

Workers Compensation & the Economy

Impact of the Financial Crisis, Economic Recession & Stimulus

**Workers Compensation Educational Conference
Orlando, FL**

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Download at www.iii.org/presentations/WCEC081809/

Robert P. Hartwig, Ph.D., CPCU, President
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Tel: (212) 346-5520 ♦ bobh@iii.org ♦ www.iii.org



Presentation Outline

- **The Economic Storm: Recession & Recovery**
- **Economic Trends: Workers Comp Exposure Implications**
- **Labor Force and Payroll Trends**
- **Financial Strength & Ratings**
- **P/C Insurance Industry Overview**
 - **Profitability**
 - **Premium Growth**
 - **Underwriting Performance**
 - **Financial Market Impacts**
 - **Capital & Capacity**

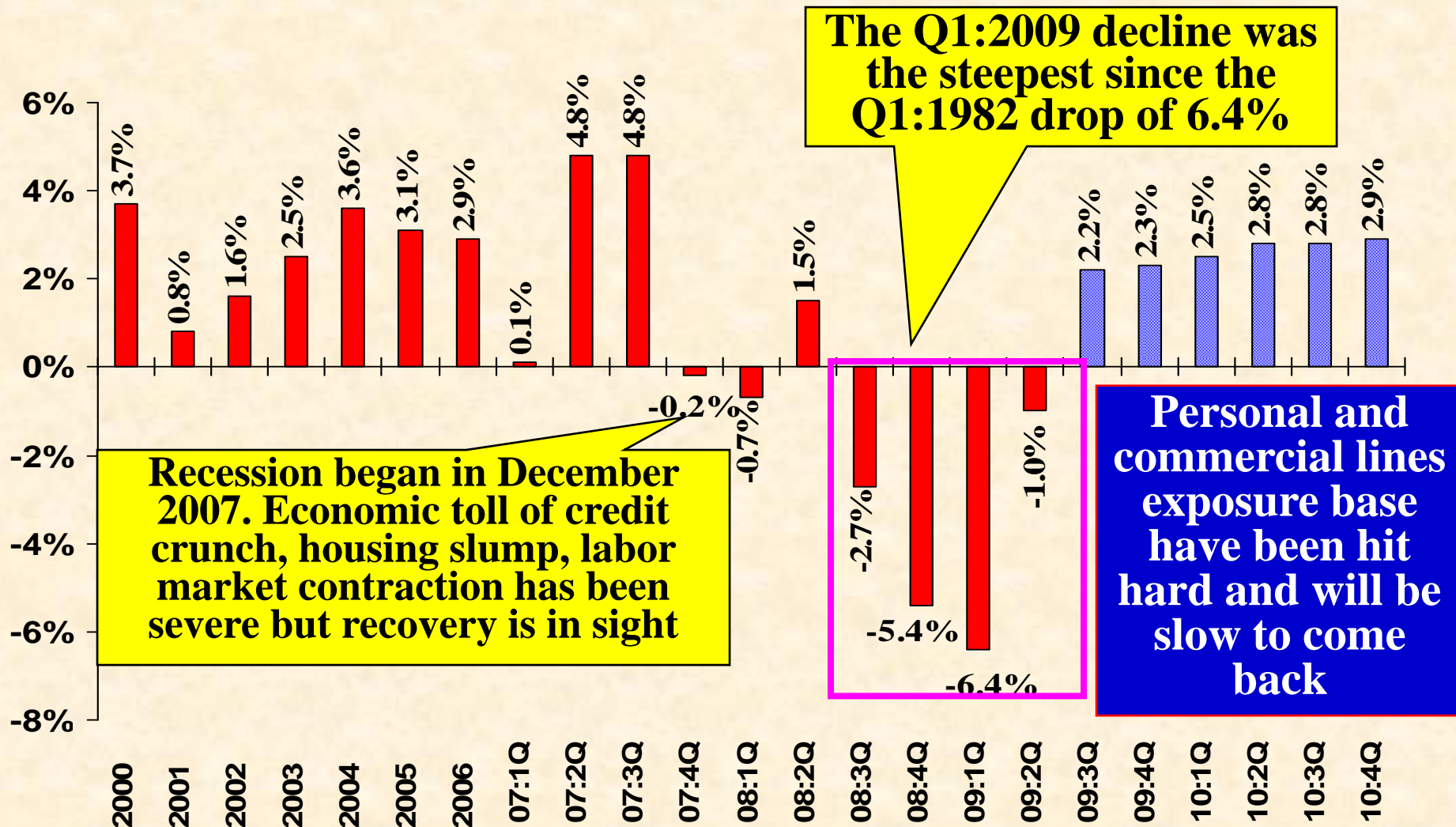
THE ECONOMIC STORM

*What the Financial Crisis and
Recession Mean for the Workers
Comp **Exposure Base**
and **Growth***





Real GDP Growth*



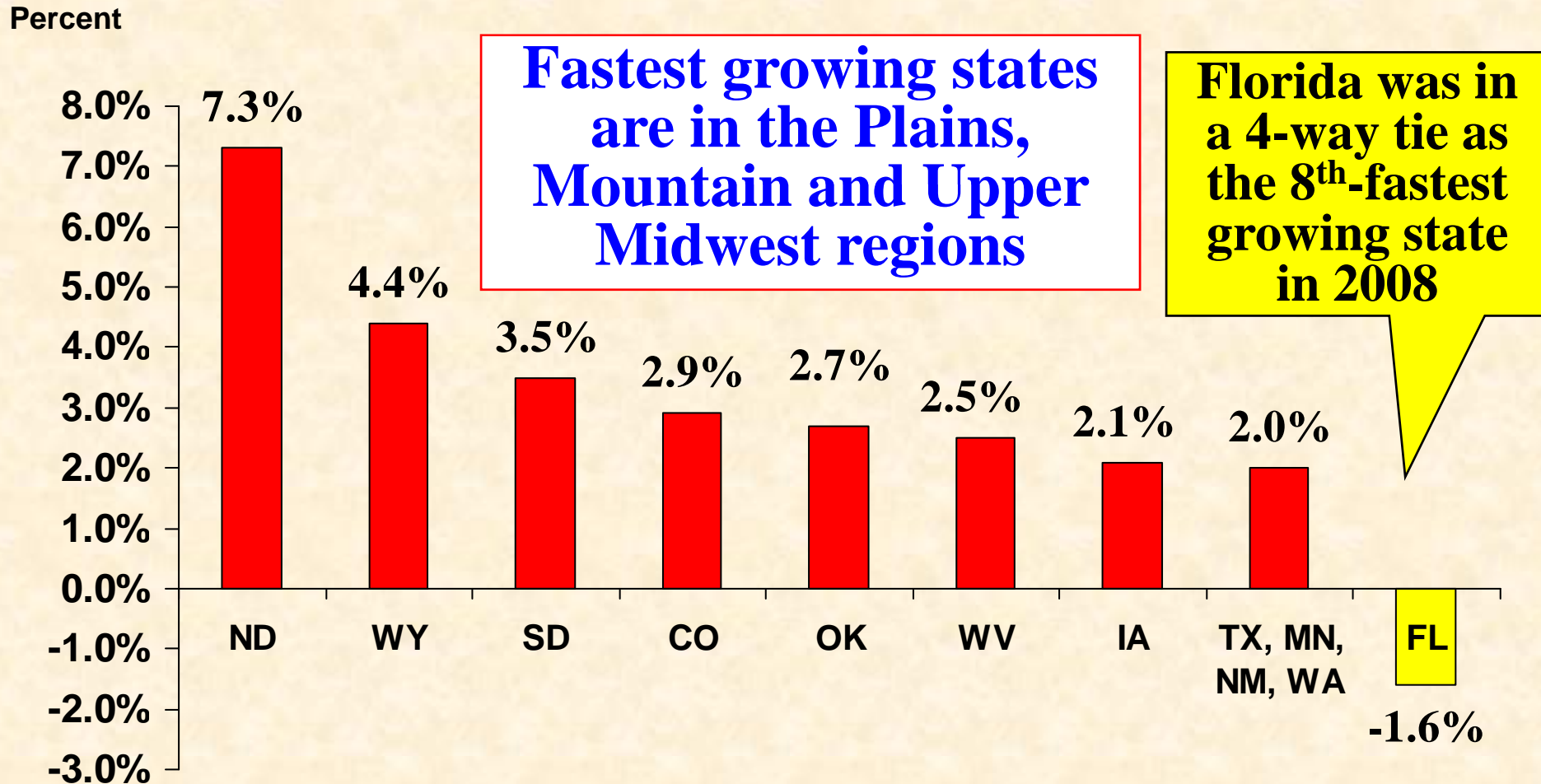
*Blue bars are Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 8/09; Insurance Information Institute.



Fastest Growing States in 2008 vs. Florida

Real State GDP Growth





Length of U.S. Business Cycles, 1929-Present*

Duration (Months)

