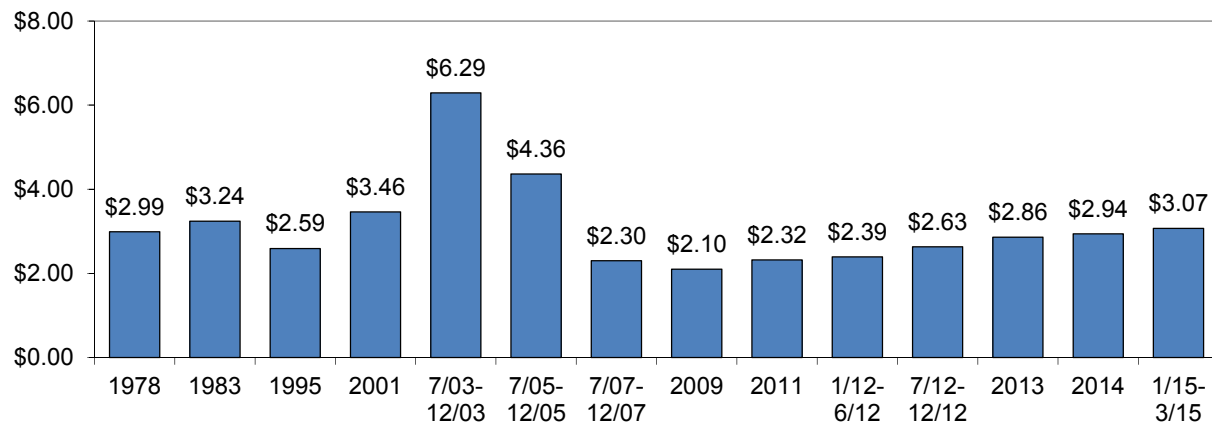


Chart 5 shows the average rates per \$100 of payroll charged by insurers in California. Insurer rates have been steadily increasing over the last few years. However, current rates¹ on average are not significantly different from rates charged in the late 1970s, as over the long-term, declining claim frequency has largely offset medical inflation and overall cost levels have grown at roughly the same rate as payroll levels.

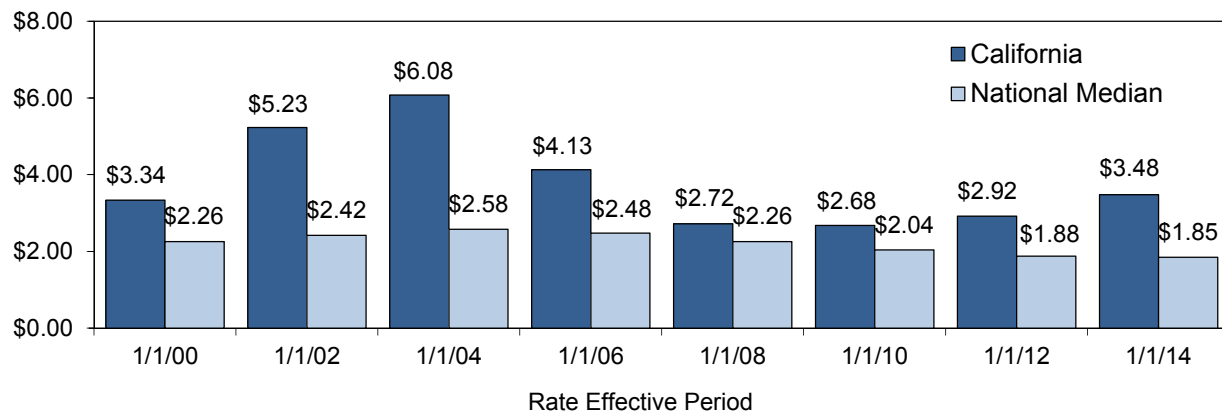
Chart 5: Average Charged Rates per \$100 of Payroll by Policy Period



¹ Since 1995, insurers file their own premium rates with the Insurance Commissioner that may in part be based on the advisory pure premium rates by classification approved by the Insurance Commissioner. Prior to 1995, the Commissioner approved a set of "minimum rates" by classification that were used by all insurers in the state.

Chart 6 compares the national median average charged rate, as reflected in the state of Oregon biennial study of workers' compensation rates, to the comparable average rate for California.² Typically, rates charged in California have been markedly higher than rates charged in other states and, in 2014, California is the only state in the study with an average rate over \$3.00 per \$100 of payroll. California's high rates are largely driven by the highest frequency of permanent disability claims in the country, very high medical costs per claim driven by a more prolonged pattern of medical treatments, and much higher than average costs of handling claims and delivering benefits.

**Chart 6: Rate Comparison Based on Oregon Studies
California vs. National Median Average Charged Rate**

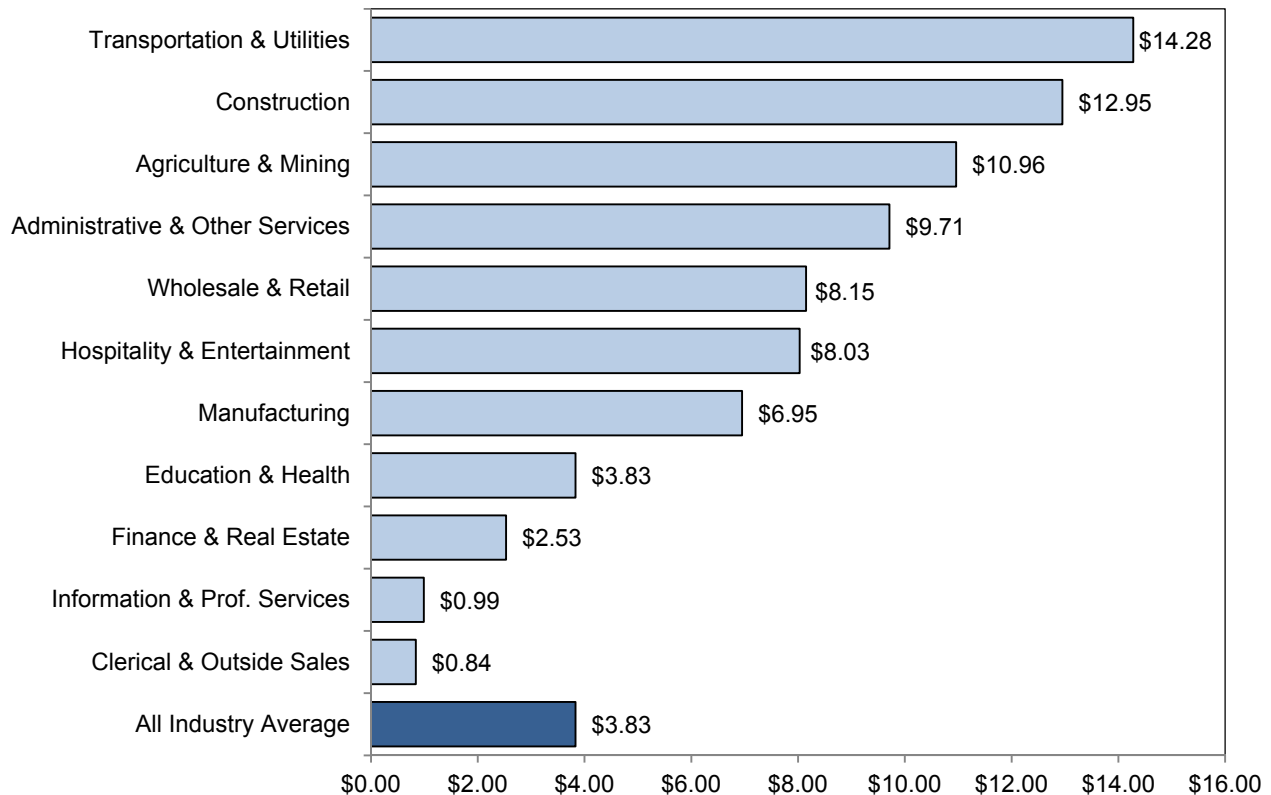


The statewide average rates discussed above are based on an average of rates for the approximately 500 industry classifications in California. The underlying claim costs and resultant rates among the individual classifications can vary significantly due to differences in the inherent risk of a workplace injury among various occupations. For example, the risk of injury for a clerical office employee is much different than the risk of injury for a construction worker.

² The average charged rates shown on Chart 6 for California are, for purposes of interstate comparison, based on the state of Oregon industrial mix and, as a result, are not comparable to other measures of average charged rates for California.

Chart 7 shows the average January 1, 2015 insurer filed manual rate³ based on insurer rate filings with the California Department of Insurance for classifications grouped by industrial sector. The average insurer filed manual rates for the clerical and information and professional services sectors are far below the all-industry average, while the average rates for the construction and transportation and utilities sectors are far above. These rates do not reflect any potential impact of the average 10.2% decrease in advisory pure premium rates approved by the Insurance Commissioner effective July 1, 2015.⁴

Chart 7: Average Insurer Filed Manual Rates per \$100 Payroll by Industrial Sector



³ Insurer manual rates are based on the rates by classification that an insurer files with the California Department of Insurance and form the basis for the premium that is charged on a workers' compensation policy. These rates differ from the average charged rates shown on Charts 5 and 6 in that the premium an insurer ultimately charges on a workers' compensation policy may reflect additional schedule credits or other premium adjustments applied by the insurer in accordance with their rating plans filed with the Insurance Commissioner.

⁴ The Insurance Commissioner's approved pure premium rates, which reflect loss costs including loss adjustment expenses per unit of exposure, are only advisory in that an insurer is not required to use either the approved pure premium rates or those proposed by the WCIRB in establishing the rates it will charge.

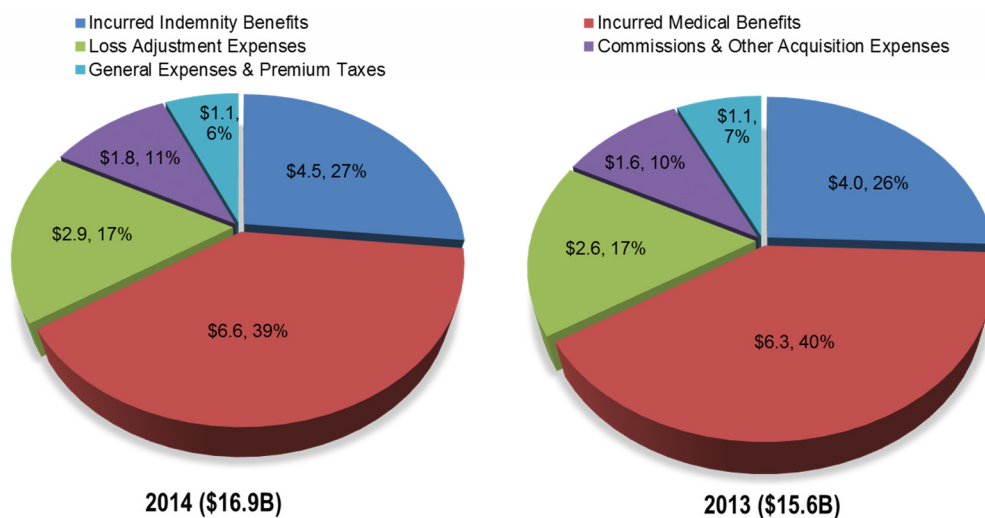
COST DISTRIBUTIONS

“The premiums paid by employers for workers’ compensation insurance policies primarily fund workers’ compensation benefits provided to their injured workers and the expenses insurers incur to deliver those benefits.”

The premiums paid by employers for workers’ compensation insurance policies primarily fund workers’ compensation benefits provided to their injured workers and the expenses insurers incur to deliver those benefits. These benefits include the cost of medical treatment for workers’ compensation injuries as well as indemnity benefits⁵ paid directly to injured workers.

Chart 8 shows the distribution of California workers’ compensation insured system costs incurred in 2014 by cost component compared to 2013. Injured worker indemnity and medical benefits currently comprise almost two-thirds of all system costs in both 2013 and 2014. The cost of administering those claims, or loss adjustment expenses, comprised an additional 17% of total system costs in both 2013 and 2014.

