

MAINE STATE LEGISLATURE

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FINAL REPORT
ON THE STATE OF COMPETITION IN THE
WORKERS' COMPENSATION INSURANCE MARKET

In compliance with Section 2335(5) of Title 24-A, the following report details the state of competition of the workers' compensation market in Maine. The purpose of this report is to identify specific markets in which competition may not exist or may be threatened. A number of accepted economic tests were used to evaluate the market structure; market performance, and market conduct.

In general, competition is desirable to ensure that resources be used efficiently. Over the long run, a competitive market has three properties:

1. The marginal cost, cost of producing the last unit of output, is equal to the price paid by consumers for that unit.
2. There will be no "economic" profits. Investors' rate of return will be just sufficient that they will maintain investment at the level needed to produce the industry's equilibrium output efficiently.
3. Firms will be producing at an output level where average cost will be minimum.

A competitive insurance market has several characteristics. The following briefly reviews these characteristics. The number of companies writing insurance is sufficient in providing multiple options to employers. No individual insurance company controls the market or more than 15% of the market share.

Insurers offer the lowest rates possible for their services and coverage. Insurers have ease of entry and exit of the market. Lastly, investors receive a fair rate of return.

According to Section 2335(3) of Title 24-A, there are seven economic tests which can be used to determine the degree of competition.

- A. The extent to which any insurer controls the market;
- B. Whether the total number of companies writing insurance is sufficient to provide multiple options to an employer;
- C. The disparity among rates and among classifications and subclassifications to the extent that they result in rate differentials;
- D. The availability of insurance and the number of insurers actively providing workers' compensation coverage and the level of and changes in market share of insurers and self-insurers;
- E. The degree of participation of employers in the residual market mechanism;
- F. Whether rate levels in the market are excessive, inadequate or unfairly discriminatory;
- G. The relationship between the premiums charged and the cost of providing coverage, with due consideration of investment income.

With respect to these economic tests, an evaluation of the market structure, market conduct, and market performance will aid in determining the level of competition in pricing of workers' compensation. Market structure refers to the number of buyers and sellers, their size and distribution,

homogeneity of the product, entry into and exit out of the market, and cost structures. Market conduct covers the actions of a firm in pricing, product design, setting output levels, innovation, and capital investment. Market performance relates to the price, profit, output levels, cost efficiency, and technological progress.

The present situation of workers' compensation insurance in Maine is as follows:

- More than 75%¹ of all employees have an assigned risk insurance policy.
- At the start of the new year, January 1, 1987, almost all insurance companies have filed to increase their rates by 10%, the maximum permitted.
- Many insurers are not willing to renew policies or write new business.

When comparing these facts to what is expected of a competitive insurance rate market, it is evident there are many conflicts.

A competitive market structure is one with many buyers and sellers, and also one with many options or availability. Judging from the high number of risk assigned insurance policies and the refusal of insurers to renew business or write new business, there are few sellers and little availability in the market structure.

Competitive firms behave independently and aggressively; they attempt to set prices that will be attractive to businesses. Cooperative behavior between

¹The figure of 75%, which was provided by the NCCI, is underestimated. It does not include the assignments for the period 10/1/86 to 12/31/86.

firms, such as fixing prices to raise profits, is uncharacteristic of a competitive market. Almost all insurers in Maine are raising their premiums by the maximum limit of 10%. This lack of differentiation in rates indicates that there is no incentive to reduce rates, or that the maximum limit does not permit insurers to earn a fair return. It is difficult to determine if the insurers are in fact cooperating together to set prices, but an analysis of the market performance indicates there are no incentives to reduce rates and that the rate level limitations discourage the operation of a competitive market.

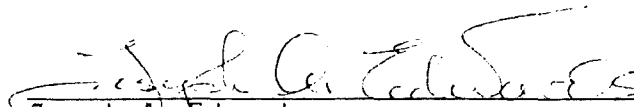
Critical to market performance is the relationship of price to cost or the rate of return on capital. In a competitive market, a firm operates at a level of output where average costs are minimum and investors receive a rate of return equal to the cost of capital. The large number of insurers who have filed for a maximum rate increase would imply that the premiums earned were not adequate to match costs; hence, there was an insufficient rate of return.

In review, the workers' compensation market is not operating as a competitive market in Maine. There are several facts which lead to this conclusion. The uniformity of rates and classifications by the majority of insurers indicates a non-competitive pricing market. Insurers are refusing to renew business or write new business because the rate of return is not great enough to maintain investments, hence, the performance is not competitive. The decreased availability of insurers and the extremely limited options to employers signify the market structure has dwindled to a non-competitive level.

Maine insurance laws state, in Section 2335(4) of Title 24-A, that any single factor under subsection 3 may be a sufficient basis for determining that a reasonable degree of competition does not exist in a market. The information presented in this report should clearly indicate that the workers' compensation market in Maine is not competitive.

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Any questions concerning this report will promptly be addressed.
Respectfully submitted -



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October 19, 1987