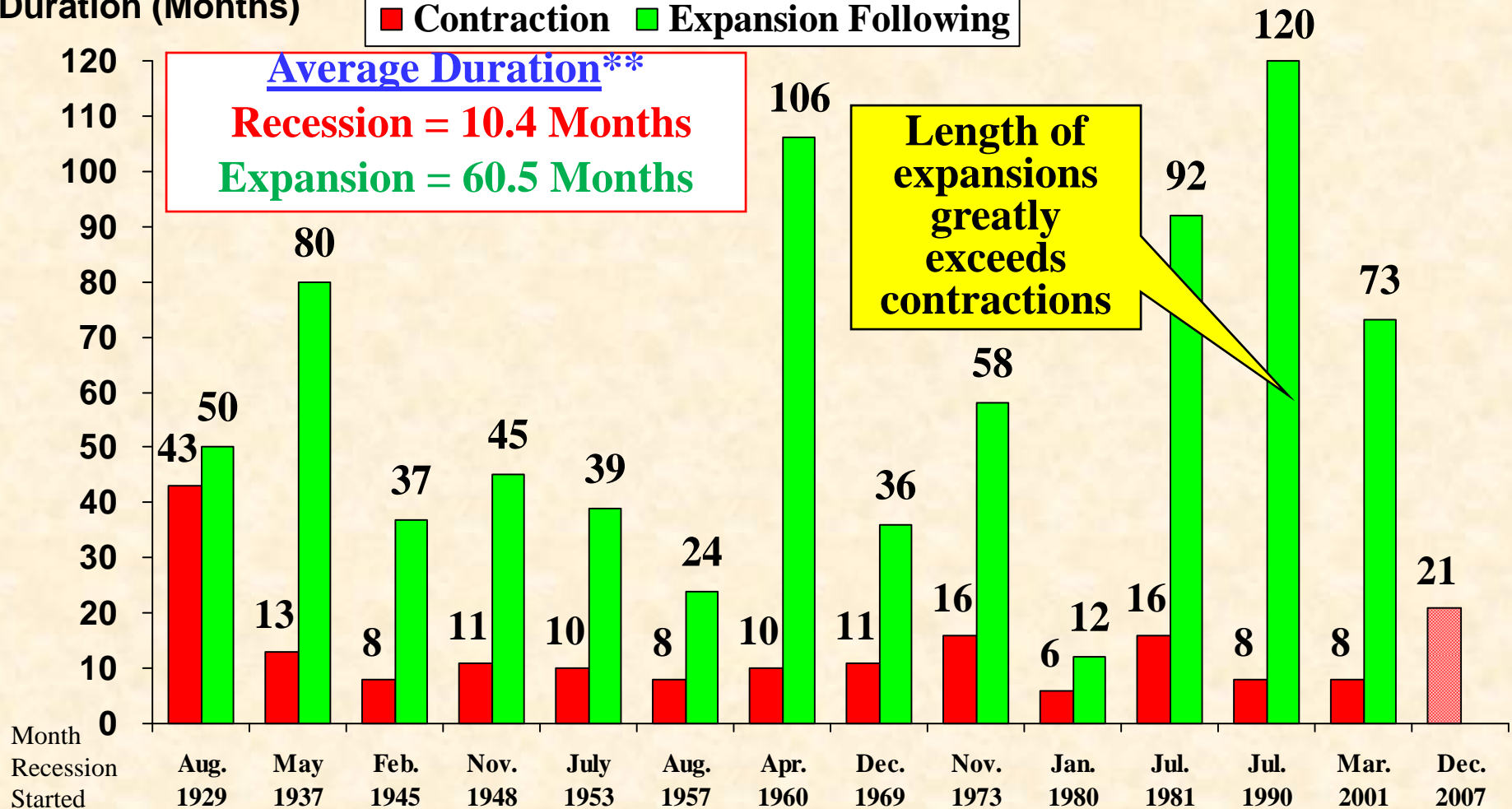
■ Contraction ■ Expansion Following

Average Duration**

Recession = 10.4 Months

Expansion = 60.5 Months

Length of
expansions
greatly
exceeds
contractions



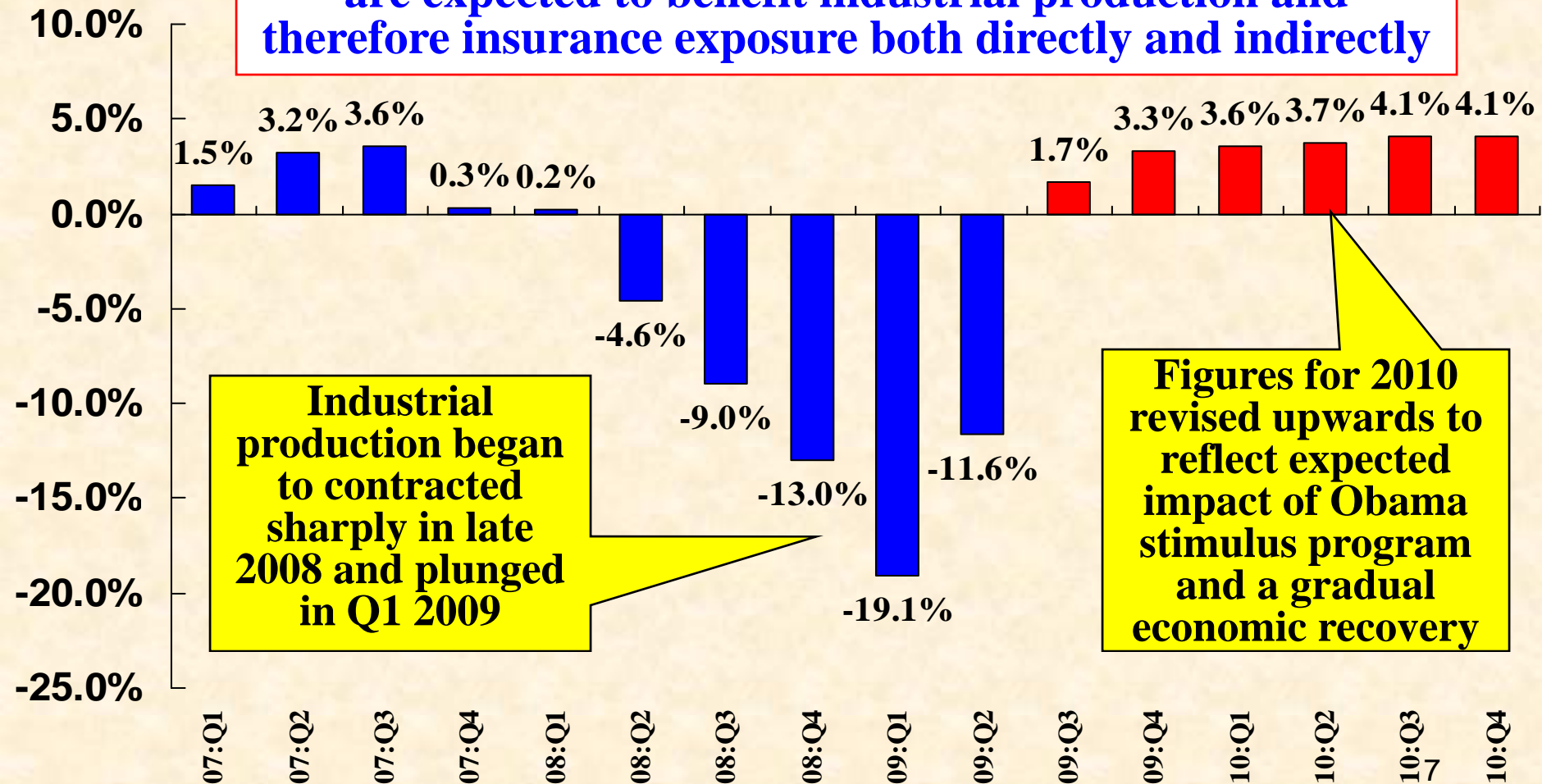
* As of August 2009, inclusive; **Post-WW II period through end of most recent expansion.

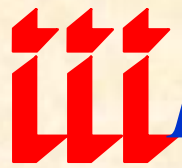
Sources: National Bureau of Economic Research; Insurance Information Institute.



Total Industrial Production, (2007:Q1 to 2010:Q4F)

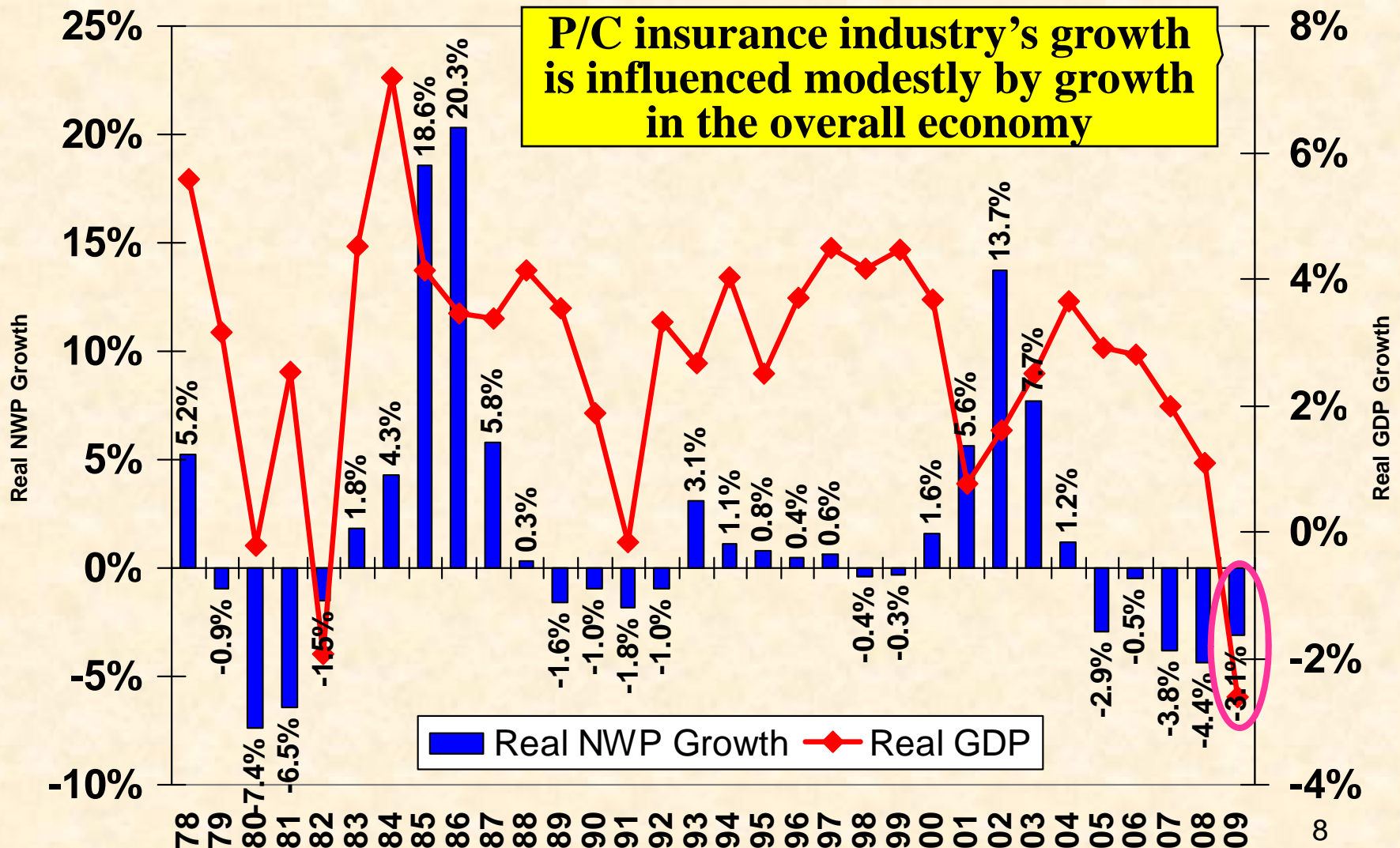
End of recession in late 2009, Obama stimulus program are expected to benefit industrial production and therefore insurance exposure both directly and indirectly





Real GDP Growth vs. Real P/C

Premium Growth: Modest Association



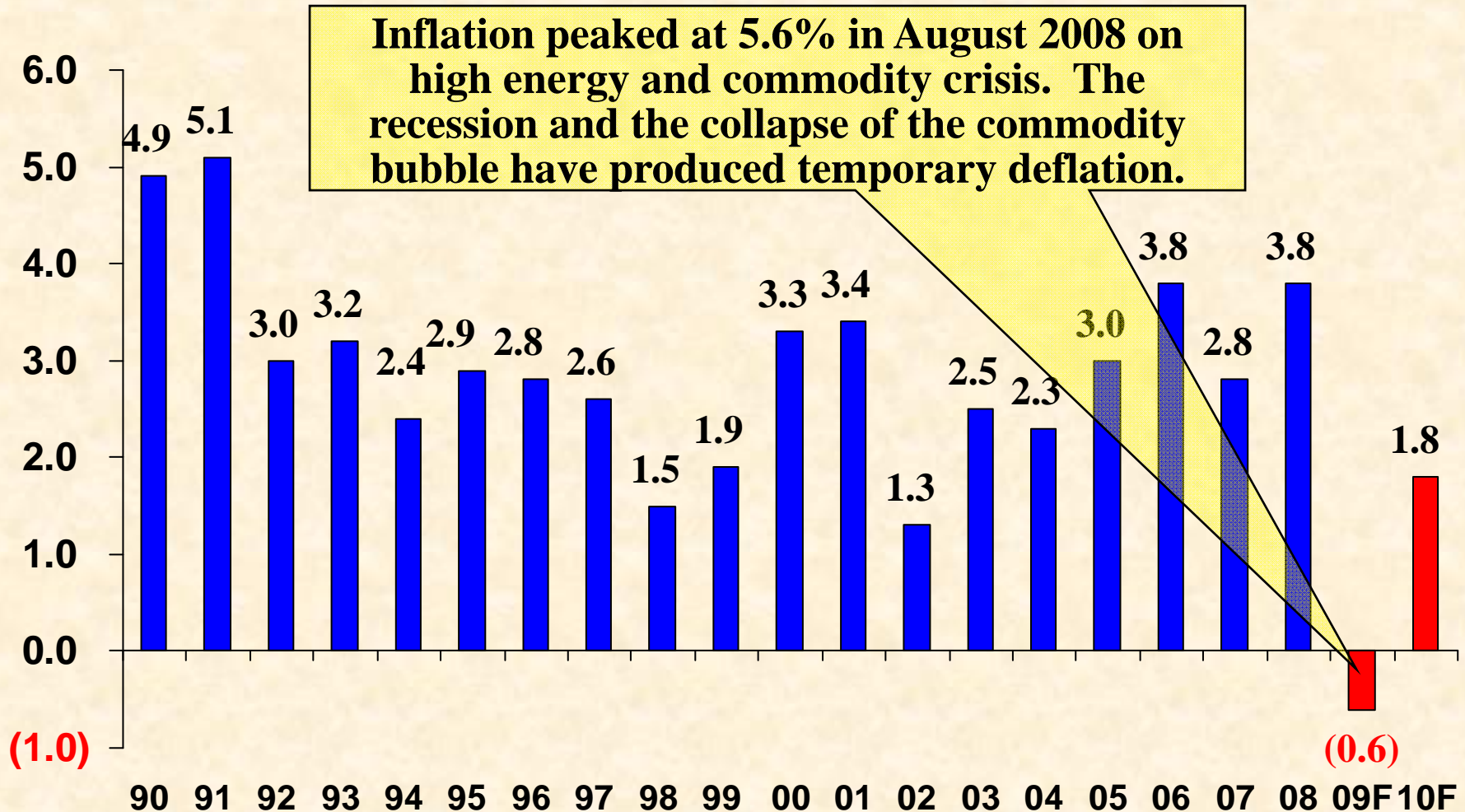
Inflation Trends

**Pressures Claim Cost
Severities via Medical and
Tort Channels**

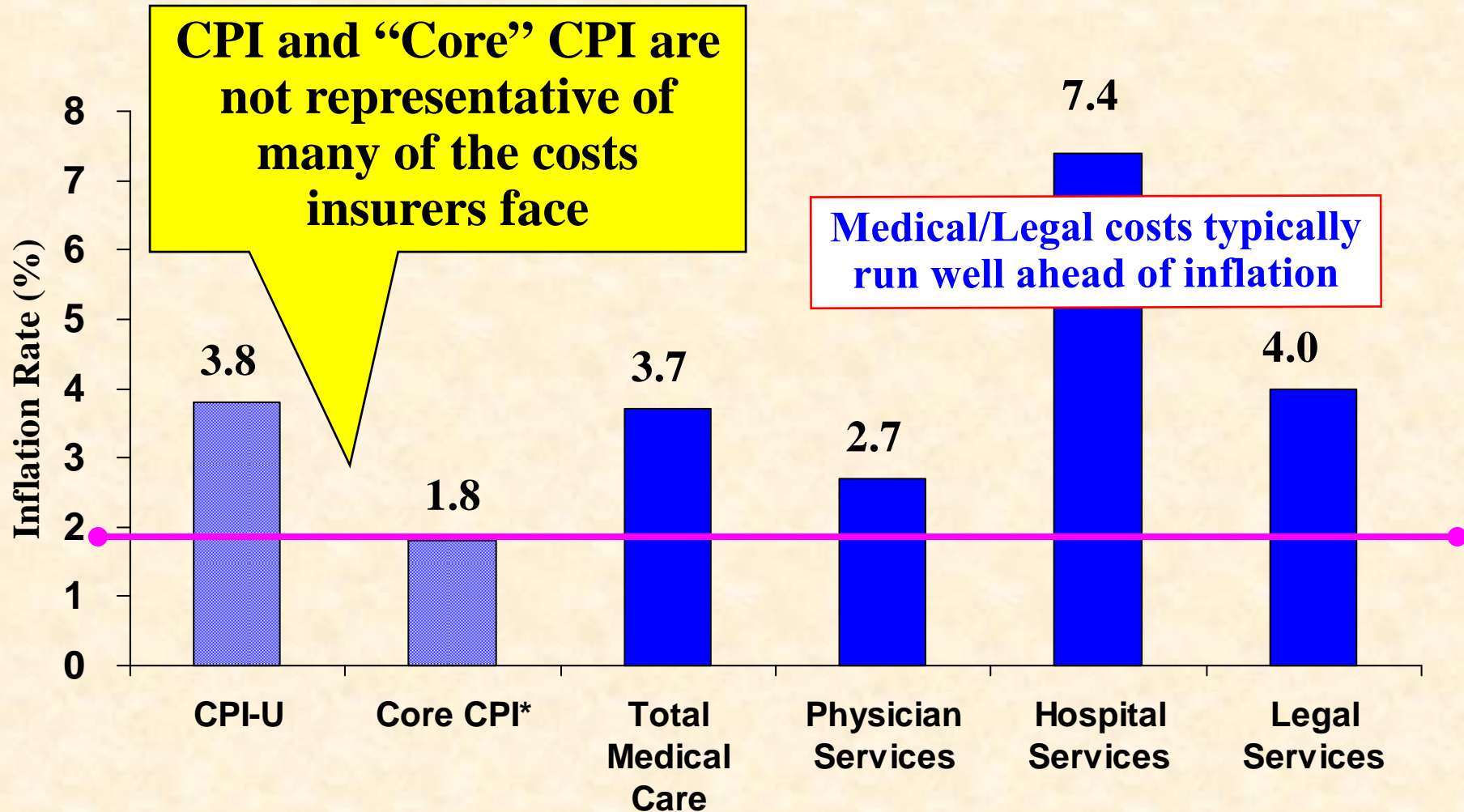




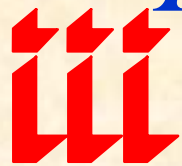
Annual Inflation Rates (CPI-U, %), 1990-2010F



Comparative 2008 Inflation Statistics Important to Insurers (%)



*Core CPI is the Consumer Price Index for all Urban Consumers (CPI-U) less food and energy costs.
Source: US Bureau of Labor Statistics; Insurance Information Institute.