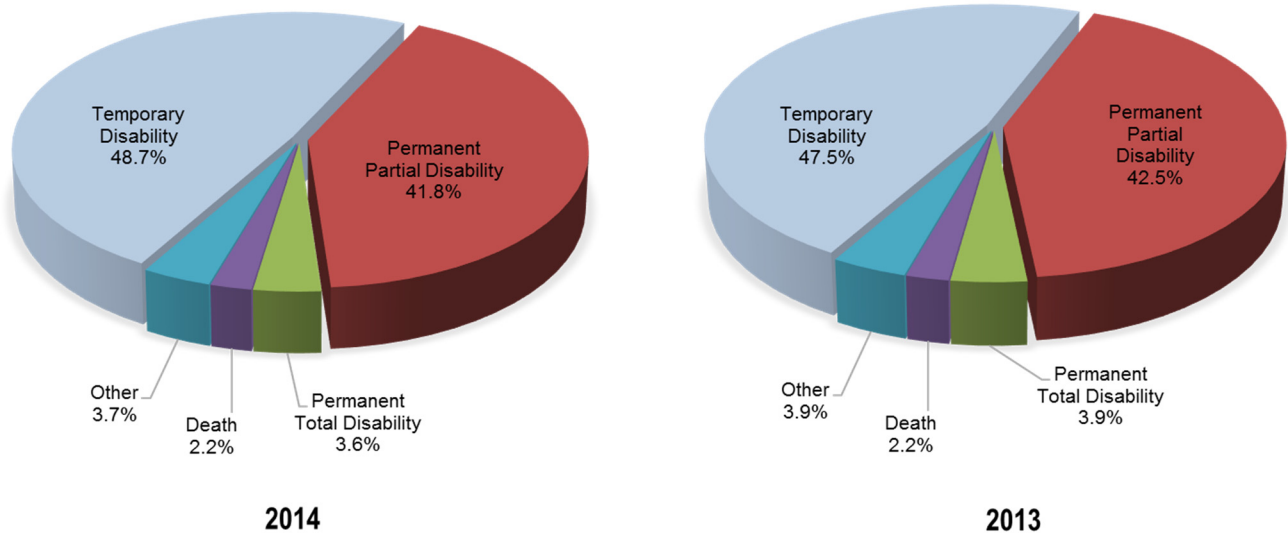
Chart 8: Distribution of Total Insured System Costs (\$'s in Billions)



⁵ Indemnity benefits are provided to injured workers or, in the case of fatal injuries, to their dependents to partially compensate for lost wages, with additional benefits provided if a worker suffers a permanent disability.

Chart 9 shows the distribution of indemnity benefits paid in 2014 by type of benefit compared to what was paid in 2013. Temporary disability and permanent partial disability benefits comprise the vast majority of indemnity benefits (approximately 90%).

Chart 9: Distribution of Indemnity Benefits Paid



Injured workers receive a variety of medical treatments, which include physician visits, prescription medications, and surgeries. Chart 10 shows the distribution of medical benefits paid in 2014 by type of service compared to 2013. The largest components of medical costs for both 2013 and 2014 are payments for physician services and payments made directly to injured workers, primarily for future medical services.

Chart 10: Distribution of Medical Benefits Paid

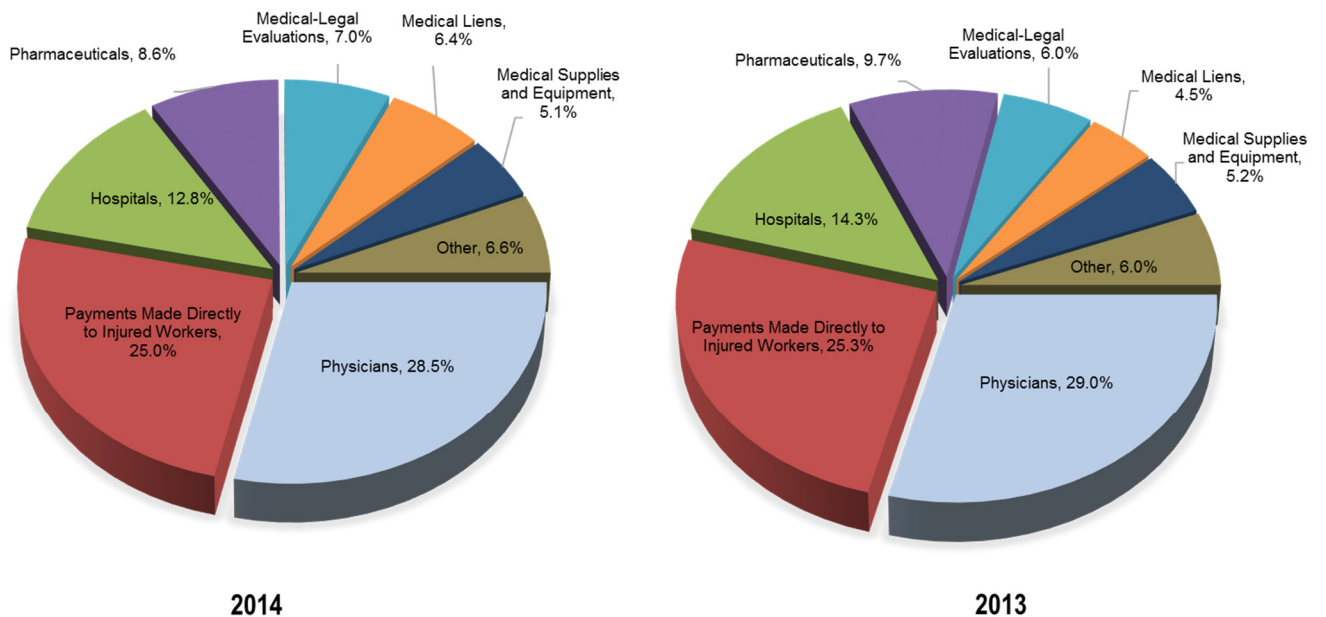
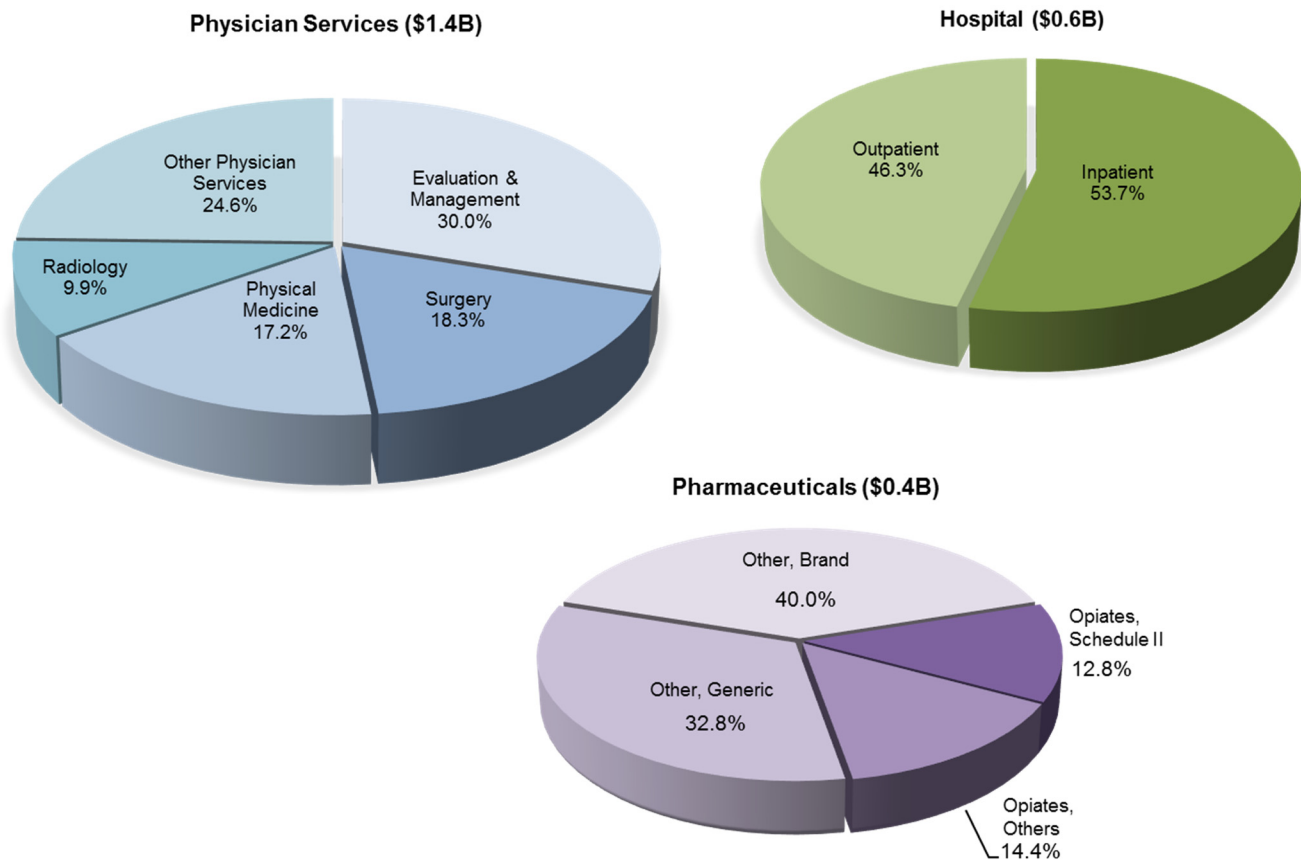


Chart 11 shows some of these categories of 2014 medical payments detailed further by type of medical service provided.

Chart 11: Detailed Distribution of Medical Services Paid in 2014



COST DRIVERS

“The cost of workers’ compensation benefits is primarily driven by the number of claims incurred and the average cost associated with those claims.”

The cost of workers’ compensation benefits is primarily driven by the number of claims incurred (claim frequency) and the average cost associated with those claims (claim severity). Costs can also be affected by how long claims stay open after the injury occurs. In addition, the cost of administering these claims, or loss adjustment expenses, is a significant driver of total system costs.

Claim Frequency

Chart 12 shows the long-term change in total claim frequency indexed to 1962. As in other states, until recently there had been a steady long-term decline in claim frequency in California, and total claim frequency is about one-fifth of its level of 50 years ago. This long-term decline in workers’ compensation claims is largely attributable to shift in economic activity in California from a more manufacturing-based “blue collar” economy to a more service-based “white collar” economy, trends toward increased mechanization within industries, and greater attention around workplace safety. This decline in claim frequency has been instrumental in offsetting long-term medical inflation and moderating workers’ compensation premium rate increases over the decades.

**Chart 12: Long-Term California Total Claim Frequency Indexed to 1962
by Policy Year**

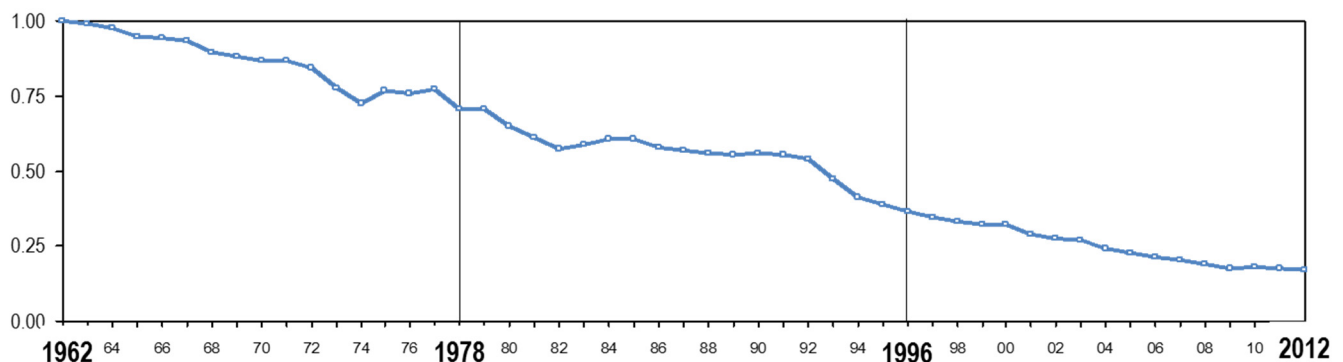
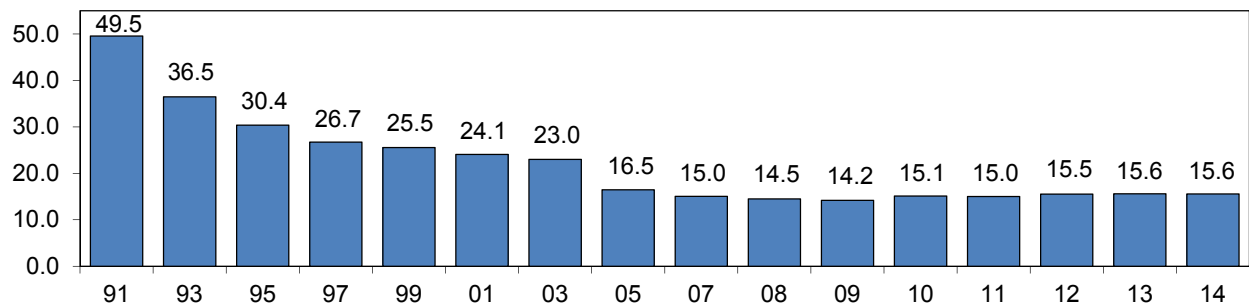


