



NCCI Holdings, Inc.

# Gauging the Economy

vol.1 2005

## Gauging Current Conditions: The Economic Outlook and its Impact on Workers Compensation

*These gauges indicate changes for the current year, the next year, and a historical average in economic factors that typically impact WC claims experience.*

### Slowing Rate of Frequency Decline

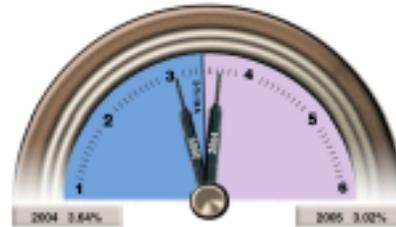
The best news in terms of the decline in claim frequency may have already occurred, as the economic expansion is bringing with it a pickup in employment. History suggests that such increases are associated with upward pressure on frequency.



Employment Growth Strengthening

### Ongoing Increases in Indemnity Severity

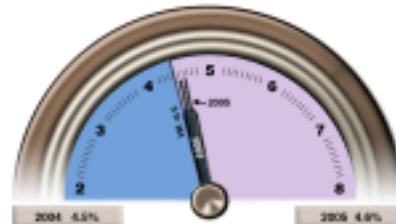
Current and prospective wage gains suggest ongoing increases in indemnity severity.



Average Weekly Wage Gains Moderating

### Ongoing Increases in Medical Severity

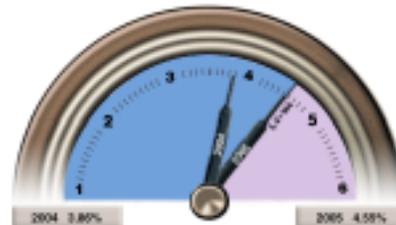
The pace of medical care inflation is not expected to slow anytime soon, suggesting continued increases in medical severity.



Medical Care Price Increases Continuing

### Investment Income Outlook Improves

Interest rates are forecast to increase gradually in 2004–2005, suggesting improved returns on carriers' fixed-income portfolios.



Interest Rates Rising Gradually

## Behind the Gauges:

Labor Conditions: Impact on Workers Compensation

## Claim Frequency

### Employment Growth

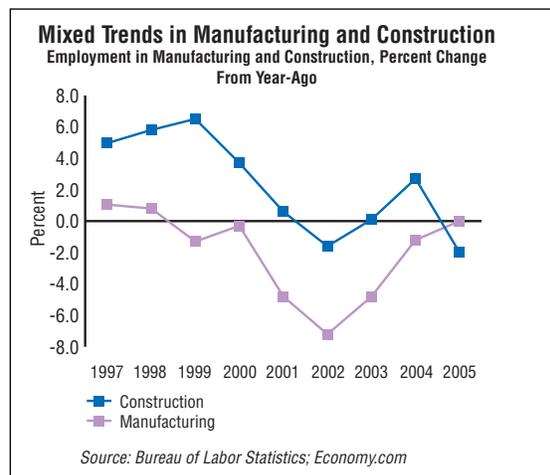
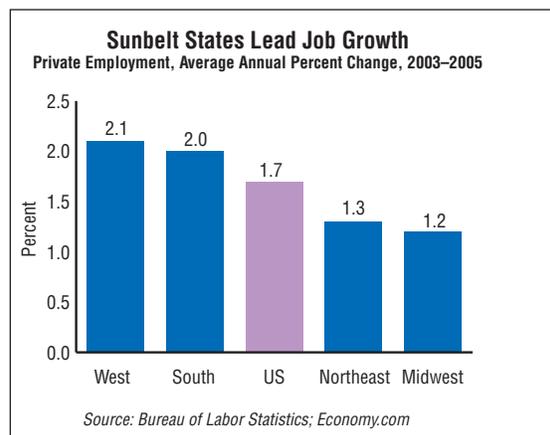
- After three years of declines, private-sector jobs are on track to rise 1.3% in 2004, with additional gains in 2005.
- Those increases suggest a slower rate of frequency declines than in the recent past, in part because accelerating employment growth brings with it a reduction in the skilllevel of the workforce.

### Regional Prospects

- Employment growth is expected to be highest in the West and South, the result of strong population trends and an increasingly high-tech (and relatively safer) industrial base.
- The old-line economies of the Northeast and Midwest are likely to show slower job gains, as weaker demographics and generally higher business costs constrain growth.