Top Concerns/Risks for Insurers if Inflation is Reignited

CONCERNS: The Federal Reserve Has Flooded Financial System with Cash (Turned on the Printing Presses), the Federal Govt. Has Approved a \$787B Stimulus and the Deficit is Expected to Mushroom to \$1.8 Trillion. All Are Potentially Inflationary.

- What are the potential impacts for insurers?
- What can/should insurers do to protect themselves from the risks of inflation?

KEY RISKS FROM SUSTAINED/ACCELERATING INFLATION

- Rising Claim Severities
 - Cost of claims settlement rises across the board (property and liability)
- Rate Inadequacy
 - Rates inadequate due to low trend assumptions arising from use of historical data
- Reserve Inadequacy
 - Reserves may develop adversely and become inadequate (deficient)
- Burn Through on Retentions
 - Retentions, deductibles burned through more quickly
- Reinsurance Penetration/Exhaustion
 - Higher costs → risks burn through their retentions more quickly, tapping into re-insurance more quickly and potential exhausting their reinsurance more quickly

Labor Market Trends

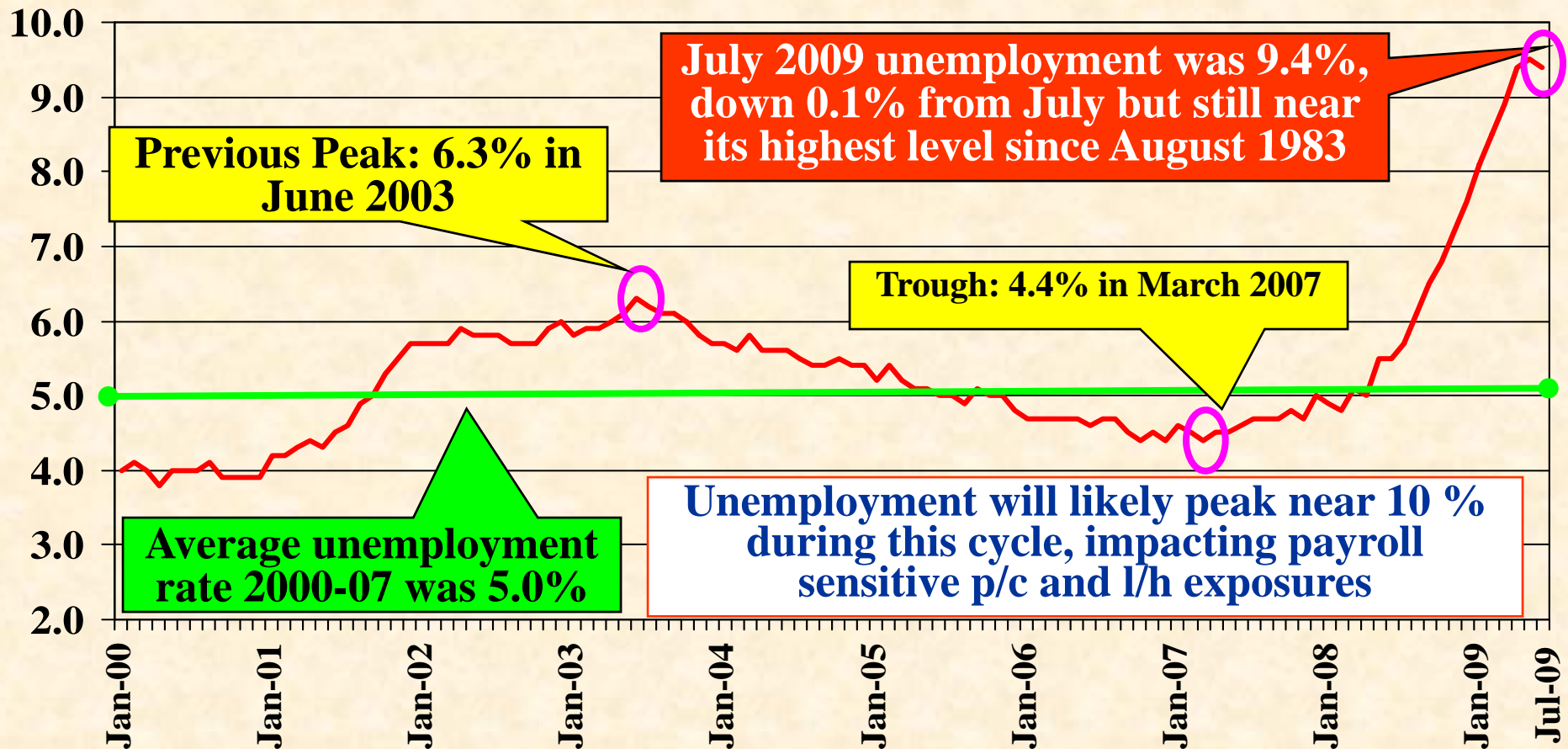
**Fast & Furious: Massive Job Losses
Sap the Economy Workers Comp &
Other Commercial Exposure**





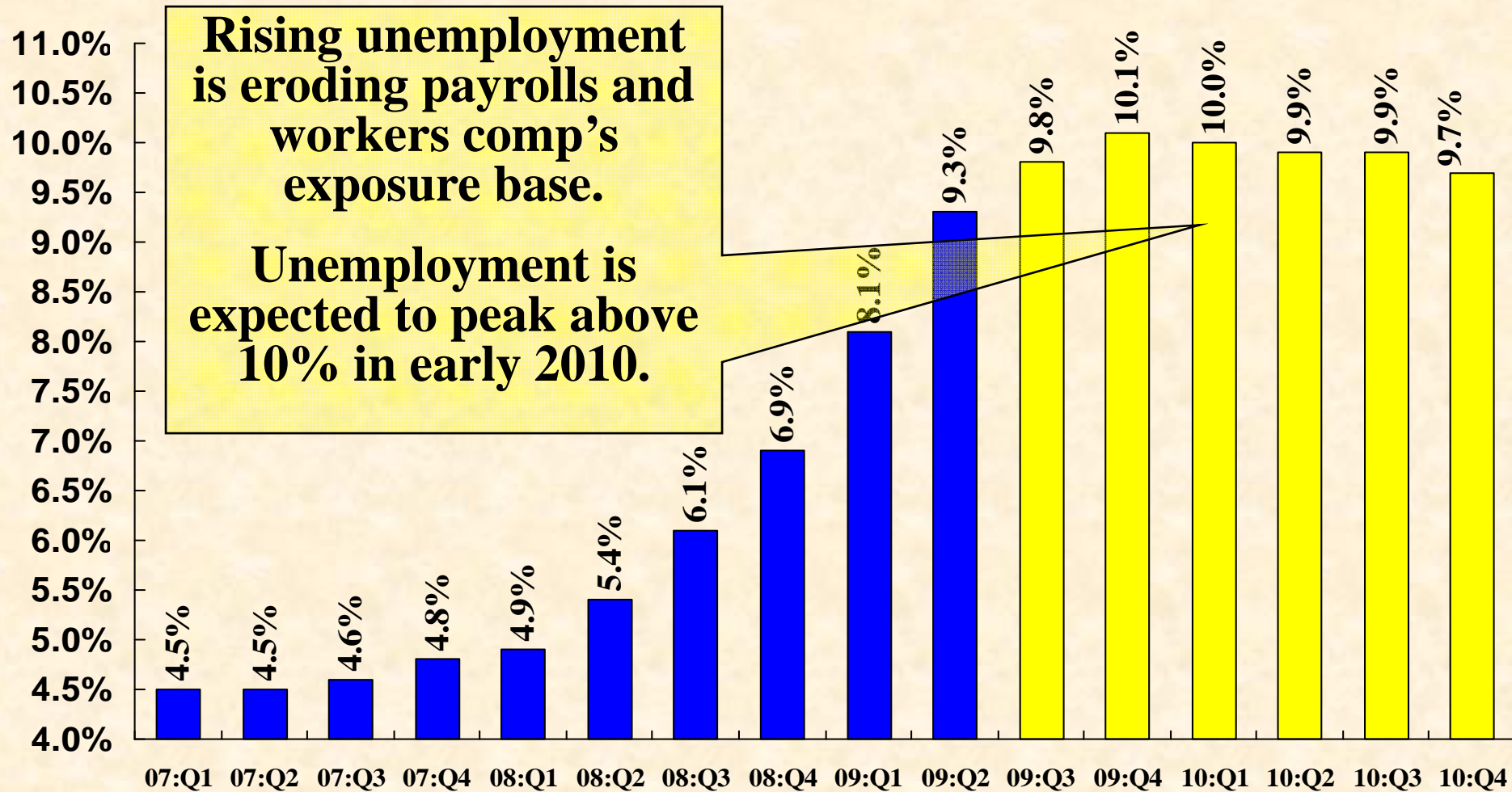
Unemployment Rate: On the Rise

January 2000 through July 2009





*U.S. Unemployment Rate, (2007:Q1 to 2010:Q4F)**



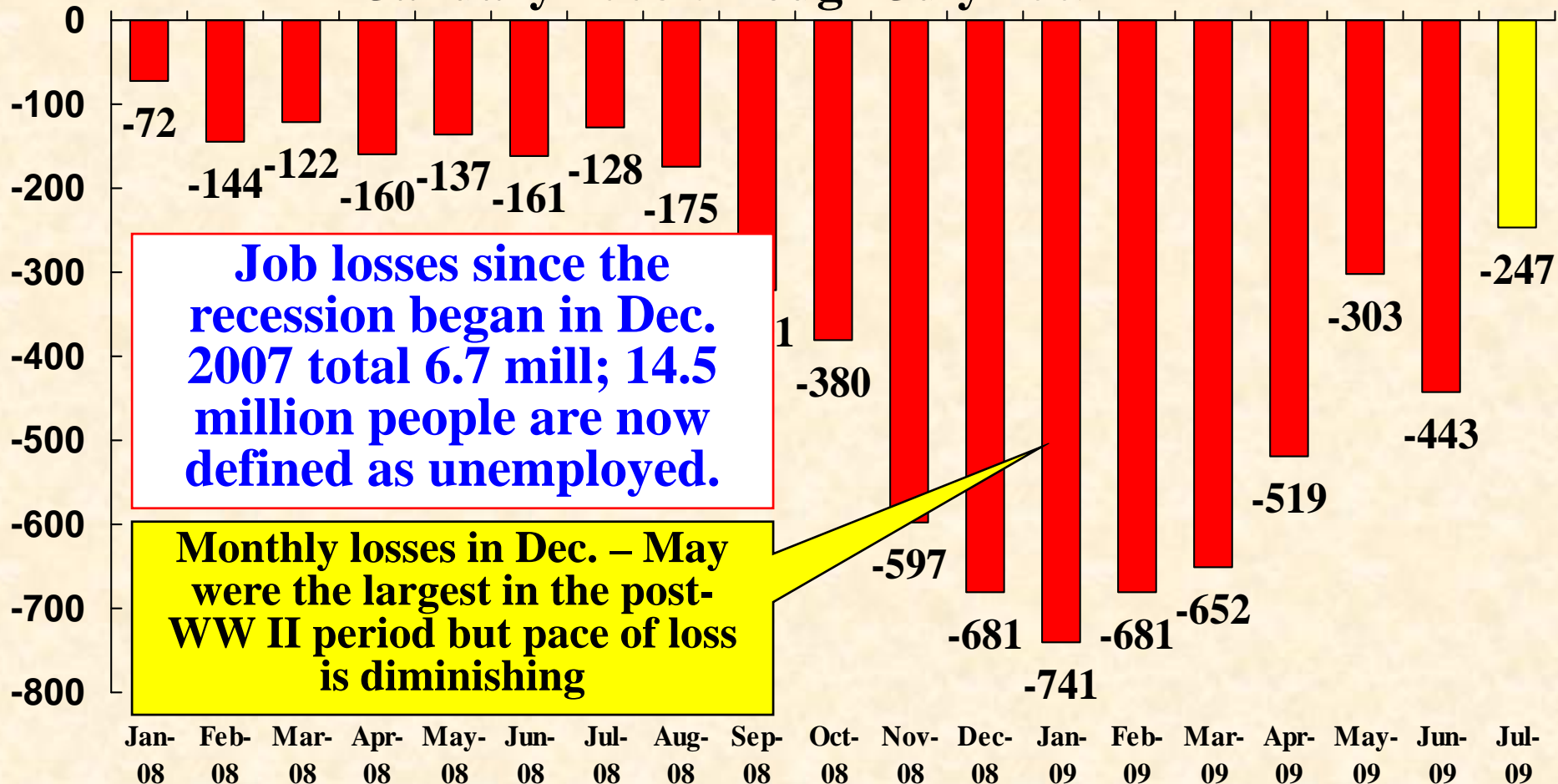
* Blue bars are actual; Yellow bars are forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (8/09); Insurance Info. Inst.