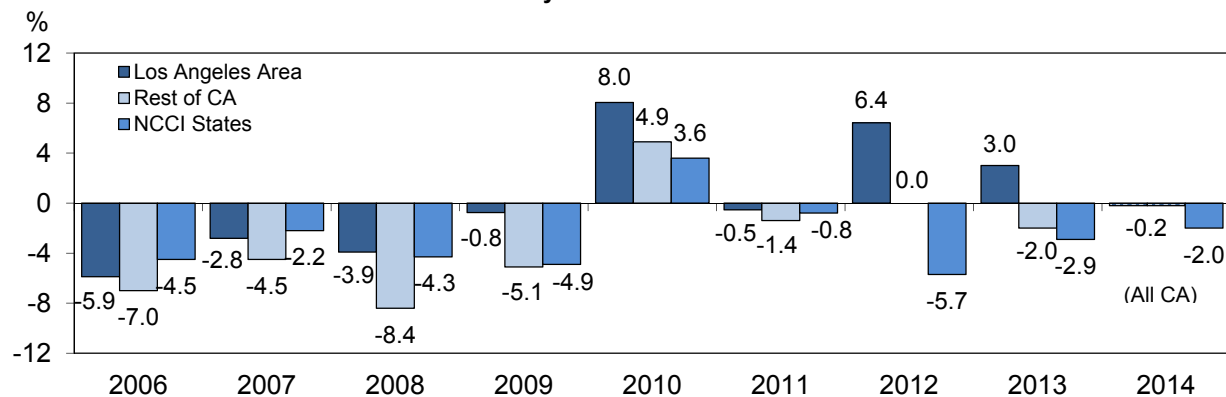
Chart 13 shows the estimated frequency of workers' compensation indemnity claims filed in California per 1,000 employees from 1991 through 2014. After a period of steady decline over many years, recently the frequency of indemnity claims in California has been increasing at a modest rate.⁶ Indemnity claim frequency in 2014 was about 11% above that for 2009. Preliminary first quarter information from accident year 2015 suggests a decline in indemnity claim frequency. At this time, it is not clear whether this indication is an anomaly or is indicative of a return to the decades-old pattern of declining claim frequency.

Chart 13: Estimated Indemnity Claims per 1,000 Employees by Accident Year



California's pattern of recent increase in indemnity frequency has not paralleled that in other states, nor has it been consistent throughout the geographic regions of California. Chart 14 shows estimated changes in indemnity claim frequency in both the Los Angeles Basin area and the remainder of California compared to a composite of frequency change estimates based on states reporting data to the National Council on Compensation Insurance (NCCI)—a nonprofit organization that provides a similar function to the WCIRB for many other states. For most years, California frequency changes had been comparable regionally within California and fairly similar to the NCCI composite measure. However, in the last several years following the post-recession frequency "bump" in 2010, indemnity claim frequency in the Los Angeles area⁷ has continued to climb, while indemnity claim frequency in other regions of California and in most other states returned to the long-term pattern of steady modest year-to-year decline.

Chart 14: Change in Estimated Indemnity Claim Frequency California Regions vs. NCCI States by Accident Year



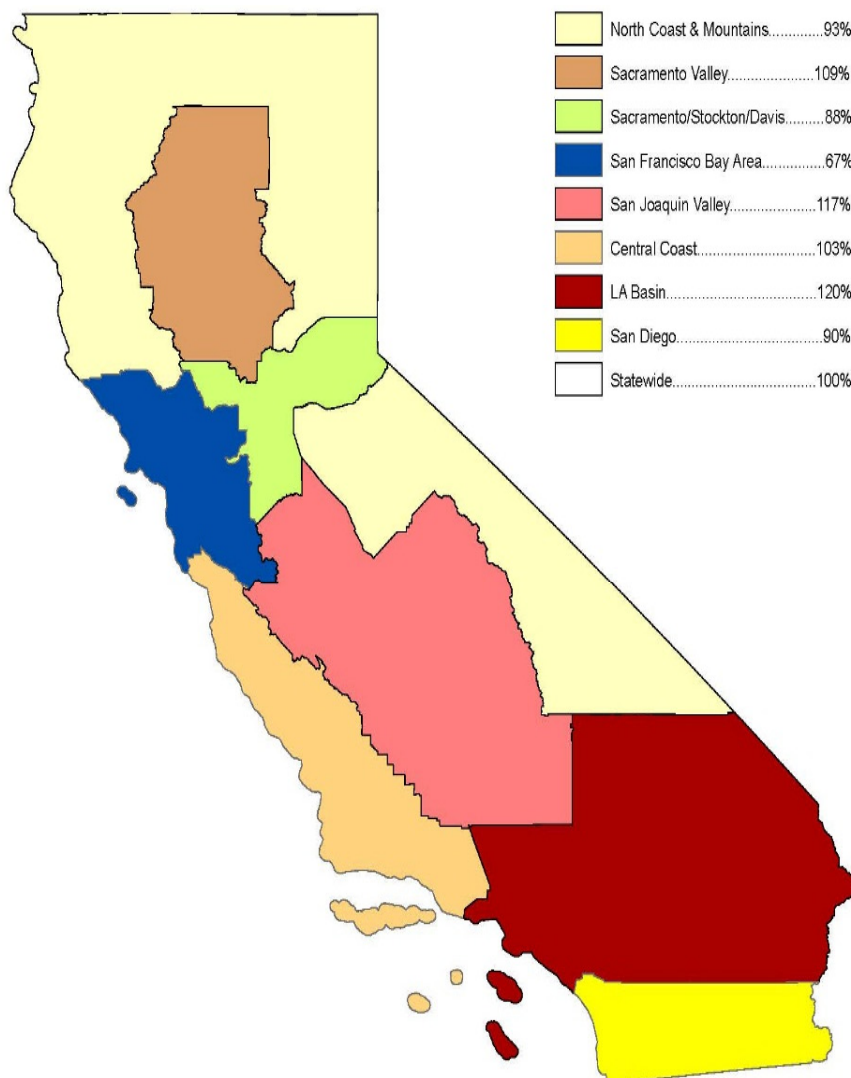
⁶ For more information on the recent indemnity claim frequency increases, see the WCIRB's *Analysis of Changes in Indemnity Claim Frequency – January 2015 Update Report*, released January 2015.

⁷ The "Los Angeles area" shown on Chart 14 represents Los Angeles County, Orange County, Riverside County, San Bernardino County, and Ventura County.

As shown in Chart 14, the frequency of claims can differ across the various regions of California. Some of this regional differential in claim frequency can be attributed to the mix of industries within a geographic area as well as regional differences in wage levels. The WCIRB is in the process of researching differences in claim frequency and other cost drivers across the various regions of California.

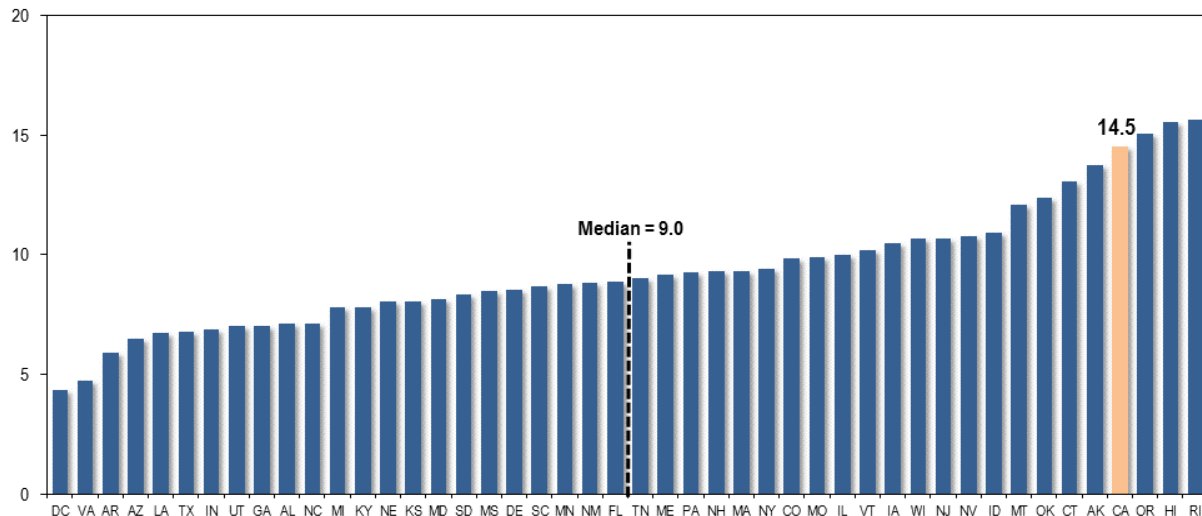
Chart 15 shows the indemnity claim frequency on policies incepting between July 1, 2012 and June 30, 2013 adjusted for wage level for a particular region as a ratio to the indemnity claim frequency for that region expected based on its industrial mix. Indemnity claim frequency in the San Francisco Bay Area is much lower than what would have been expected based on its particular mix of industries while indemnity claim frequency in the Los Angeles Basin and the San Joaquin Valley is much higher. In particular, the frequency of permanent partial disability claims—including those involving cumulative injuries or multiple injured body parts—is highest in the Los Angeles area.

Chart 15: Indemnity Claim Frequency by Region
Actual to Expected Indemnity Claim Frequency
Adjusted for Regional Wage Differentials and Industrial Mix



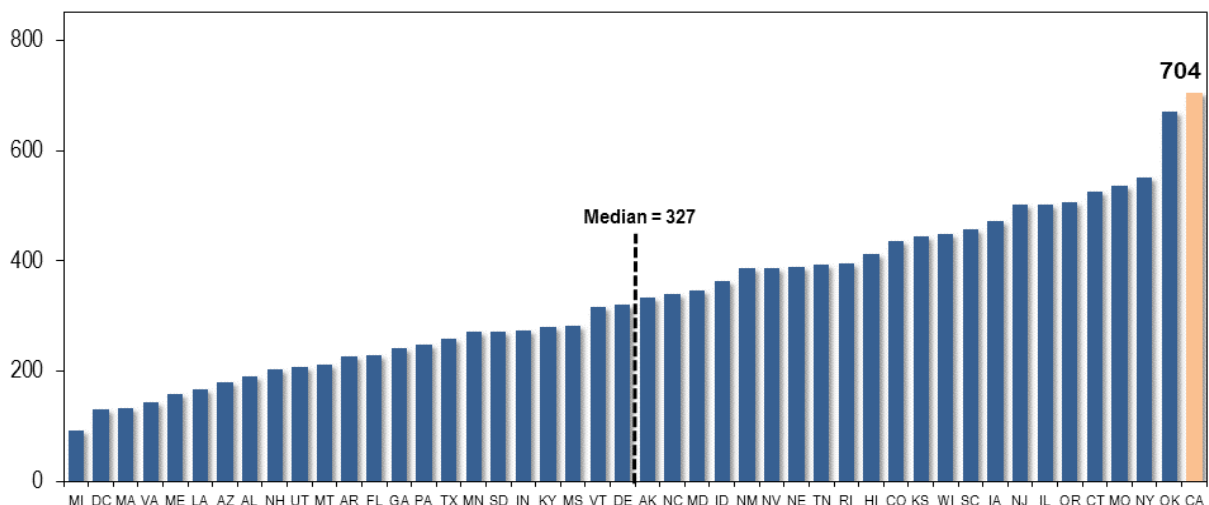
Indemnity claim frequency in California is higher than in most other states. Chart 16 shows indemnity claim frequency per 1,000 workers across the country, ranking California as the 4th highest state, with an indemnity frequency rate more than 60% higher than the median state.