### Manufacturing and Construction

- These more-hazardous sectors account for 16% of employment and 37% of workers compensation claims
- Construction jobs are expected to increase, reflective of strong home building, and then decline in 2005, as mortgage rates rise.
- Manufacturing jobs are expected to halt their protracted decline as the ongoing expansion boosts demand.



## Indemnity Severity

### Wage Increases

- In most states, changes in indemnity payments are tied to changes in the state's average weekly wage.
- Prospects nationally are for a pickup in wage pressures, although increases will still be well below those seen during the boom-like years of 1998–2000.

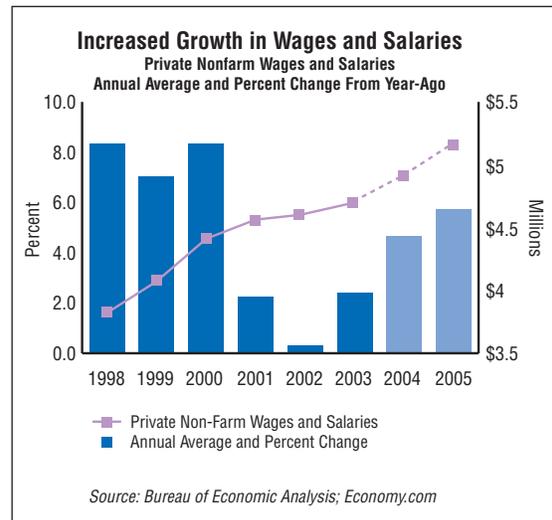
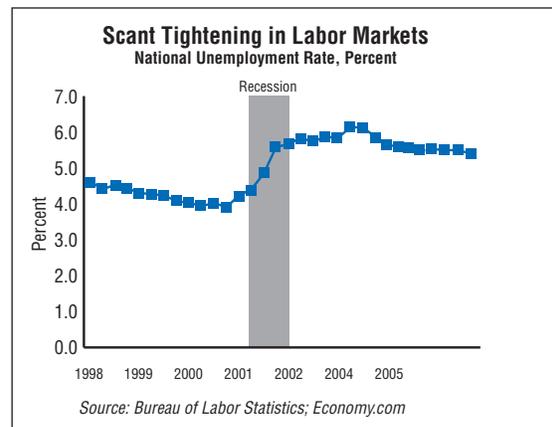
### Unemployment Rate

- One reason why wage increases are likely to be restrained is that the unemployment rate is expected to remain relatively high—well above the 4.2% average in 1998–2000.
- The small unemployment rate declines expected through 2005 are the result of job gains that are only slightly greater than increases in the labor force.

## Premium Growth

### Wages and Salaries

- Since payrolls are the basis for workers compensation premiums, prospective growth in wages and salaries are suggestive as to future increases in premium revenue.
- Payroll growth is forecast to pick up in both 2004 and 2005, consistent with the improved jobs outlook. However, gains are not expected to be nearly as large as during the late 1990s.



## Economic Headlines: Graying of the Workforce Implications for Workers Compensation

One of the hot topics during the past election campaign was the aging of America's population and its implications for Social Security and Medicare. There were often-heated debates about how best to address the funding needs of these programs—and that debate is sure to continue when the new Congressional session gets under way. The workers compensation system will also face challenges as the population ages—not only from the likelihood of rising claim costs, but also from the need to make the workplace safer.

### The Graying of the Workforce

As with Social Security and Medicare, the problems facing workers compensation from the graying of the workforce lie in the not-so-distant future. Currently, workers aged 60–64 comprise just 4% of the workforce, with those aged 65–74 comprising a bit over 3%. However, those percentages are likely to increase dramatically.

As shown in **Exhibit 1**, the number of persons in the 60–64 age group is projected to increase to 6% of the population in 2020 from 4% in 2000 (that's an increase of some 10 million persons), while those in the 65–74 age group will increase their share of the population to 10% from 7% (a rise of some 13 million). In contrast, the percentage of persons in the younger age groups is projected to decline between 2 and 3 percentage points in each of the categories shown.