Monthly Change Employment* (Thousands)

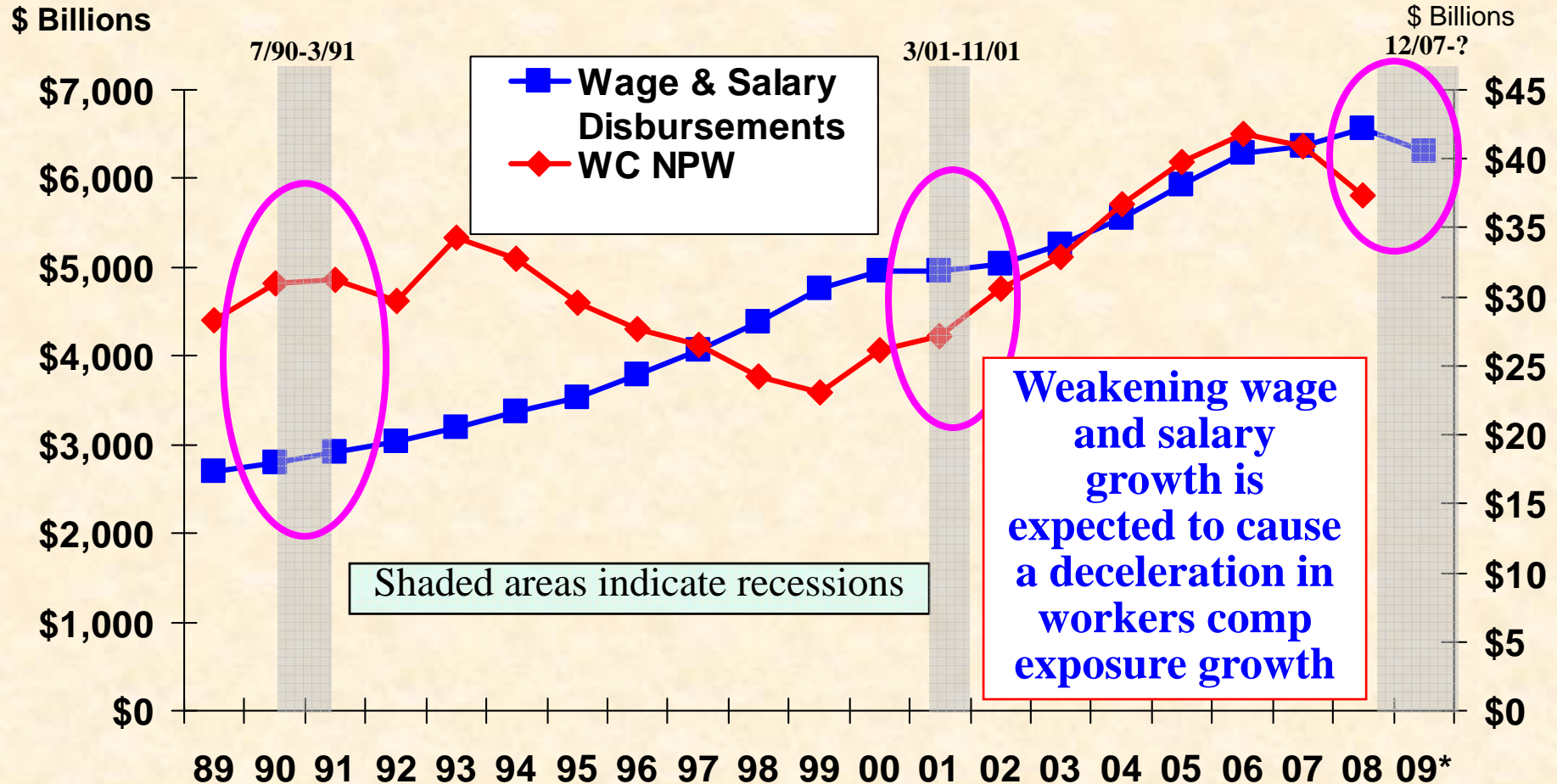
January 2008 through July 2009





Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums

Wage & Salary Disbursement (Private Employment) vs. WC NWP



*Average Wage and Salary data as of 4/1/2009.

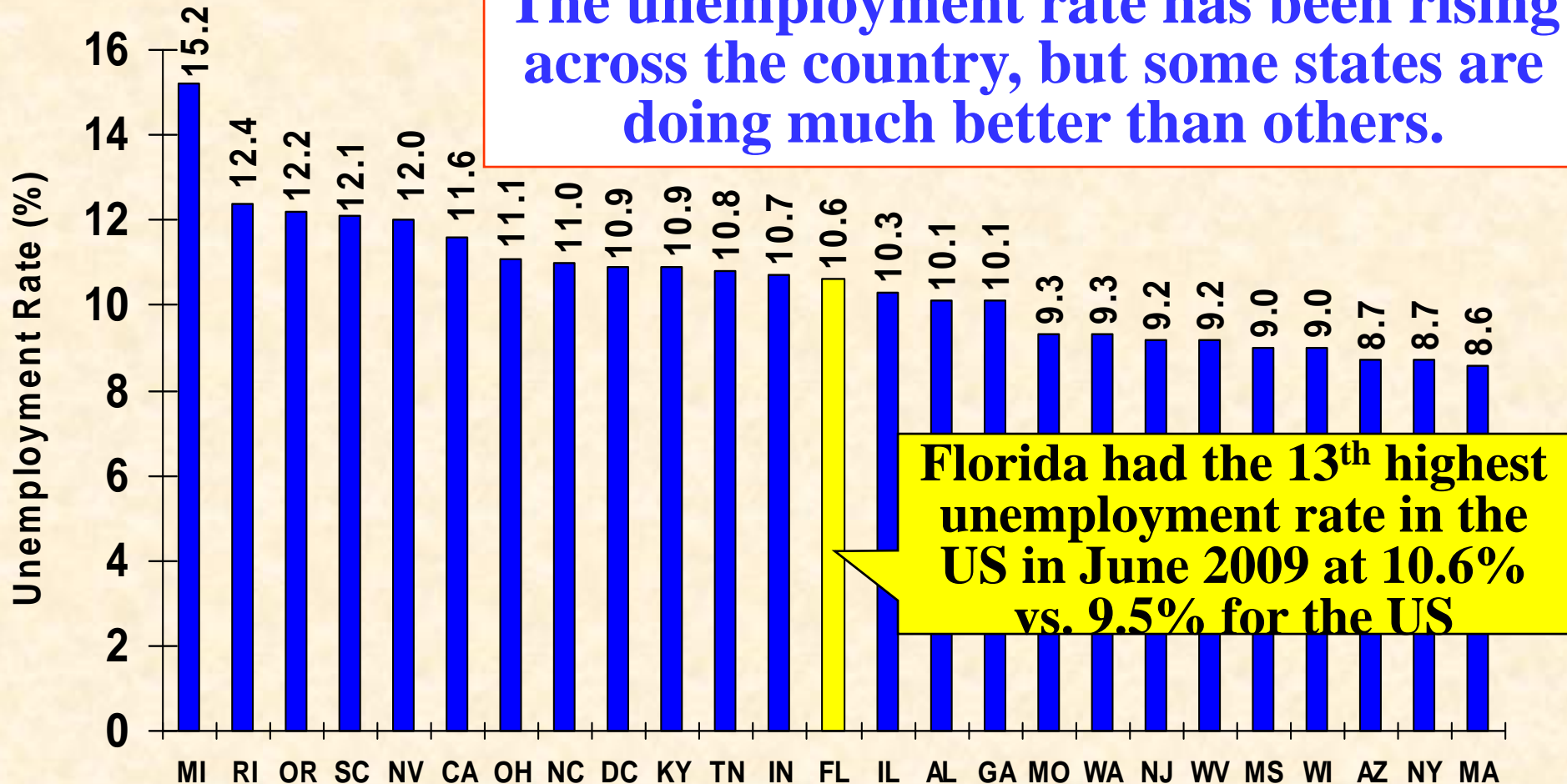
Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at

<http://research.stlouisfed.org/fred2/series/WASCUR>; I.I.I. Fact Books



Unemployment Rates by State, June 2009: Highest 25 States*

The unemployment rate has been rising across the country, but some states are doing much better than others.



Florida had the 13th highest unemployment rate in the US in June 2009 at 10.6% vs. 9.5% for the US

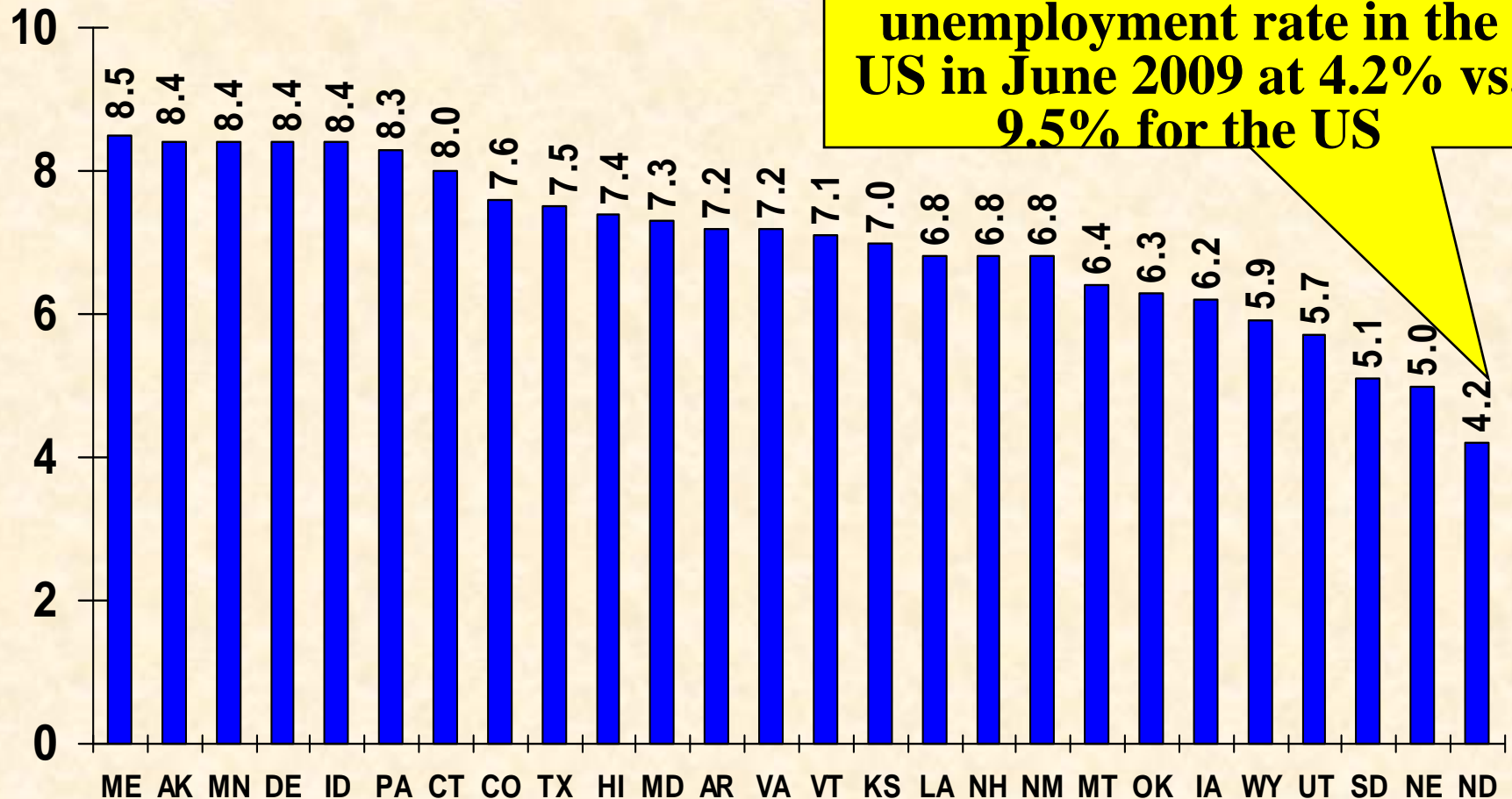
*Provisional figures for June 2009, seasonally adjusted.

Sources: US Bureau of Labor Statistics; Insurance Information Institute.



*Unemployment Rates By State, June 2009: Lowest 25 States**

North Dakota had the lowest unemployment rate in the US in June 2009 at 4.2% vs. 9.5% for the US



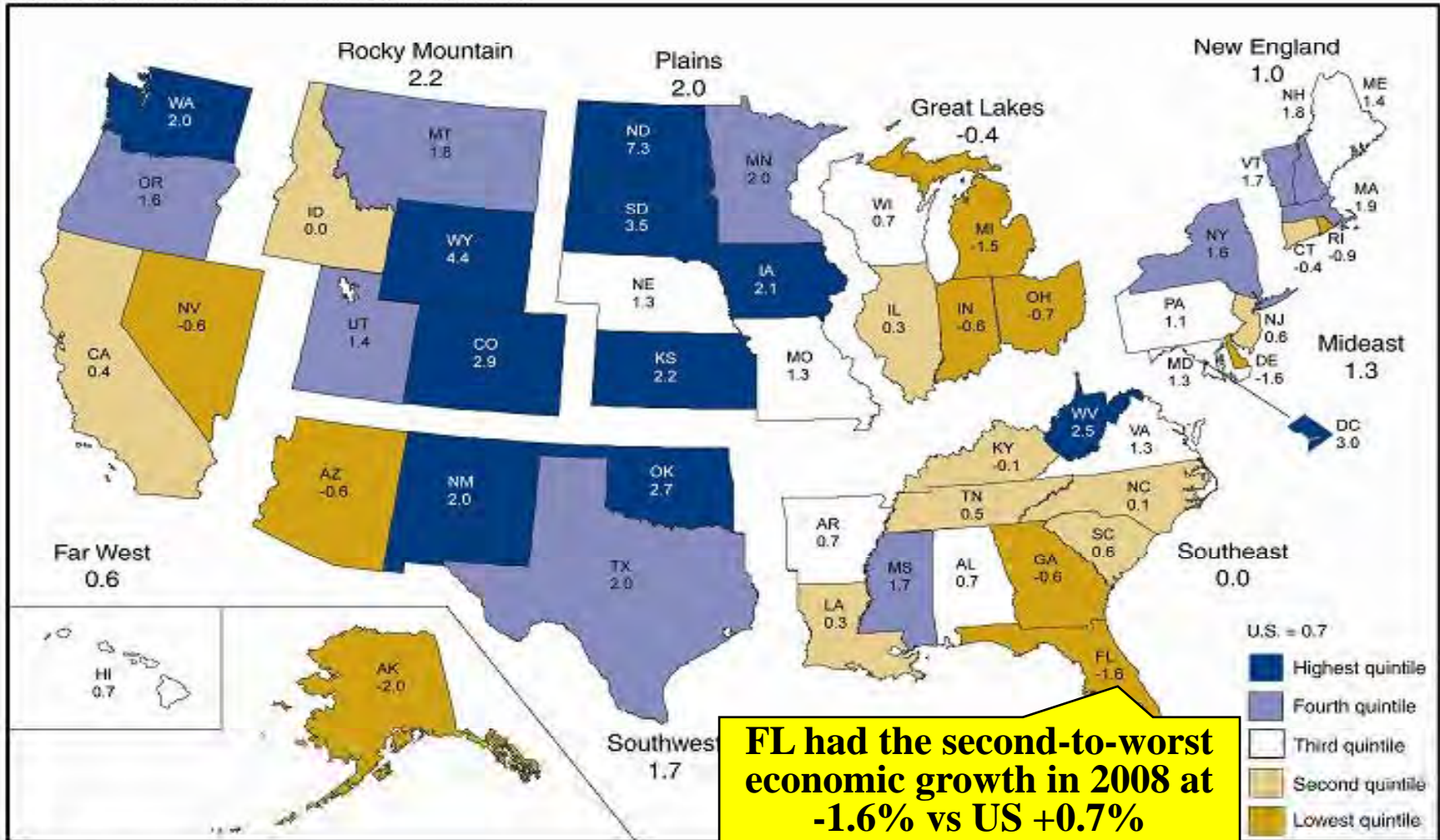
*Provisional figures for June 2009, seasonally adjusted.