Chart 16: Countrywide Estimated Indemnity Claims per 1,000 Employees



Many workers injured at the workplace will suffer some form of permanent disability, and claims involving permanent disability generate the vast majority of costs in the system. Chart 17 shows the frequency of permanent partial disability claims per 100,000 workers. California has the highest permanent disability claim frequency in the country, which is more than twice the countrywide median. California does not have a particularly more hazardous industrial mix yet has a significantly higher rate of permanent disability claims than other states, including those that utilize the American Medical Association (AMA) Guides 5th Edition to determine permanent disability ratings similar to California. As a result, the differences from other states appear to be more related to the interpretation and application of California's Permanent Disability Rating Schedule rather than the California industrial mix or the actual AMA Guides upon which the Schedule is predicated.

Chart 17: Countrywide Permanent Partial Disability Claims per 100,000 Employees



Claim Severity

In addition to the number of claims filed, the average cost, or “severity”, of claims is also a driver of workers’ compensation system costs. Chart 18 shows the average cost of indemnity benefits per indemnity claim. While indemnity costs per claim have more than doubled over the last 20 years, average indemnity costs had recently been fairly stable up until 2014. Average indemnity costs per claim in 2014 are about 8% higher than in 2013, which is primarily attributable to SB 863 increases to permanent disability benefits effective in 2014.

Chart 18: Estimated Average Indemnity Cost per Indemnity Claim by Accident Year

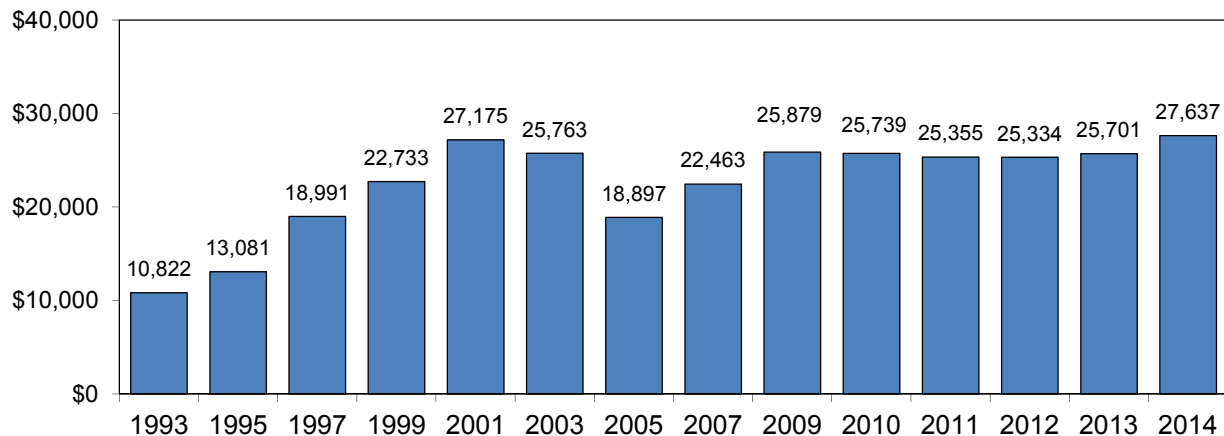


Chart 19 shows changes in average indemnity costs for California compared to those for the composite of NCCI states. Changes in average indemnity costs per claim in California have generally been consistent with countrywide indemnity cost changes from NCCI in recent years.

**Chart 19: Estimated Change in Indemnity Claim Severity by Accident Year
California vs. NCCI States**

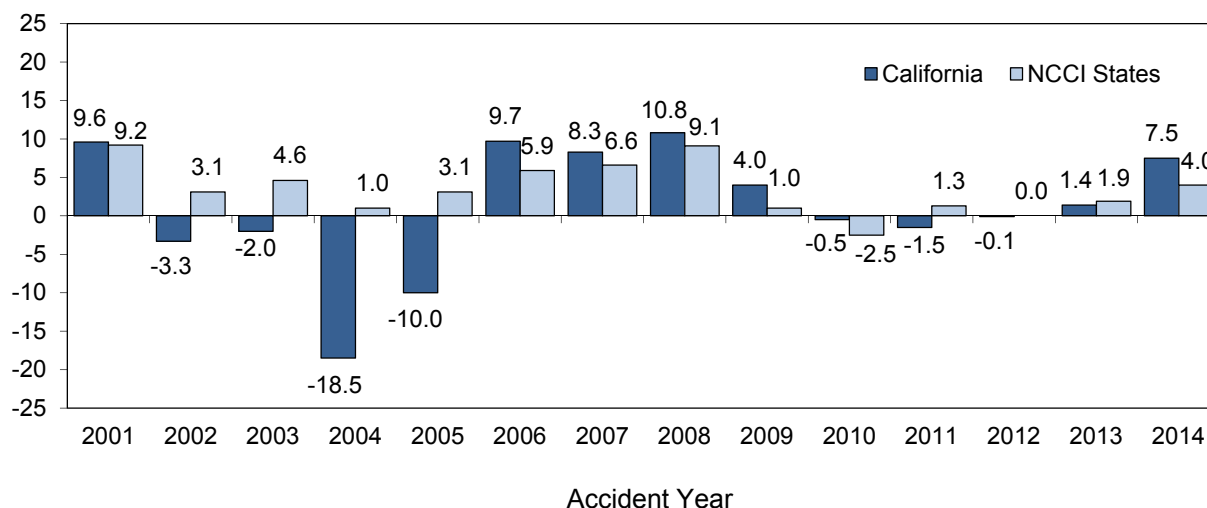
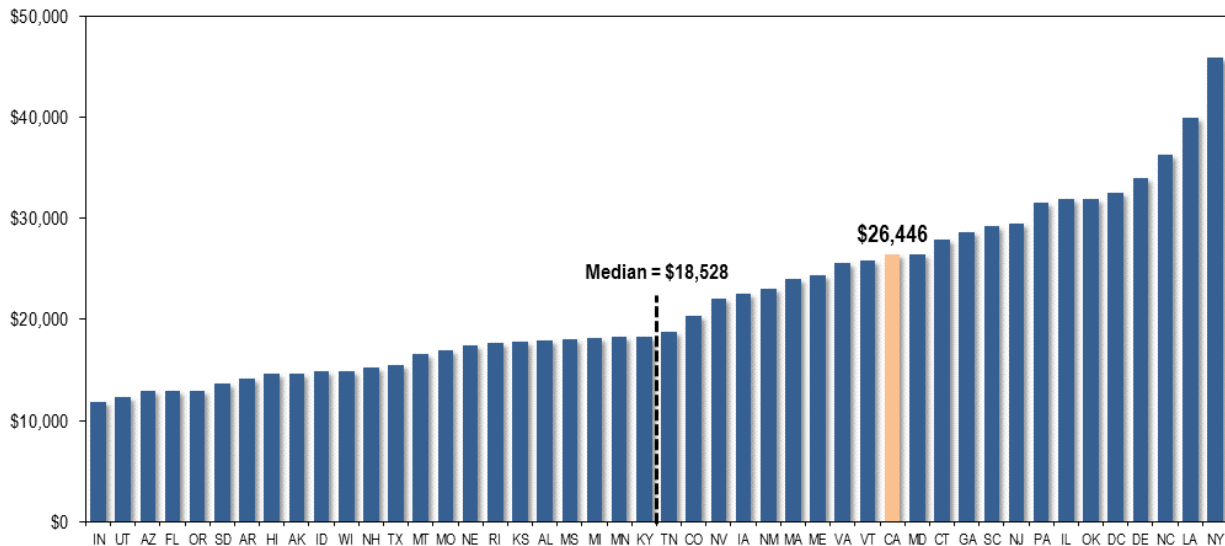


Chart 20 compares average indemnity benefits per indemnity claim by state. California indemnity costs per claim are well above the median level. To a large extent, the higher-than-average indemnity costs are driven by the high proportion of indemnity claims involving permanent disability benefits in California.

Chart 20: Countrywide Indemnity Benefits per Claim



Medical costs comprise almost two-thirds of the benefit dollars in California. Chart 21 shows average medical costs per indemnity claim in California. While increasing almost five-fold since 1993, medical severities over the last three years, which reflect many SB 863 reforms impacting medical costs, have decreased by approximately 9%.

Chart 21: Estimated Average Medical Cost per Indemnity Claim by Accident Year

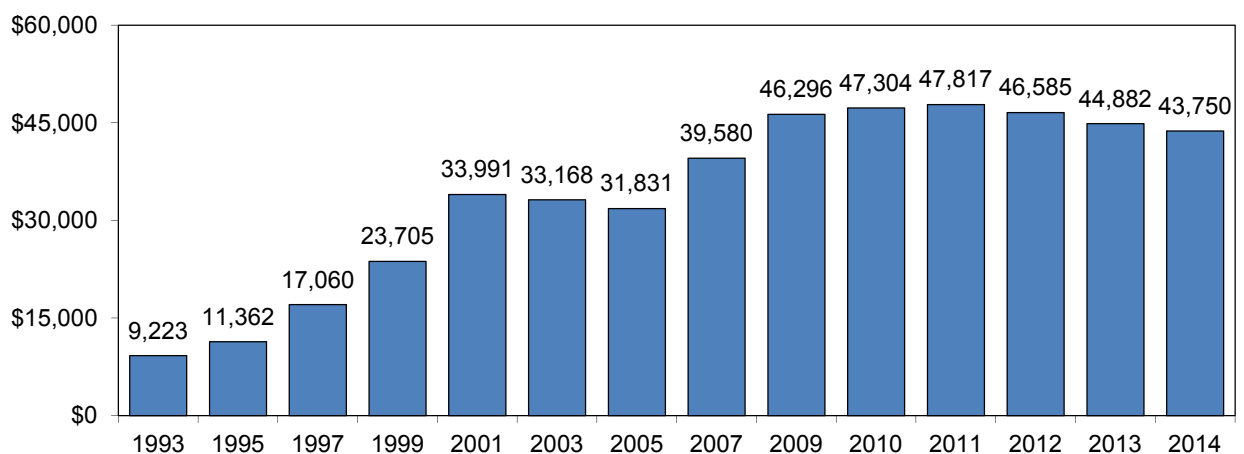


Chart 22 compares changes in average medical costs for California with that for NCCI states as well as countrywide changes in medical costs as measured by the medical component of the consumer price index (CPI). Estimated average medical costs per indemnity claim in California have declined over the last few years, while other states' medical severities and countrywide average medical costs as measured by the CPI have continued to increase.