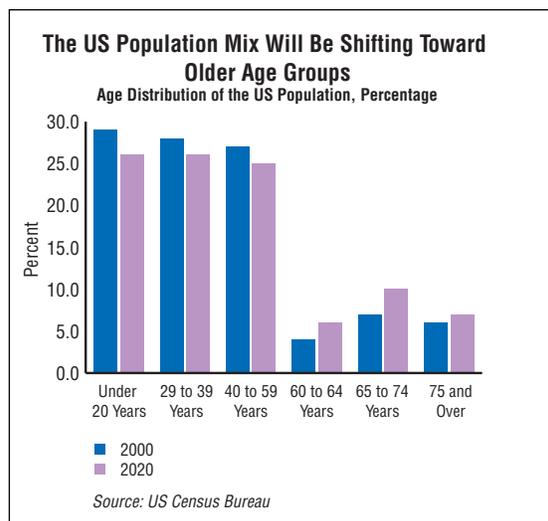
In addition, older persons are deciding to stay in the workforce rather than retire. That's seen in the recent up-trend in labor force participation rates (the percentage of the population working) among workers nearing "traditional" retirement age as well as for workers who are aged 65 and above.

Various factors account for this development, including the increased costs of maintaining preretirement lifestyles, changes in pension plans toward defined contribution arrangements (which tend to reduce retirement income), and the increasing age to obtain full Social Security benefits.

### Compensation Claims Sure to Be Affected

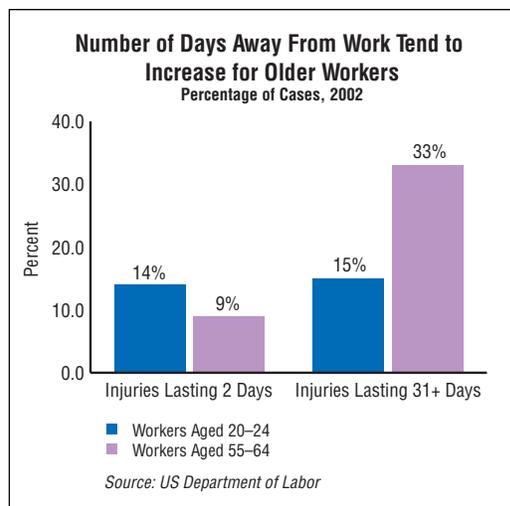
From a workers compensation perspective, the increased share of older workers in the workforce brings with it a likelihood of increases in both medical and indemnity severity. In addition, there may be some upward pressure on claim frequency as well.

NCCI research on the top 10 diagnosis codes for both medical-only and lost-time claims indicate that medical severity (cost per claim) generally increases through age 64 and then stabilizes or declines slightly among workers 65 and older—possibly because workers older than age 65 may be assigned less strenuous duties, so that resulting injuries may be less severe. Interestingly, carpal tunnel-related injuries, typically associated with desk-bound computer work that may be more suitable for older workers, showed increased medical severity among workers 65 and older, especially for medical-only claims.



**Exhibit 1.** The number of persons in the 60–64 age group is projected to increase to 6% of the population in 2020 from 4% in 2000.

A similar analysis for indemnity severity showed consistent increases across all major diagnosis categories through age 64 and then declines thereafter (reflecting offset provisions in most state workers compensation laws). The rise in indemnity severity with age should not be at all surprising, since older workers tend to take longer to recover from injuries and illnesses than younger workers. This is borne out in data on "days away from work" compiled by the US Department of Labor. As shown in **Exhibit 2**, younger workers have a higher percentage of their lost-time injuries result in two days away from work than do older workers, while older workers have a much higher percentage of claims result in more than 31 days away from the job.



**Exhibit 2.** Injuries involving older workers tend to have longer durations.

In contrast to severity, analyses of claim frequency and age suggest that frequency tends to decline as workers get older—at least to age 55 and possibly 60. Beyond age 60, the data becomes very thin. However, a report by the National Highway Traffic Safety Administration may be suggestive.

That report shows a gradual increase in auto fatalities beginning at about age 60, with fatality rates moving sharply higher after age 70. It attributes the increases to the type of age-related problems that might also affect workers in general—weakening eyesight, muscular/skeletal deterioration, and reduced reaction times.

### **Preventive Measures Can Make a Difference**

Dealing with the health and safety issues relating to an aging workforce does not necessarily mean major changes in how companies run their businesses. Indeed, simple actions can make a big difference, such as improved lighting, greater use of handrails and nonslip surfaces, improved signage, and more visible/louder warning devices on machinery and equipment. Older workers might also be encouraged to take vision and/or hearing examinations in order to identify potential problems and take corrective actions, and to participate in company-sponsored exercise/wellness programs.

All participants in the workers compensation system can be proud of the enormous progress that has been made in the past decade to improve workplace safety and in the resulting decline in claim frequency. Continuing that progress as the workforce ages will become an increasingly important challenge in the decades ahead.



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