Sources: US Bureau of Labor Statistics; Insurance Information Institute.



State Economic Growth Varied Tremendously in 2008

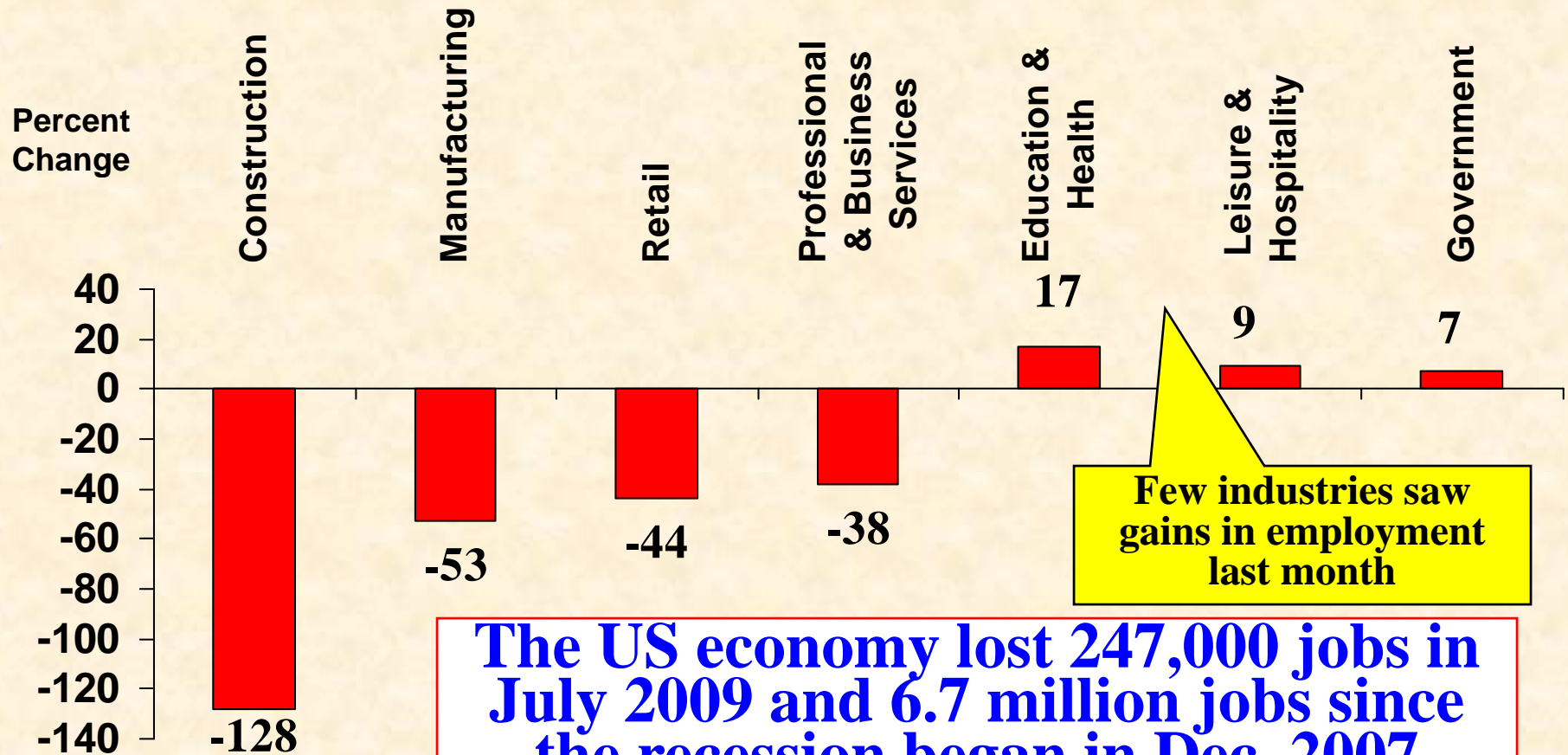
Percent Change in Real GDP by State, 2007-2008





Percent Change in Employment by Industry: Most Declined

Change in July 2009 vs. June 2009



State-by-State Infrastructure Spending & Job Gains

**Bigger States Get More, Should Benefit
Commercial Insurers Exposure**





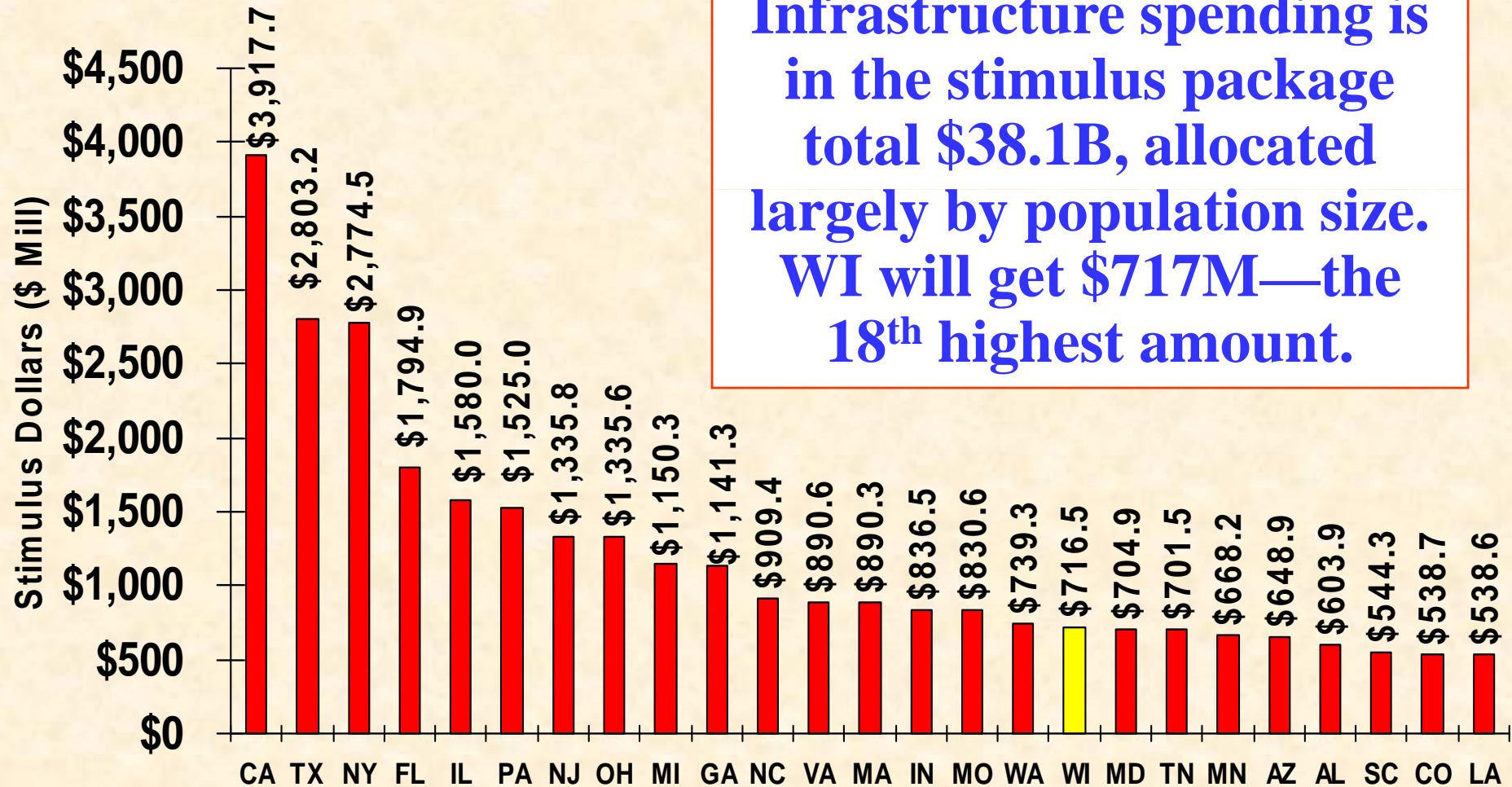
Infrastructure Stimulus Spending by State (Total = \$38.1B)

State	Allocation	State	Allocation	State	Allocation
AL	\$603,871,807	LA	\$538,575,876	OK	\$535,407,908
AK	\$240,495,117	ME	\$174,285,111	OR	\$453,788,475
AZ	\$648,928,995	MD	\$704,863,248	PA	\$1,525,011,979
AR	\$405,531,459	MA	\$890,333,825	RI	\$192,902,023
CA	\$3,917,656,769	MI	\$1,150,282,308	SC	\$544,291,398
CO	\$538,669,174	MN	\$668,242,481	SD	\$213,511,174
CT	\$487,480,166	MS	\$415,257,720	TN	\$701,516,776
DE	\$158,666,838	MO	\$830,647,063	TX	\$2,803,249,599
DC	\$267,617,455	MT	\$246,599,815	UT	\$292,231,904
FL	\$1,794,913,566	NE	\$278,897,762	VT	\$150,666,577
GA	\$1,141,255,941	NV	\$270,010,945	VA	\$890,584,959
HI	\$199,866,172	NH	\$181,678,856	WA	\$739,283,923
ID	\$219,528,313	NJ	\$1,335,785,100	WV	\$290,479,108
IL	\$1,579,965,373	NM	\$299,589,086	WI	\$716,457,120
IN	\$836,483,568	NY	\$2,774,508,711	WY	\$186,111,170
IA	\$447,563,924	NC	\$909,397,136	U.S. Territories	\$238,045,760
KS	\$413,837,382	ND	\$200,318,301		
KY	\$521,153,404	OH	\$1,335,600,553	Total	\$38,101,898,173

Sources: USA Today, 2/17/09; House Transportation and Infrastructure Committee; the Associated Press.



Infrastructure Stimulus Spending By State: Top 25 States (\$ Millions)

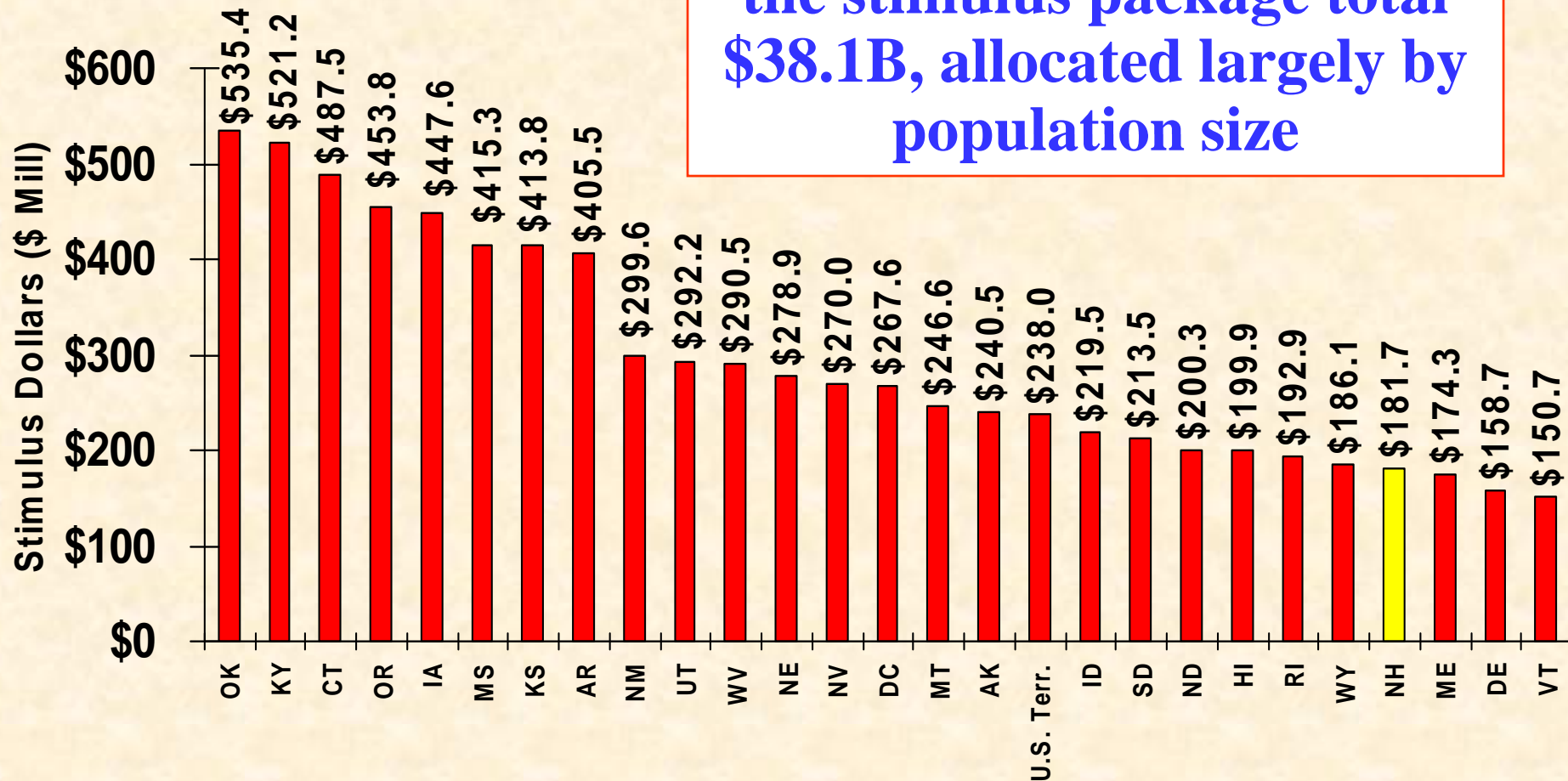


Infrastructure spending is in the stimulus package total \$38.1B, allocated largely by population size. WI will get \$717M—the 18th highest amount.