**Chart 22: Estimated Change in Medical Claim Severity by Accident Year
California vs. NCCI States**

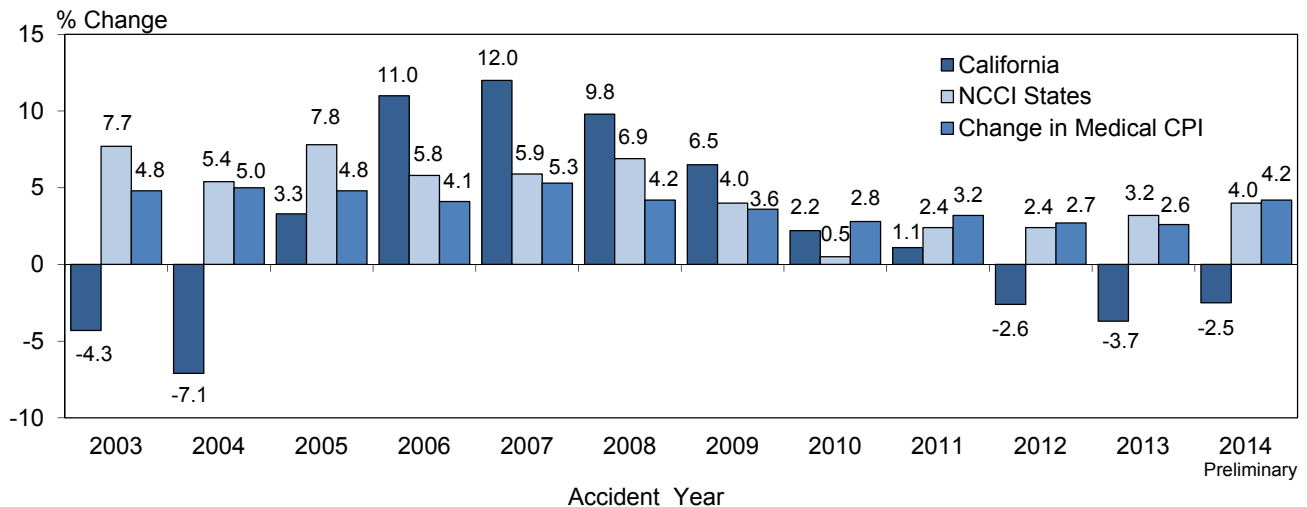
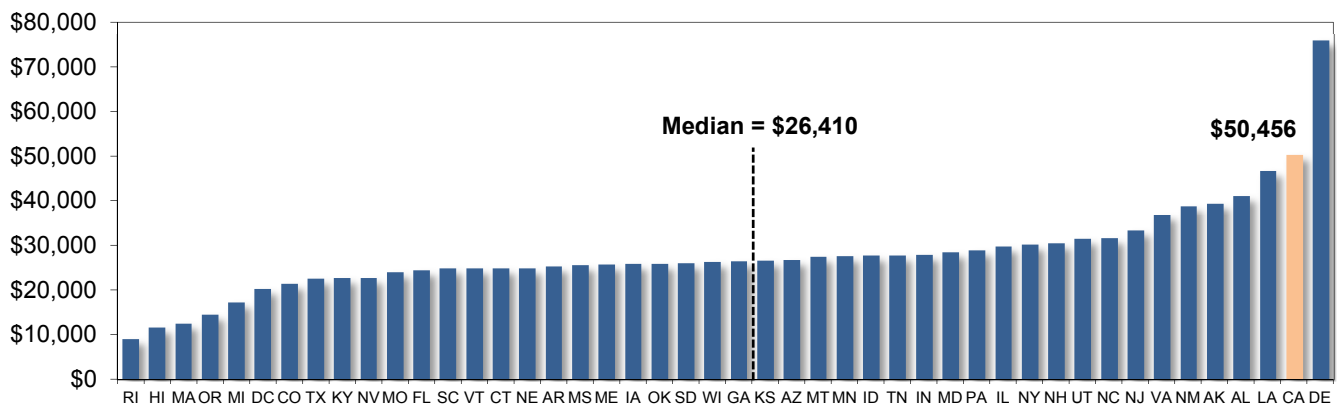


Chart 23 compares the average medical benefits per indemnity claim by state. California reported medical costs per claim are the second-highest in the country with an average cost more than 90% above the median level.

Chart 23: Countrywide Medical Benefits per Indemnity Claim



While California is a very high cost medical state, medical cost levels are not necessarily higher early in the life of a claim. In fact, the most recent Workers Compensation Research Institute (WCRI) Compscope benchmark study⁸ showed that California medical payments through 36 months on claims with seven or more days of lost time was 7% below the 17-state median measure.

The higher cost of medical benefits in California is largely the result of the duration of medical benefit payments. Chart 24 shows the estimated percentage of estimated final (or “ultimate”) medical costs paid after three years by state. California is the slowest-paying state for medical benefits at three years, with a percentage of ultimate costs paid almost 30% lower than the countrywide median.

Chart 24: Percentage of Ultimate Medical Benefits Paid at 3 Years

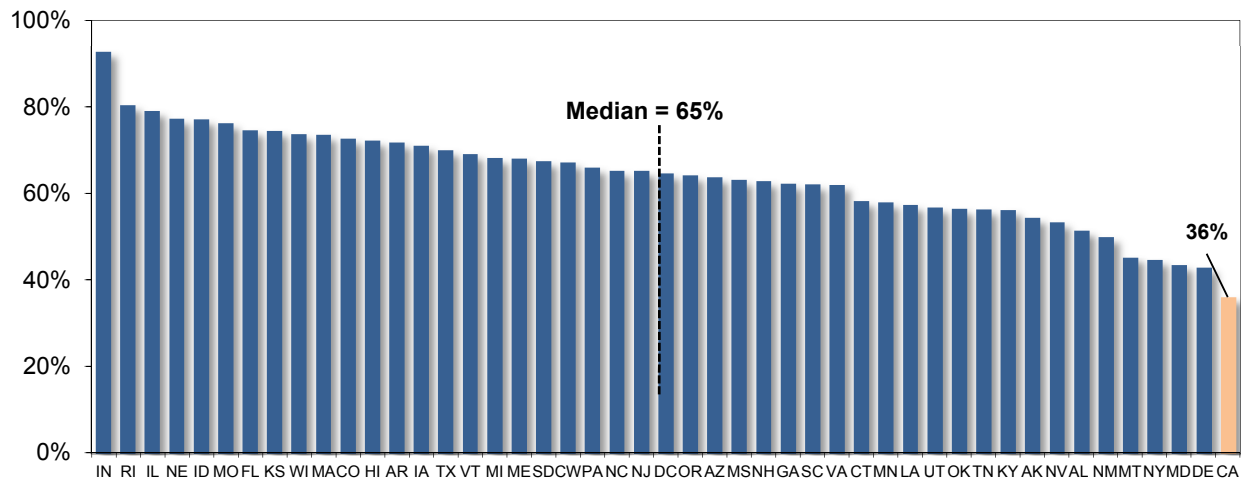
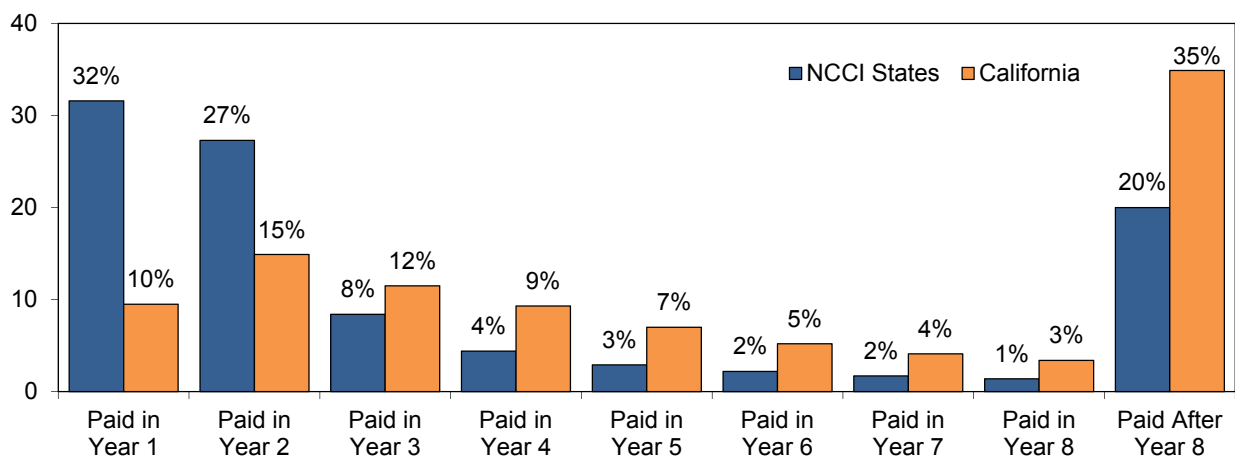


Chart 25 shows the percentage of medical benefits paid in each year for California compared to the average for NCCI states. Almost 30% of medical benefits in California are paid in the fourth through eighth years compared to 12% for NCCI states.

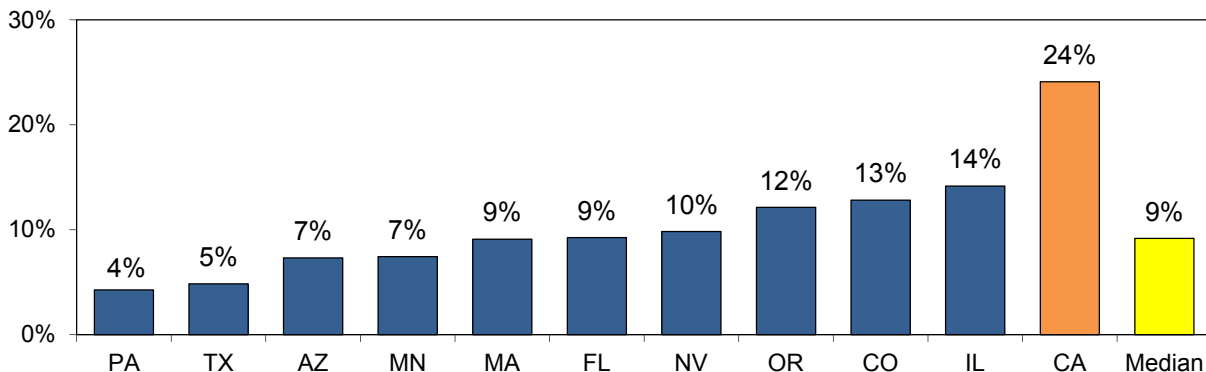
Chart 25: Percentage of Medical Benefits Paid by Year



⁸ *Compscope Benchmarks for California, 15th Edition*, WCRI, 2015. For claims arising from October 1, 2010 through September 30, 2011 evaluated as of March 31, 2014.

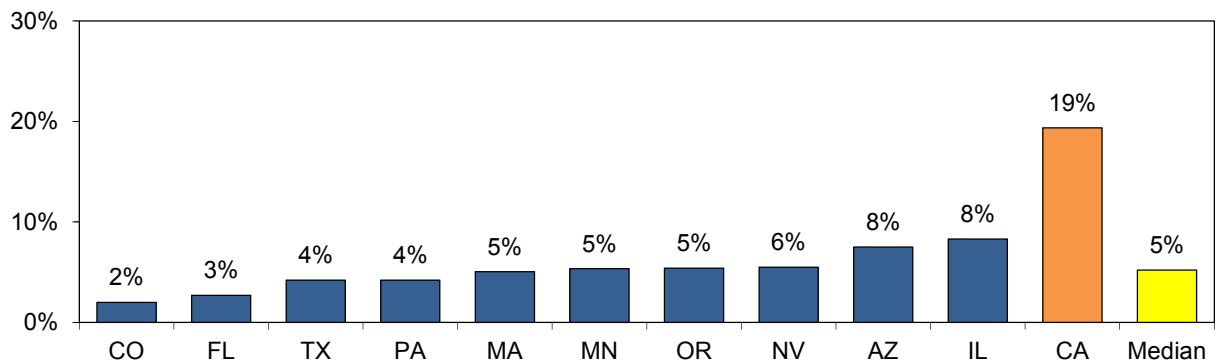
The prolonged payment pattern in California is in part driven by how quickly claims are reported in California and the length of time they stay open. Chart 26 shows the percentage of the estimated total number of indemnity claims unreported after 12 months for California and a number of other states. Almost three times as many indemnity claims are unreported at 12 months in California when compared to most other states in this interstate comparison. Many of the late-reported claims in California are related to claims involving cumulative trauma injuries, some of which are related to claims involving a specific injury that had already been filed.