Infrastructure Stimulus Spending By State: Bottom 25 States (\$ Millions)

Infrastructure spending is in the stimulus package total \$38.1B, allocated largely by population size



Expected Number of Jobs Gained or Preserved by Stimulus Spending

*Larger States = More Jobs
Workers Comp Benefits*





Estimated Job Effect of Stimulus: Jobs Created/Saved By State – 3.5 Mill Total

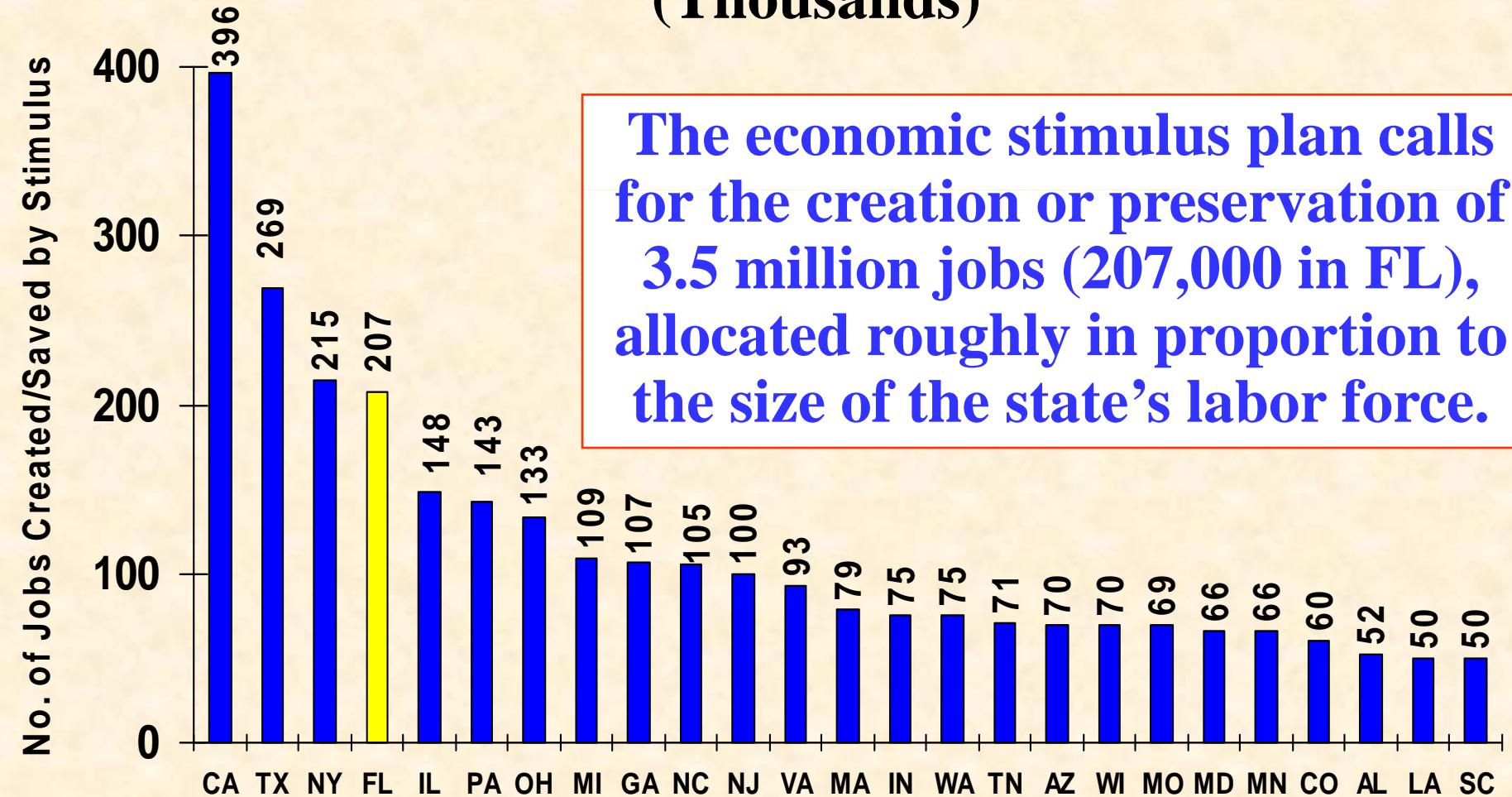
State	Jobs Created	State	Jobs Created	State	Jobs Created
AL	52,000	LA	50,000	OK	40,000
AK	8,000	ME	15,000	OR	44,000
AZ	70,000	MD	66,000	PA	143,000
AR	32,000	MA	79,000	RI	12,000
CA	396,000	MI	109,000	SC	50,000
CO	60,000	MN	66,000	SD	10,000
CT	41,000	MS	30,000	TN	71,000
DE	11,000	MO	69,000	TX	269,000
DC	12,000	MT	11,000	UT	32,000
FL	207,000	NE	23,000	VT	8,000
GA	107,000	NV	34,000	VA	93,000
HI	16,000	NH	16,000	WA	75,000
ID	17,000	NJ	100,000	WV	20,000
IL	148,000	NM	22,000	WI	70,000
IN	75,000	NY	215,000	WY	8,000
IA	37,000	NC	105,000		
KS	33,000	ND	9,000		
KY	48,000	OH	133,000	Total	3,467,000

Sources: <http://www.recovery.gov/>; Council of Economic Advisers; Insurance Information Institute.



Estimated Job Effect of Stimulus Spending By State: Top 25 States

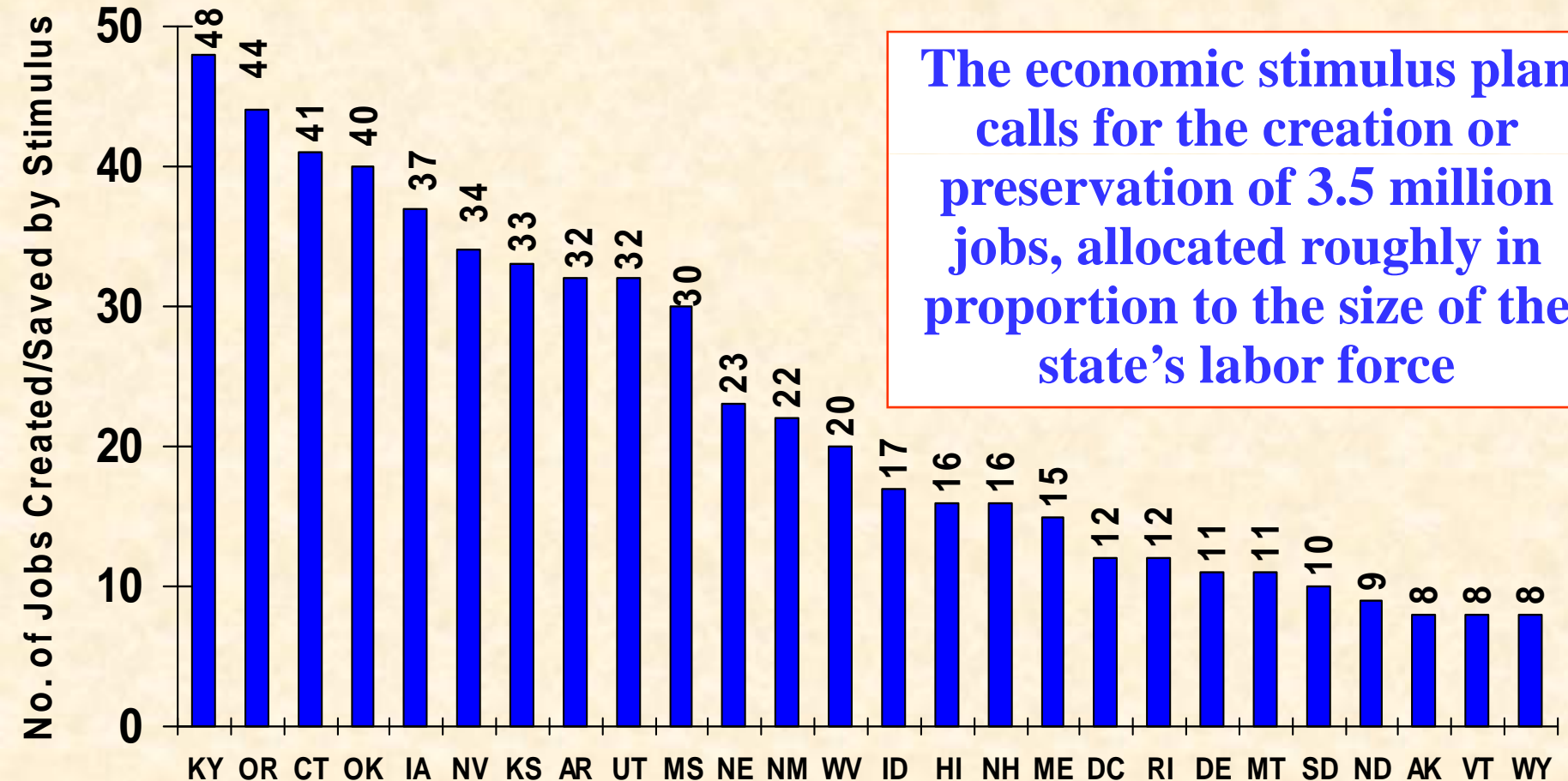
(Thousands)





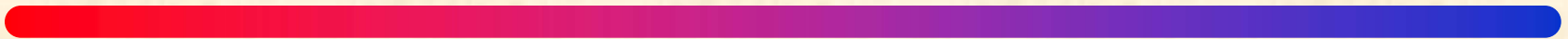
Estimated Job Effect of Stimulus Spending By State: Bottom 25 States

(Thousands)



GREEN SHOOTS

*Is the Recession
Nearing an End?*





Hopeful Signs That the Economy Will Begin to Recover Soon

- **Recession Appears to be Bottoming Out, Freefall Has Ended**
 - Pace of GDP shrinkage is beginning to diminish
 - Pace of job losses is slowing
 - Major stock market indices well off record lows, anticipating recovery
 - Some signs of retail sales stabilization are evident
- **Financial Sector is Stabilizing**
 - Banks are reporting quarterly profits
 - Many banks expanding lending to credit worthy people & businesses
- **Housing Sector Likely to Find Bottom Soon**
 - Home are much more affordable (attracting buyers)
 - Mortgage rates are still low relative to pre-crisis levels (attracting buyers)
 - Freefall in housing starts and existing home sales is ending in many areas
- **Inflation & Energy Prices Are Under Control**
- **Consumer & Business Debt Loads Are Shrinking**



11 Industries for the Next 10 Years: Insurance Solutions Needed

**Government
Education
Health Care
Energy (Traditional)
Alternative Energy
Agriculture
Natural Resources
Environmental
Technology
Light Manufacturing
Export Oriented Industries**

Crisis-Driven Exposure Implications

*Exposure Growth Slowed
as Economy Nosedived*



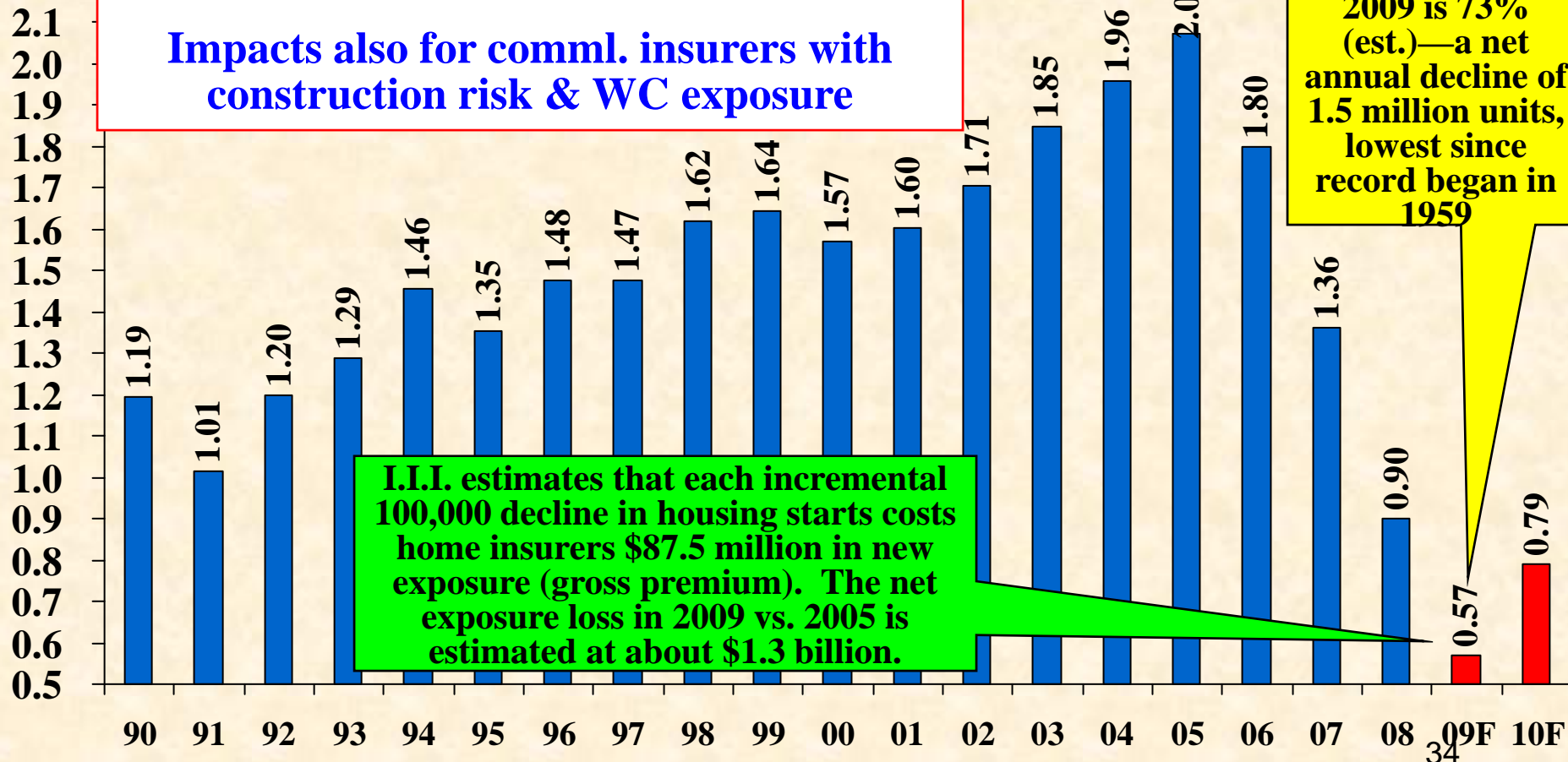


New Private Housing Starts, 1990-2010F (Millions of Units)