Chart 26: Percentage of Indemnity Claims Unreported at 12 Months



The rate that claims are settled and closed also impacts the volume of late-term medical payments. Chart 27 shows the percentage of indemnity claims that remain open after five years from the beginning of the year of injury. Almost one-fifth of indemnity claims remain open in California at 60 months compared to 5% for the median state in this interstate comparison. In fact, it takes 11 years in California before only 5% of the indemnity claims remain open compared to 5 years for the 11-state median. A recent WCIRB study showed that as claims age their medical treatment patterns evolve with greater use of pharmaceuticals, including narcotics and psychoactive drugs, more treatment of chronic medical problems of aging that are unrelated to the acute injury, and more treatment of complications that arise from post-injury medical treatment.⁹

Chart 27: Percentage of Reported Indemnity Claims Open after 60 Months



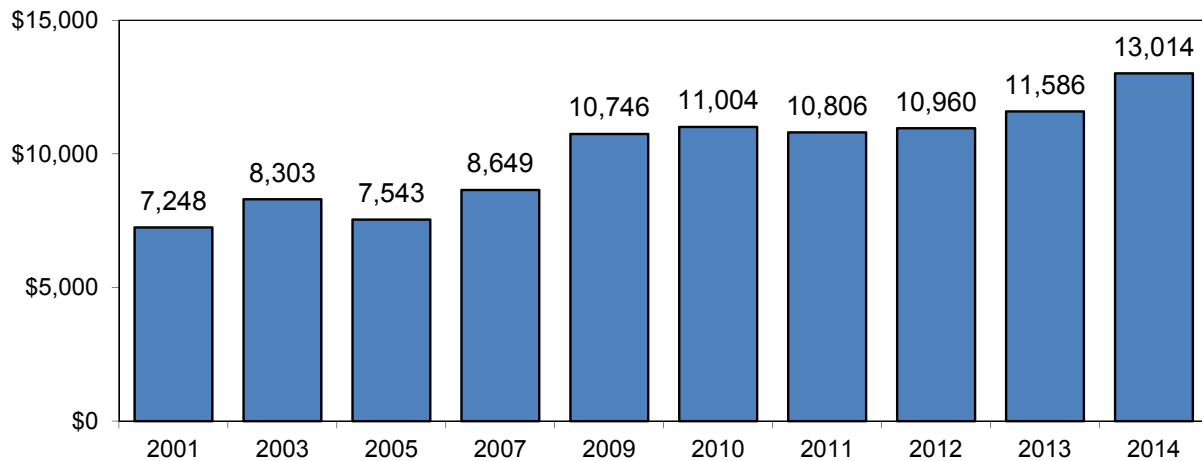
⁹ California Medical Payment Development Up to 30 Years Post-Injury, WCIRB, July 8, 2015.

Loss Adjustment Expenses

In addition to indemnity and medical benefits, insurers incur expenses related to the handling and administration of workers' compensation claims. These expenses, known as "loss adjustment expenses", include the cost of insurer claims staff to administer the claims, the cost of attorney and other legal expenses in defending claims, the cost of medical cost containment programs, and other court and claims-related expenses.

Chart 28 shows the average cost of loss adjustment expenses that can be allocated to a particular claim for private insurers writing business in California.¹⁰ Allocated loss adjustment expenses per indemnity claim have increased steadily since 2005. In fact, instead of declining following the enactment of SB 863 in 2013 as was expected, allocated loss adjustment expenses per claim increased by 19% over the last two years.¹¹

**Chart 28: Estimated Average Allocated Loss Adjustment Expense Cost
per Indemnity Claim by Accident Year**

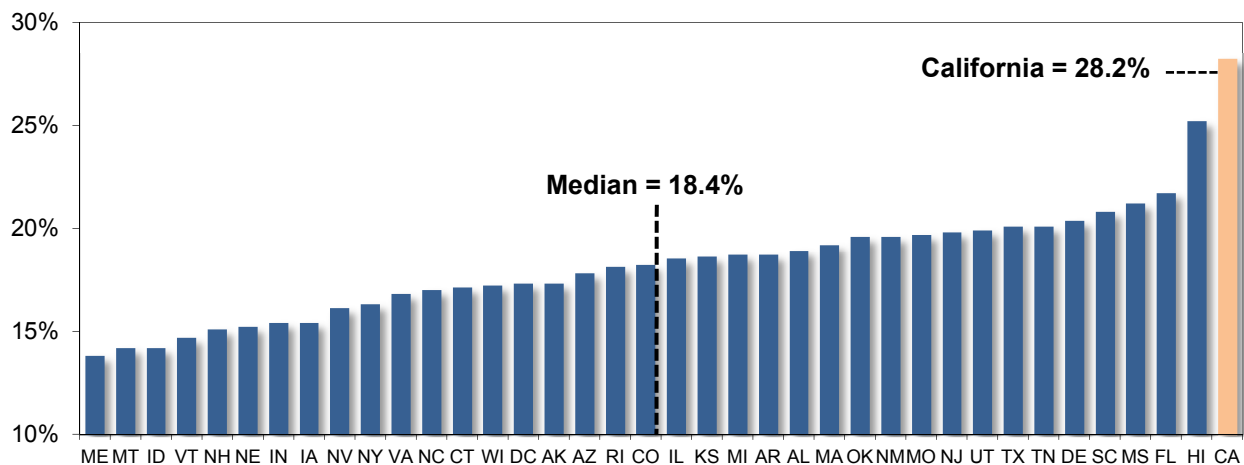


¹⁰ Excludes the State Compensation Insurance Fund.

¹¹ The WCIRB initially projected an approximate 13% decrease in loss adjustment expenses following the implementation of SB 863. See *Updated WCIRB Evaluation of the Cost Impact of Senate Bill No. 863*, WCIRB, October 12, 2012 for more information.

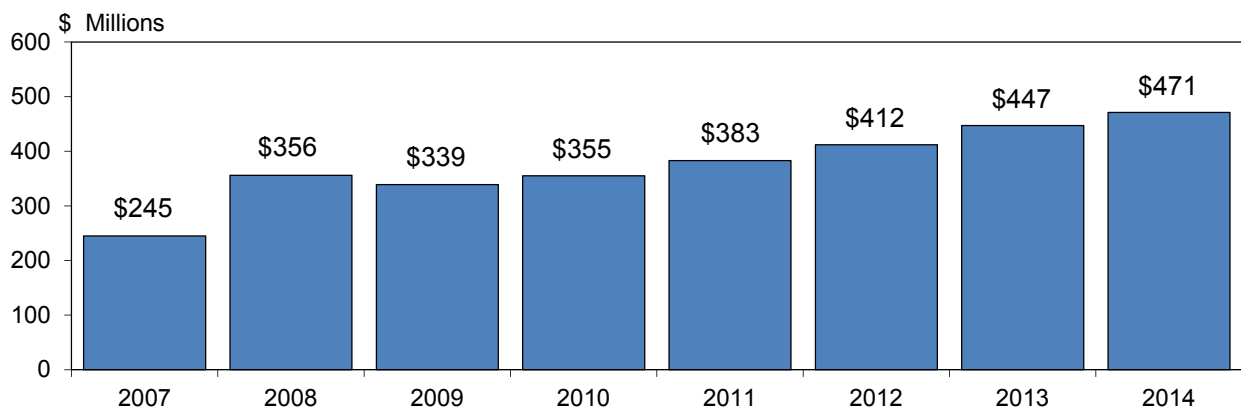
California has a high cost of delivering benefits compared to other states. Chart 29 compares ratios of total loss adjustment expenses to losses from California to those for other states. California has the highest loss adjustment expense ratio, which is almost 10 percentage points greater than the countrywide median. Among the reasons for the high loss adjustment expenses or benefit delivery costs in California are a greater-than-average proportion of permanent disability claims, high litigation rates (particularly in the Los Angeles area) and a large number of active liens. The high frequency of independent medical reviews (IMR) conducted pursuant to SB 863 in California is also impacting loss adjustment expenses.

Chart 29: Countrywide Ratios of Loss Adjustment Expense Costs to Losses



One of the components contributing to the high level of loss adjustment expenses is the cost of medical cost containment (MCC) programs. As shown in Chart 30, total MCC expenses in California have almost doubled in the last seven years. WCRI data shows that California MCC costs per claim at 36 months was among the highest-cost states in the most recent WCRI study, with both the proportion of claims with MCC expenses paid and the MCC expense paid per claim well above that of the median state.¹²

Chart 30: Total Paid Cost of Medical Cost Containment by Calendar Year

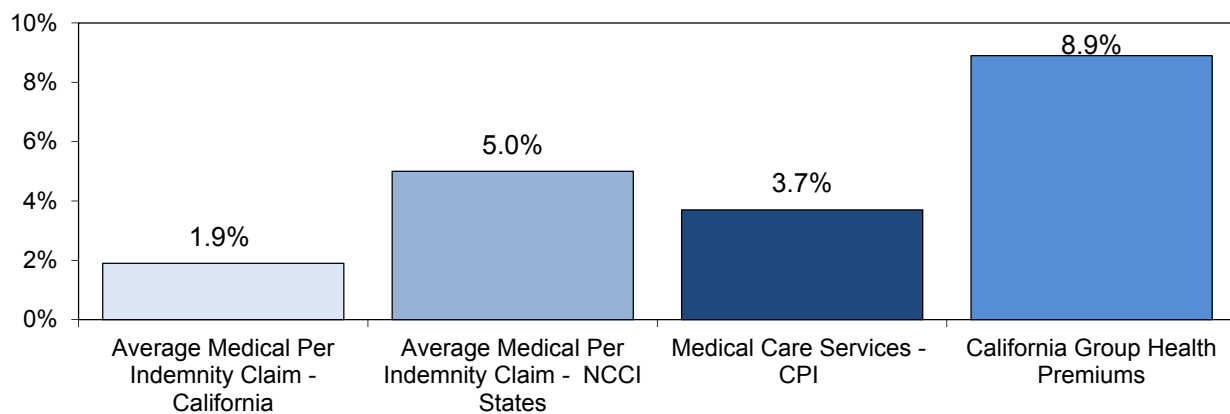


¹² *CompScope Benchmarks for California 15th Edition*, WCRI, 2015.

The cost of MCC has increased significantly over the years as insurers have implemented the tools provided by the reforms of Assembly Bill No. 227 and Senate Bill No. 228 in 2003, Senate Bill No. 899 in 2004, and Senate Bill No. 863 in 2012. However, with the implementation of these tools, medical inflation in California workers' compensation has been well below that of other systems. Chart 31 compares the average annual growth in medical costs per indemnity claim since 2001 in California workers' compensation to (a) a similar measure for the average of the 35 states for which NCCI provides ratemaking services, (b) the consumer price index for medical care services (not seasonally adjusted) as published by the Bureau of Labor Statistics, and (c) the average increase in California group health premiums as published by the California Healthcare Foundation.

Chart 31 shows that the annual growth in California's average medical per indemnity claim since 2001 is approximately one half of the rate of growth of the medical CPI, 40% of the rate of growth in medical severities in other states, and 20% of the rate of growth in California group health premiums. If for example, medical costs per claim since 2001 had grown in California at the same rate as shown for the average of the NCCI states, the projected accident year 2014 medical costs would be almost \$3 billion higher.¹³

Chart 31: Average Annual Medical Cost Inflation from 2001 to 2014



¹³ In the WCIRB's July 1, 2015 Pure Premium Rate Filing submitted to the Insurance Commissioner on April 6, 2015, the WCIRB projected almost \$6 billion of ultimate medical costs on 2014 accidents. If medical costs per claim had grown by 5% per year since 2001 rather than 1.9%, ultimate medical losses on 2014 accidents would be projected to be almost \$9 billion.

SENATE BILL NO. 863 (2012)

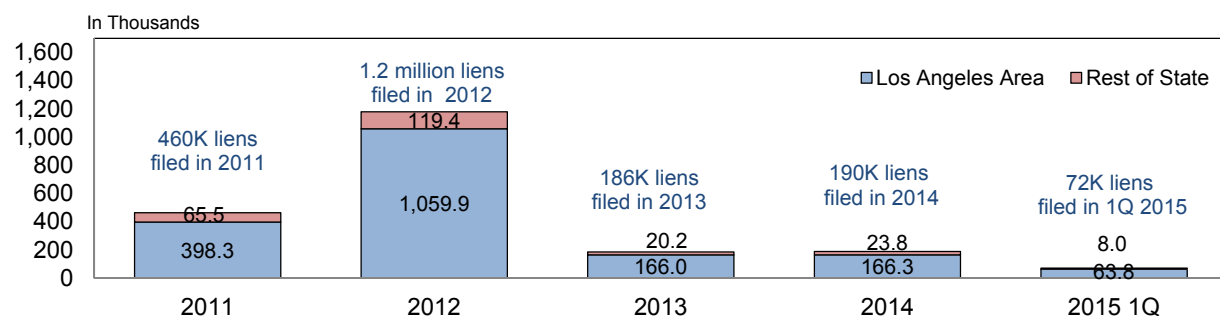
“SB 863 included significant increases in permanent disability benefits effective January 1, 2013 and 2014 and a series of comprehensive reforms to the California workers’ compensation system”

In September 2012, the Governor signed SB 863 into law. SB 863 included significant increases in permanent disability benefits effective January 1, 2013 and 2014 and a series of comprehensive reforms to the California workers’ compensation system. The WCIRB initially estimated that the combined cost impact of the SB 863 structural changes that can be evaluated including the Resource-Based Relative Value Scale (RBRVS) schedule promulgated late in 2013 approximately offset the cost of the SB 863 permanent disability benefit increases.¹⁴

The WCIRB provided the California Department of Insurance a multi-year plan to monitor the emerging costs of SB 863.¹⁵ The most recent report on emerging SB 863 costs was released in November of 2014.¹⁶

SB 863 included a number of provisions related to liens, including a \$150 fee for all new liens filed and a statute of limitations on filing liens based on the date of service. Chart 32 summarizes the number of liens filed before and after the enactment of SB 863. While the WCIRB initially projected a reduction in liens filed of about 40%, the number of liens filed in 2014 was 80% lower than the number filed in 2012 and 60% lower than the number filed in 2011.