**Exposure growth due to home construction
forecast for HO insurers is dim for 2009
with some improvement in 2010.**

**Impacts also for comml. insurers with
construction risk & WC exposure**

**New home starts
plunged 34%
from 2005-2007;
Drop through
2009 is 73%
(est.)—a net
annual decline of
1.5 million units,
lowest since
record began in
1959**



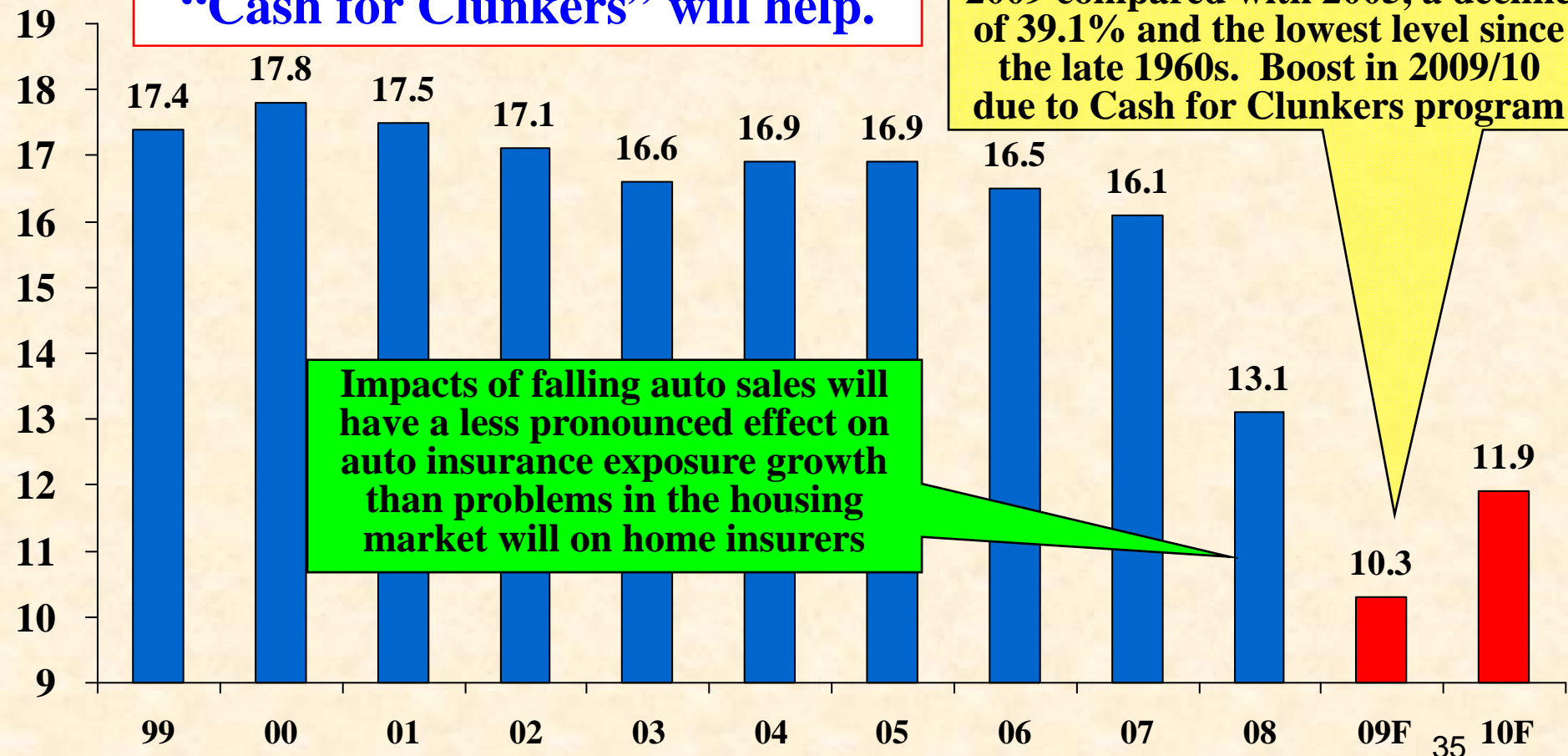
**I.I.I. estimates that each incremental
100,000 decline in housing starts costs
home insurers \$87.5 million in new
exposure (gross premium). The net
exposure loss in 2009 vs. 2005 is
estimated at about \$1.3 billion.**



Auto/Light Truck Sales, 1999-2010F (Millions of Units)

**Weak economy, credit crunch,
gas prices hurt auto sales;
“Cash for Clunkers” will help.**

**New auto/light truck sales are
expected to experience a net drop
of 6.6 million units annually by
2009 compared with 2005, a decline
of 39.1% and the lowest level since
the late 1960s. Boost in 2009/10
due to Cash for Clunkers program**



FINANCIAL STRENGTH & RATINGS

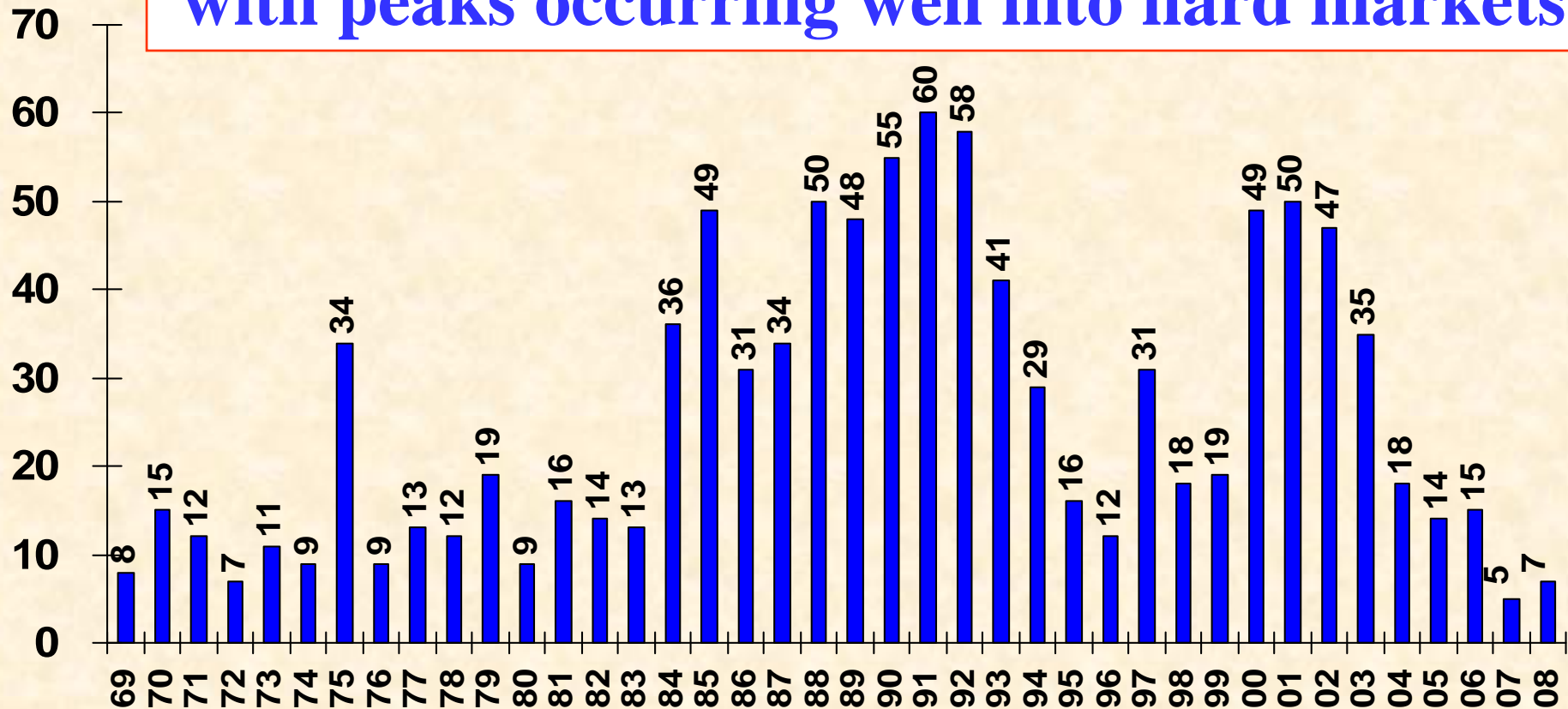
**Industry Has Weathered
the Storms Well**





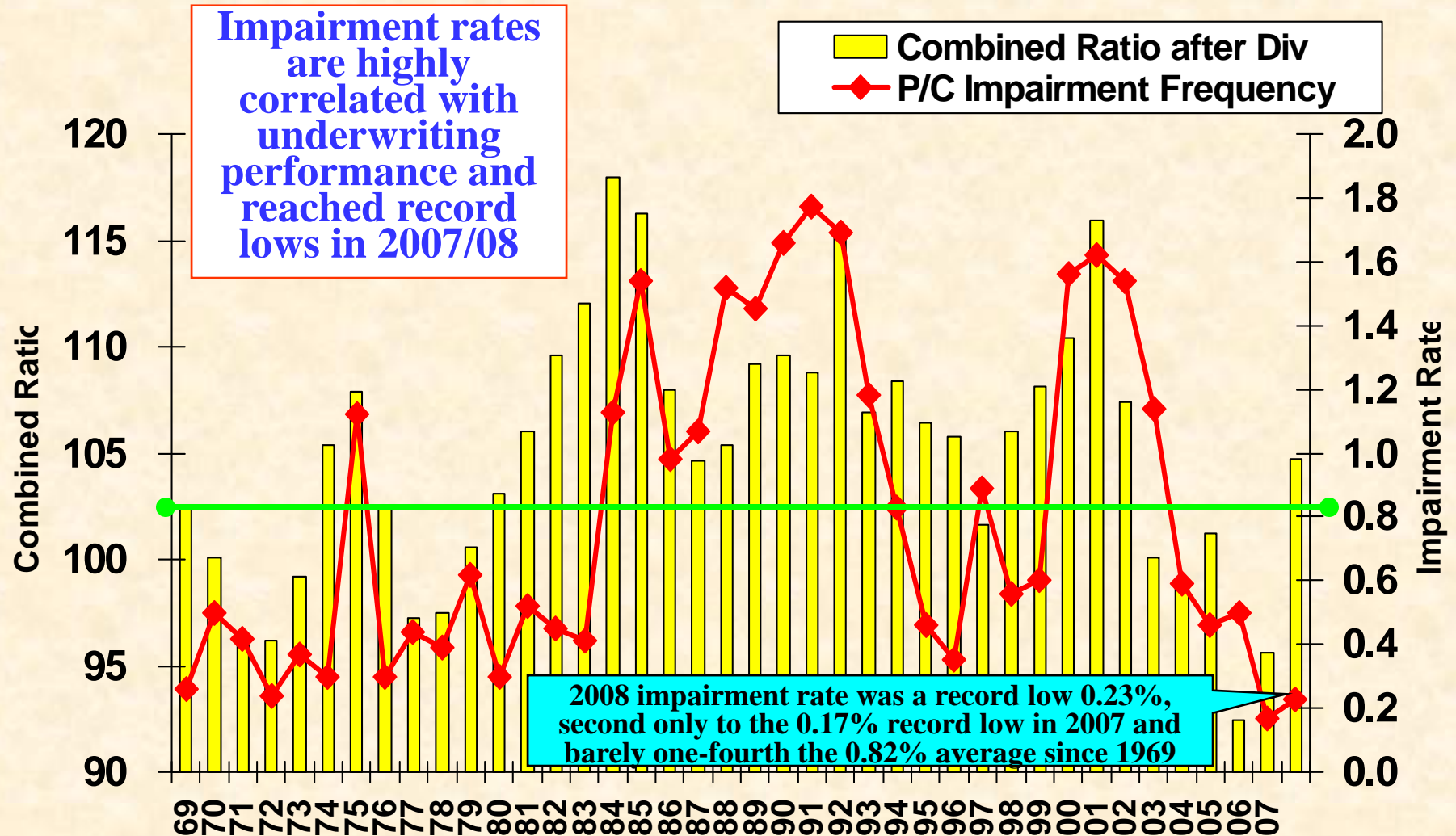
P/C Insurer Impairments, 1969-2008

The number of impairments varies significantly over the p/c insurance cycle, with peaks occurring well into hard markets