Chart 32: Number of Liens Filed



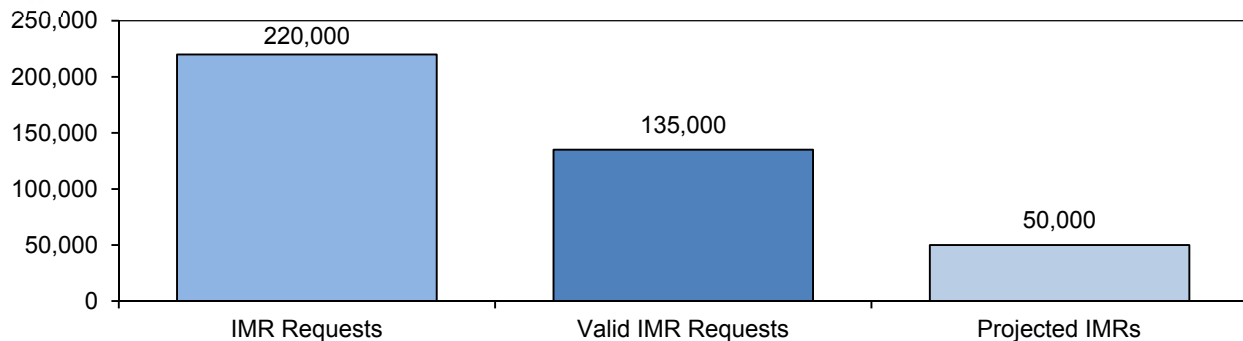
¹⁴ See *Updated WCIRB Evaluation of the Cost Impact of Senate Bill No. 863*, WCIRB, October 12, 2012 and the WCIRB's Amended January 1, 2014 Pure Premium Rate Filing submitted on October 23, 2013.

¹⁵ *Senate Bill No. 863 WCIRB Cost Monitoring Plan*, WCIRB, March 27, 2013.

¹⁶ *Senate Bill No. 863 WCIRB Cost Monitoring Report – 2014 Retrospective Evaluation*, WCIRB, November 14, 2014.

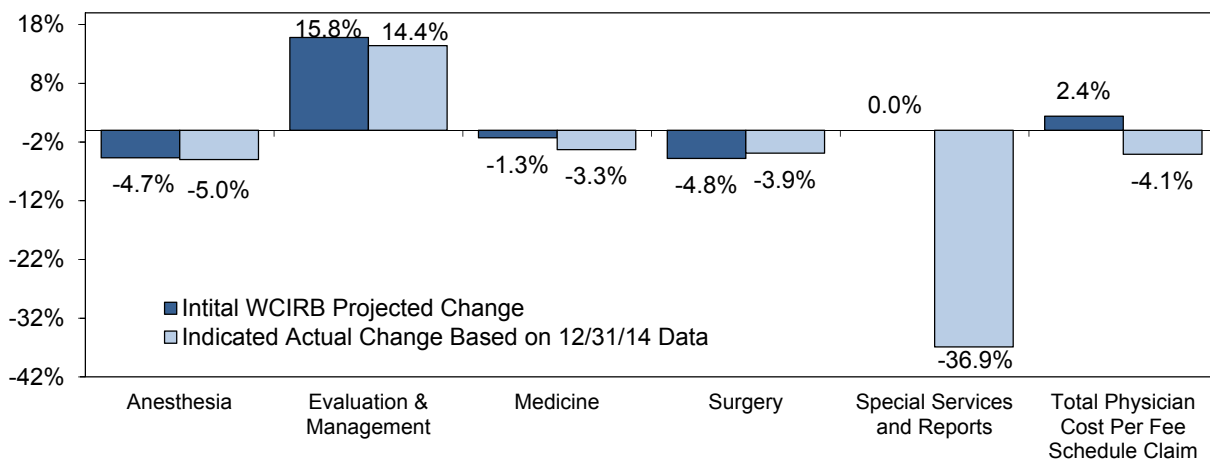
SB 863 also created a new independent medical review (IMR) process to resolve medical treatment disputes. Chart 33 shows the number of IMRs filed in 2014 compared to initial WCIRB projections. Even after excluding duplicate and other invalid IMR requests, the number of IMRs filed in 2014 was almost three times higher than initial WCIRB projections.

Chart 33: Number of Independent Medical Reviews Filed in 2014



In 2013, the Division of Workers' Compensation adopted a new physician fee schedule effective January 1, 2014 based on the resource-based relative value scale (RBRVS). The 2014 fee schedule changes reflect the first year of a four year phase-in to RBRVS. Chart 34 compares the changes in costs by fee schedule component in 2014 compared to initial WCIRB projections. While the emerging data for most components is consistent with WCIRB projections, emerging savings in the special services and reports category are significantly greater than initial cost estimates, as a number of the reports that were being reimbursed under the pre-RBRVS schedule are no longer being separately reimbursed. As a result, the total physician cost per fee schedule claim is emerging at a significantly lower level than initially projected for 2014.

Chart 34: Change in Physician Payments in 2014 Compared to Initial Projections



Many components of SB 863 can impact claim severities. Chart 35 compares post-SB 863 changes in indemnity, medical, and loss adjustment expense severities projected by the WCIRB based on initial cost estimates to the actual post-SB 863 changes. While medical severities are emerging far below initial post-SB 863 projections, loss adjustment expense severities are increasing rather than declining as originally projected. Among the SB 863 components believed to be impacting the post-SB 863 reduction in medical severities are the new physician fee schedule based on RBRVS, IMR, independent bill review, reduced fees for ambulatory surgery centers, lien reforms, reforms related to spinal implant hardware, and provisions related to medical provider networks. Among the factors believed to be impacting the higher-than-expected loss adjustment expenses are more IMRs than anticipated, an increased frequency of cumulative injury claims, increased rates of injured workers being represented by attorneys, and, despite the creation of the IMR process, a greater-than-expected number of expedited hearings on medical issues.

Chart 35: Projected Post-SB 863 Changes in Claim Severities Compared to Actual Changes

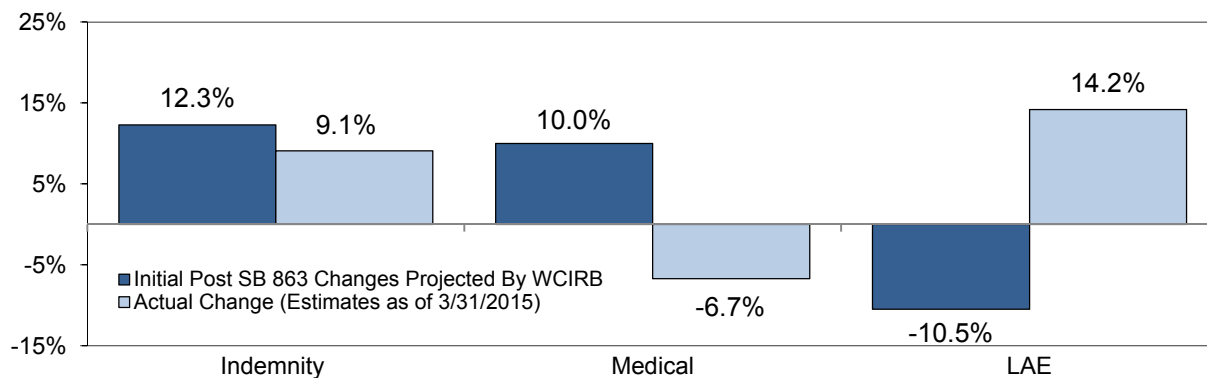


Chart 36 summarizes the WCIRB's prospective cost estimate of the key components of SB 863 and the results emerging based on the WCIRB's most recent retrospective evaluation. The WCIRB will continue to evaluate post-SB 863 costs as they emerge. The WCIRB's 2015 comprehensive SB 863 cost monitoring report will be published this November.

Chart 36: WCIRB Cost Evaluation of SB 863
Summary of Estimates (\$'s in Billions)

SB 863 Provisions	WCIRB Original Cost Estimates (In billions)	Updated WCIRB Assessment
2013 & 2014 PD Benefit Changes	+\$1.2	▬
Liens	(\$0.5)	▲
Independent Medical Review (Impact on Frictional Costs)	(\$0.4)	▼
Other Reforms	(\$0.5)	▬
Indemnity Claim Frequency	Small Increase	▼
Indemnity Severities	Increase	▲
Medical Severities	Small Increase	▲
LAE Severities	Significant Declines	▼
Total Estimate – All Items	(\$0.2)	▬

▼ Indicates that the cost savings are emerging at levels less than projected or cost increases are emerging at levels greater than projected.
 ▬ Indicates cost savings are emerging generally consistently with projections.
 ▲ Indicates cost savings are emerging generally consistently with projections.

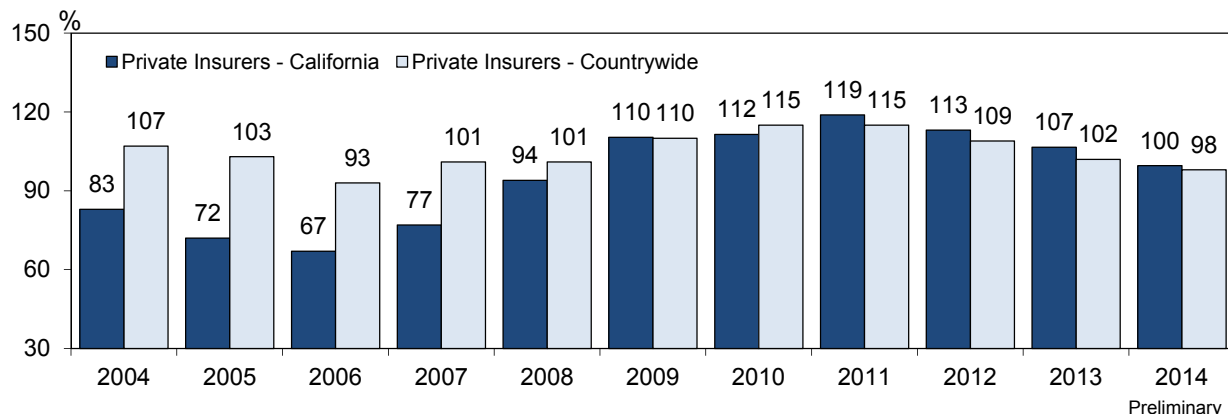
INSURER RESULTS

“A commonly used measure to evaluate the profitability of insurers from an underwriting perspective is the relationship between losses and expenses to premium (typically referred to as the “combined ratio”).”

A commonly used measure to evaluate the profitability of insurers from an underwriting perspective is the relationship between losses and expenses to premium (typically referred to as the “combined ratio”). Due to investment income earned on collected premiums as claims are paid out over many years, insurers can generate a profit with a combined ratio above 100%, assuming a favorable investment climate. However, industry combined ratios significantly above 110% could, over a sustained period, threaten the competitive viability of the insurance market.

Chart 37 shows the historical calendar year combined ratios of private insurers writing workers' compensation business in California compared to the countrywide average for private insurers as published by the NCCI. California combined ratios, while improving, still exceed 100% and have been consistently above the countrywide average over the last several years.

Chart 37: Insurer Reported Combined Loss and Expense Ratios by Calendar Year

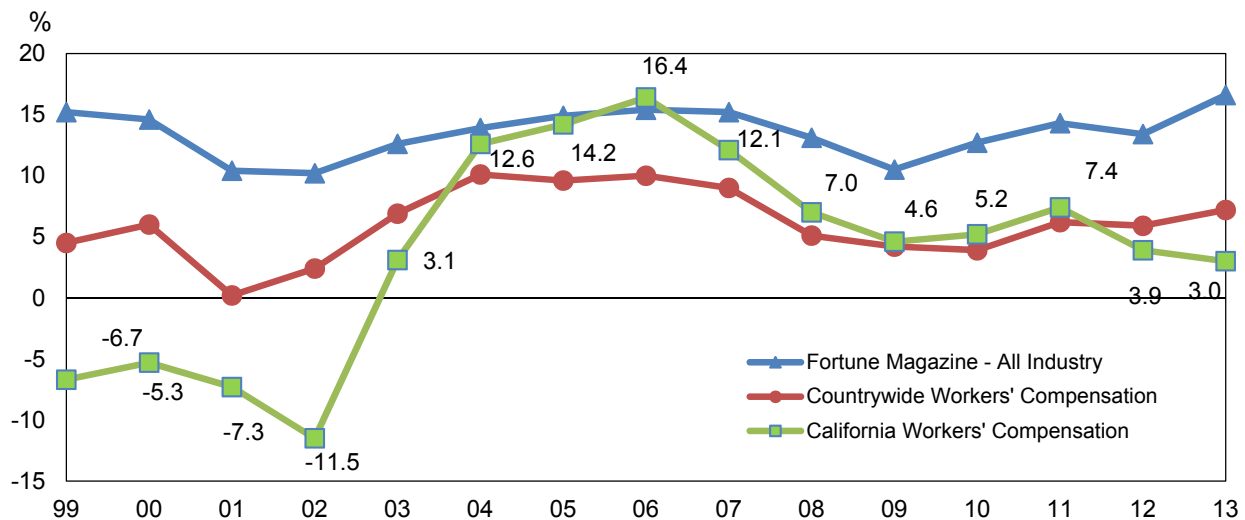


As mentioned, combined ratios are ratios of losses and insurer expenses to premiums. These ratios do not include or account for the impact of investment income, federal income taxes, or insurer profits. The National Association of Insurance Commissioners (NAIC) annually publishes a summary of total insurer profitability by line of insurance and state based on calendar year information reported by each insurer to

the NAIC. The NAIC estimates the total return to the industry after reflecting premiums, losses, and expenses, as well as allocations of an insurer's total investment income, federal income taxes, and policyholder surplus to California workers' compensation.

Chart 38 shows the estimated NAIC return on net worth for California workers' compensation over the fifteen years through calendar 2013 and, for comparison purposes, also shows the Fortune Magazine all-industry average return and the total countrywide workers' compensation return. California workers' compensation insurance market returns have been volatile and, on average over the long-term, have been below the countrywide workers' compensation average return as well as the Fortune Magazine all-industry average.

Chart 38: Average Return on Net Worth by Calendar Year



<u>Arithmetic Average Returns</u>	<u>10 Years</u>	<u>15 Years</u>
Fortune Magazine – All Industry	14.0%	13.5%
Total Countrywide Workers' Compensation	7.1%	6.1%
California Workers' Compensation	8.6%	3.9%

SUMMARY

Chart 39 summarizes some of the key components of the California workers' compensation insurance system discussed in this report and their comparison within the California workers' compensation market or to other workers' compensation information where applicable.

Chart 39: Summary of the California Workers' Compensation Insurance System

Component	Recent Trends	Comparisons within California or to Other States
Premiums	Double-digit increases in written premium continuing; a larger share driven by economic growth	California premiums comprise more than one-quarter of Countrywide premium. Market share of California-focused insurers increasing.
Insurer Rates	Steady increases, but comparable to rates in the 1970s	California rates highest in country
Claim Frequency	Continued modest increases, particularly in Southern California regions	California permanent disability claim frequency is the highest in the country; recent patterns in non-Los Angeles regions more similar to countrywide patterns
Average Indemnity Costs	Fairly stable in recent years; increases in 2014 consistent with SB 863 projections	California indemnity costs higher than countrywide median; recent changes comparable to countrywide
Average Medical Costs	Decreasing over last few years believed to be attributable to SB 863	California medical costs are among the highest in the nation but gap should narrow with recent declines
Long-term Medical Costs	Significant percentage of medical benefits paid in later periods	Indemnity claims reported and settled much slower in California than in other states
Loss Adjustment Expenses	Increasing greater than SB 863 projections	California loss adjustment expenses higher than other states
SB 863	Liens, medical severities, RBRVS emerging favorably but projected savings from loss adjustment expenses not emerging	N/A
Insurer profitability	Combined ratios improving but still above 100%	Recent California WC combined ratios higher than countrywide averages and long-term overall returns far below all industry average

CHART NOTES

- Chart 1 Source of the data is WCIRB aggregate financial data calls. Premiums shown are gross of any deductible credits.
- Chart 2 Data sources include WCIRB aggregate financial data calls and the National Council on Compensation Insurance (NCCI) May 14, 2015 State of the Line Presentation. The 2014 estimate is preliminary. Premiums are net of any deductible credits.
- Chart 3 Source of the data is WCIRB aggregate financial data calls and is based on written premiums prior to any deductible credits. "California Private Insurers" is defined as private insurers who write at least 80% of their workers' compensation business in California.
- Chart 4 Data sources include WCIRB aggregate financial data calls and UCLA Anderson School of Business. Premiums shown are gross of any deductible credits.
- Chart 5 Data sources include WCIRB aggregate financial data calls and unit statistical data.
- Chart 6 Rates are per \$100 of payroll. The information in this chart is based on the state of Oregon biennial rate comparison and is based on the state of Oregon classification mix and, as a result, the California average charged rates shown on this exhibit differ from other measures of the California average charged rate.
- Chart 7 Manual rates are based on insurer rate filings and do not necessarily represent the final premium charged to the employer, which may involve several additional adjustments. Data sources include WCIRB unit statistical data and insurer rate filings with the California Department of Insurance. The average rates shown are based on policy year 2012 distribution of payroll by classification and insurer.
- Chart 8 The source of the data is WCIRB aggregate financial data calls. Changes in total insurer reserves by calendar year have been apportioned to indemnity and medical benefits based on the distribution of indemnity and medical payments during that calendar year.
- Chart 9 The source of the data is WCIRB aggregate financial data calls.
- Chart 10 Data sources include WCIRB aggregate financial data calls and WCIRB medical transaction data.
- Chart 11 The source of the data is WCIRB medical transaction data.
- Chart 12 The source of the data is claim counts and payrolls reported in WCIRB unit statistical data. Payrolls have been adjusted for the impact of wage inflation.
- Chart 13 The information in this graph through accident year 2013 is based on WCIRB unit statistical data developed to the 5th report level. Accident year 2014 is based on changes in reported indemnity claim counts from WCIRB aggregate financial data calls as of March 31, 2015 compared to estimated changes in statewide employment.
- Chart 14 WCIRB information is based on WCIRB unit statistical data at the first report level (through 2013) and aggregate financial data calls (2014). Region information is based on the employer zip code reported on the California workers' compensation policy. Regional break out of the 2014 change for California is not available at this time. NCCI estimates are based on the May 14, 2015 State of the Line Presentation (NCCI 2014 estimate is preliminary and the 2010 and 2011 estimates have been adjusted to remove the impact of audit premium and other factors).
- Chart 15 The source of the data is WCIRB unit statistical data from policies incepting between July 1, 2012 and June 30, 2013. Unit statistical data was linked with Hoover's/Dun and Bradstreet data to develop information on the numbers of employees and operations at employers' locations geographically. Individual claims were linked with WCIRB medical transaction data to locate claims geographically. Estimates were controlled for geographic differences in industrial mix and average wage level.
- Chart 16 The source of the data is the 2015 NCCI Annual Statistical Bulletin for 2011 policy year at the first report level.
- Chart 17 The source of the data is the 2015 NCCI Annual Statistical Bulletin for 2011 policy year at the first report level.
- Chart 18 The source of the data is WCIRB aggregate financial data calls as of March 31, 2015. Values are developed to a final or ultimate cost basis by the WCIRB.
- Chart 19 The source of the data is WCIRB aggregate financial data calls. NCCI estimates are based on the May 14, 2015 State of the Line Presentation (2014 NCCI estimate is preliminary).
- Chart 20 The source of the data is the 2015 NCCI Annual Statistical Bulletin for 2011 policy year at the first report level. Values are developed to a final or ultimate cost basis.

- Chart 21 Source of the data is WCIRB aggregate financial data calls as of March 31, 2015. Values are developed to a final or ultimate cost basis by the WCIRB. The average costs shown exclude the cost of medical-only claims and includes the cost of medical cost containment programs.
- Chart 22 The source of the data is WCIRB aggregate financial data calls. All years reflect the cost of medical cost containment programs. The NCCI estimates are based on the May 14, 2015 State of the Line Presentation (2014 estimate is preliminary). Medical CPI estimates are from the Bureau of Labor Statistics and based on the average of the Medical Care components for San Francisco and Los Angeles.
- Chart 23 The source of the data is the 2015 NCCI Annual Statistical Bulletin for 2011 policy year at the first report level. Values are developed to a final or ultimate cost basis.
- Chart 24 The source of the data is the 2015 NCCI Annual Statistical Bulletin based on the average of the two most recent development years.
- Chart 25 The source of the data is the 2015 NCCI Annual Statistical Bulletin based on the average of the two most recent development years.
- Chart 26 The source of the data is WCIRB aggregate financial data calls based on the most recent development year. Individual state summaries were provided by NCCI, the Minnesota Workers' Compensation Insurers Association, the Workers' Compensation Rating & Inspection Bureau of Massachusetts, and the Pennsylvania Compensation Rating Bureau.
- Chart 27 The source of the data is WCIRB aggregate financial data calls based on the most recent development year. Individual state summaries were provided by NCCI, the Minnesota Workers' Compensation Insurers Association, the Workers' Compensation Rating & Inspection Bureau of Massachusetts, and the Pennsylvania Compensation Rating Bureau.
- Chart 28 The source of the data is WCIRB aggregate financial data calls from private insurers writing workers' compensation business in California as of March 31, 2015. Values are developed to a final or ultimate cost basis by the WCIRB.
- Chart 29 The source of the data is the 2015 NCCI Annual Statistical Bulletin. Figures represent loss adjustment expenses as a percentage of losses for the most recent filed pure premium rates or loss costs by state.
- Chart 30 The source of the data is WCIRB aggregate financial data calls.
- Chart 31 Data sources include WCIRB aggregate financial data calls, the NCCI May 14, 2015 State of the Line Presentation, the Bureau of Labor Statistics, and the California Healthcare Foundation.
- Chart 32 The source of the data is the Division of Workers' Compensation Electronic Adjudication Management System.
- Chart 33 The source of the data is the Division of Workers' Compensation from information collected from the IMR vendor.
- Chart 34 The source of the data is WCIRB medical transaction data. Changes shown are based on the change in the total volume of medical payments for that fee schedule component from 2013 to 2014.
- Chart 35 Initial changes projected by the WCIRB are based on the WCIRB's initial SB 863 cost evaluation and pure premium rate filings. Actual changes are based on WCIRB aggregate financial data calls developed to a final or ultimate cost basis. Loss adjustment expense severities are based on private insurers writing workers' compensation business in California.
- Chart 37 The source of the data is WCIRB aggregate financial data calls. Countrywide estimates are from the NCCI May 14, 2015 State of the Line Presentation and was computed based on Annual Statement data. The 2014 NCCI estimate is preliminary.
- Chart 38 The source of the data is the NAIC Report on Profitability in 2013.

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ABOUT THE WCIRB

The WCIRB is a private, nonprofit association of all insurers licensed to write workers' compensation insurance in California. It is a licensed rating organization pursuant to the California Insurance Code and operates as the Insurance Commissioner's designated statistical agent for workers' compensation in the state of California.

The WCIRB collects a wide range of statistical information on insured payrolls, premiums, losses, and insurer expenses from each insurer writing workers' compensation policies in California. That information is then validated, compiled and analyzed to provide the Commissioner, insurers, employers, and other stakeholders with important cost information related to the California workers' compensation system.

Since its founding in 1915, the WCIRB has served as a trusted, integral and objective part of the California workers' compensation system and is proud of its Century of Service in support of a healthy workers' compensation system.



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