P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2008

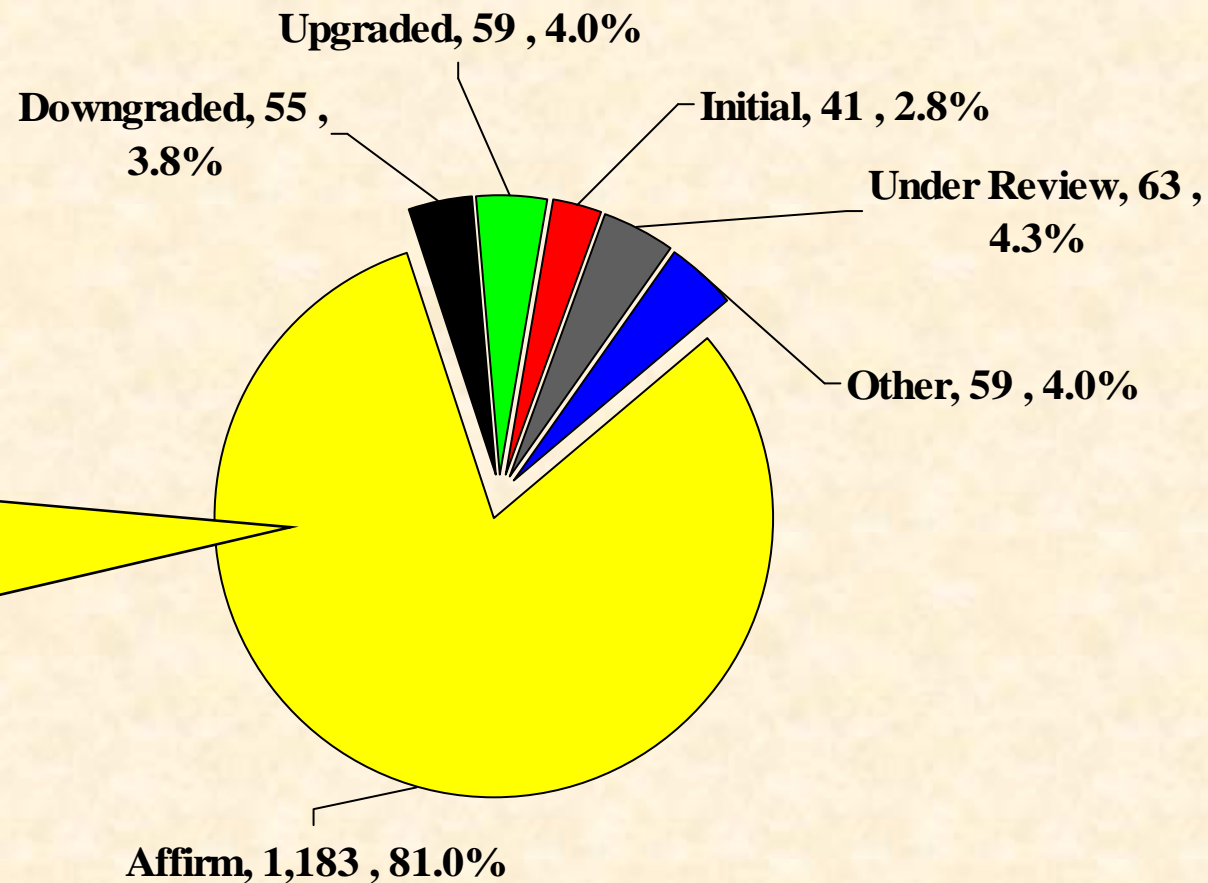




Summary of A.M. Best's P/C Insurer Ratings Actions in 2008*

P/C insurance is by design a resilient in business. The dual threat of financial disasters and catastrophic losses are anticipated in the industry's risk management strategy.

Despite financial market turmoil, high cat losses and a soft market in 2008, 81% of ratings actions by A.M. Best were affirmations; just 3.8% were downgrades and 4.0% upgrades



*Through December 19.

Source: A.M. Best.



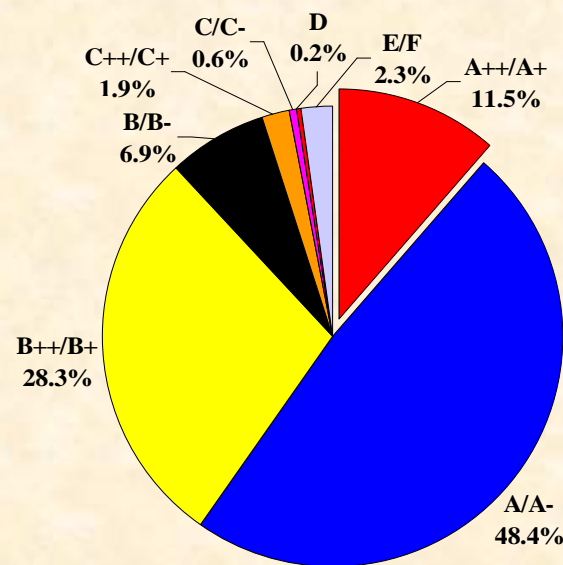
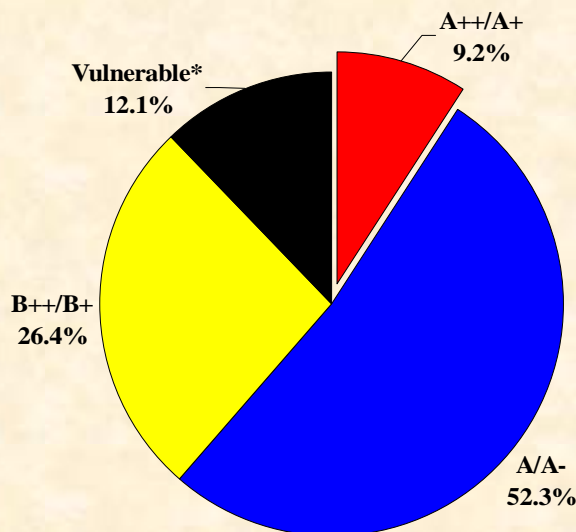
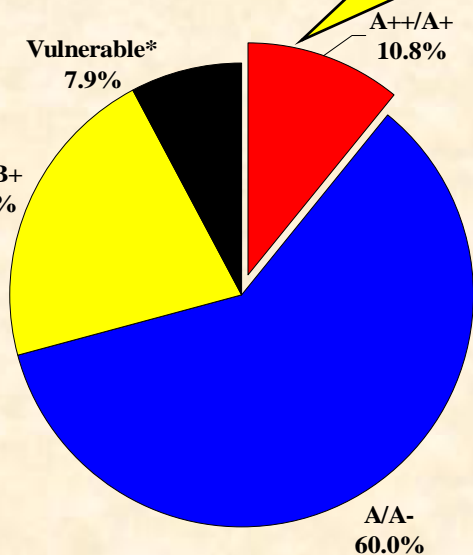
Historical Ratings Distribution, US P/C Insurers, 2008 vs. 2005 and 2000

2008

**A++/A+ and
A/A- gains**

2005

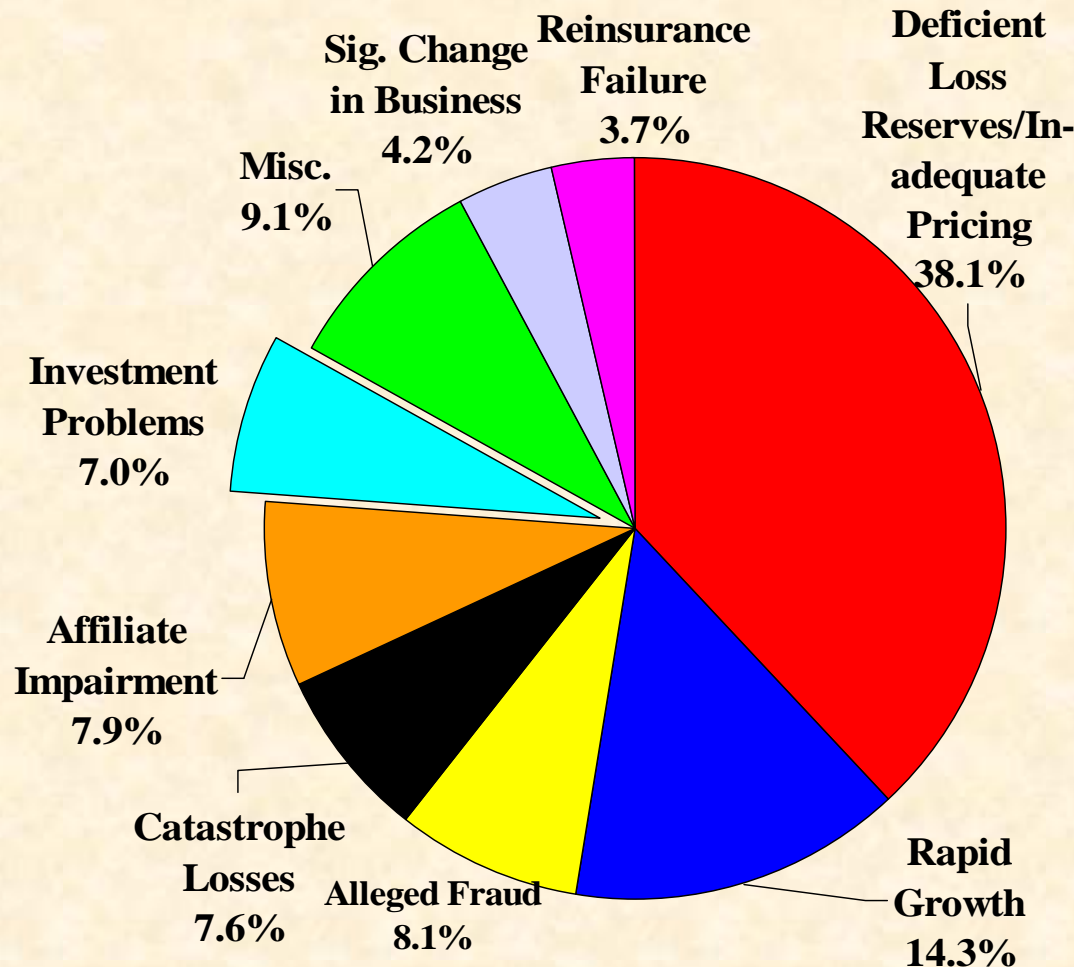
2000



**P/C insurer financial strength
has improved since 2005
despite financial crisis**



Reasons for US P/C Insurer Impairments, 1969-2008



Deficient loss reserves and inadequate pricing are the leading cause of insurer impairments, underscoring the importance of discipline. Investment catastrophe losses play a much smaller role.

P/C INSURANCE FINANCIAL PERFORMANCE

**A Resilient Industry in
 Challenging Times**

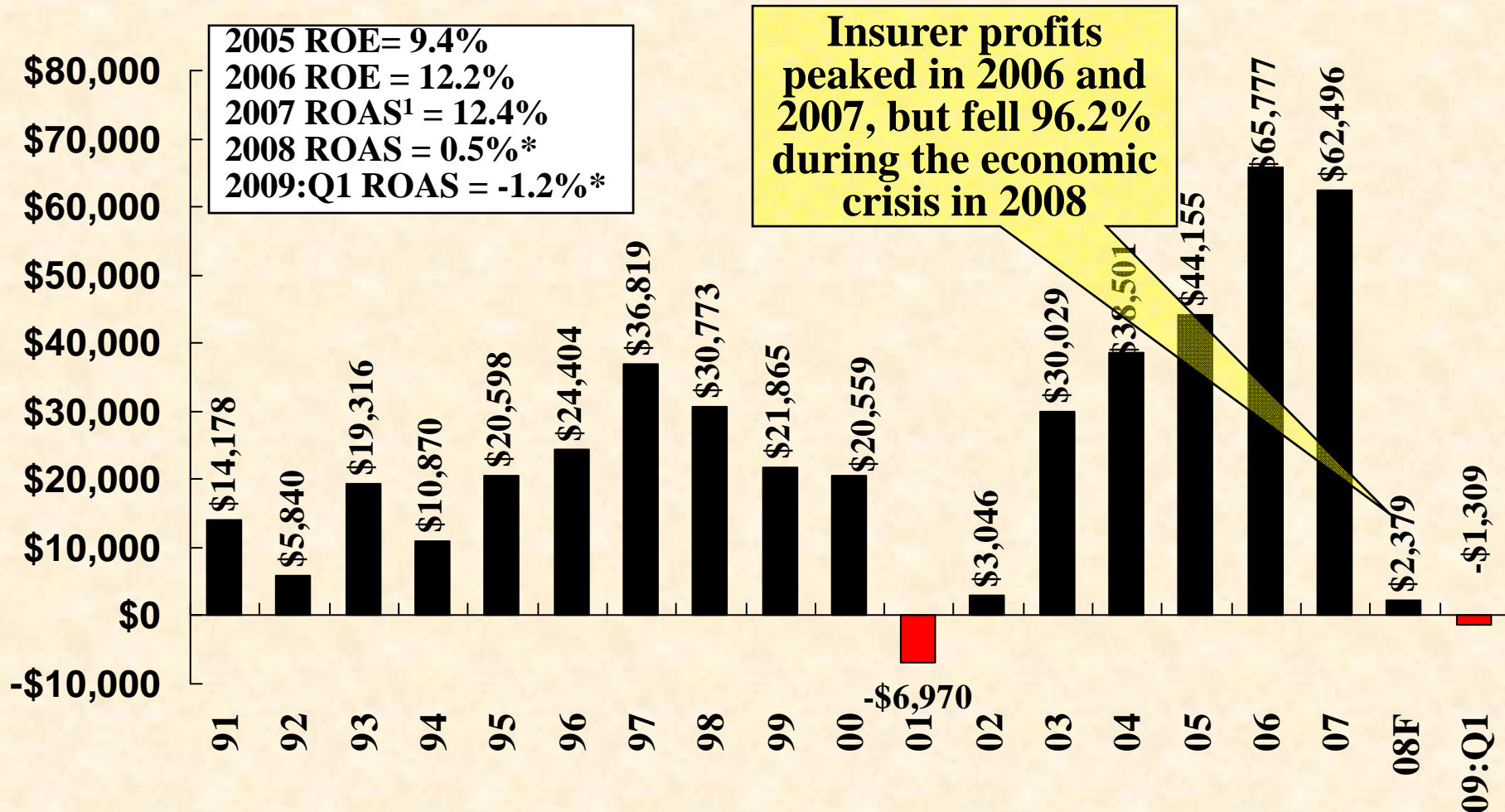
Profitability

Historically Volatile





*P/C Net Income After Taxes 1991-2009:Q1 (\$ Millions)**

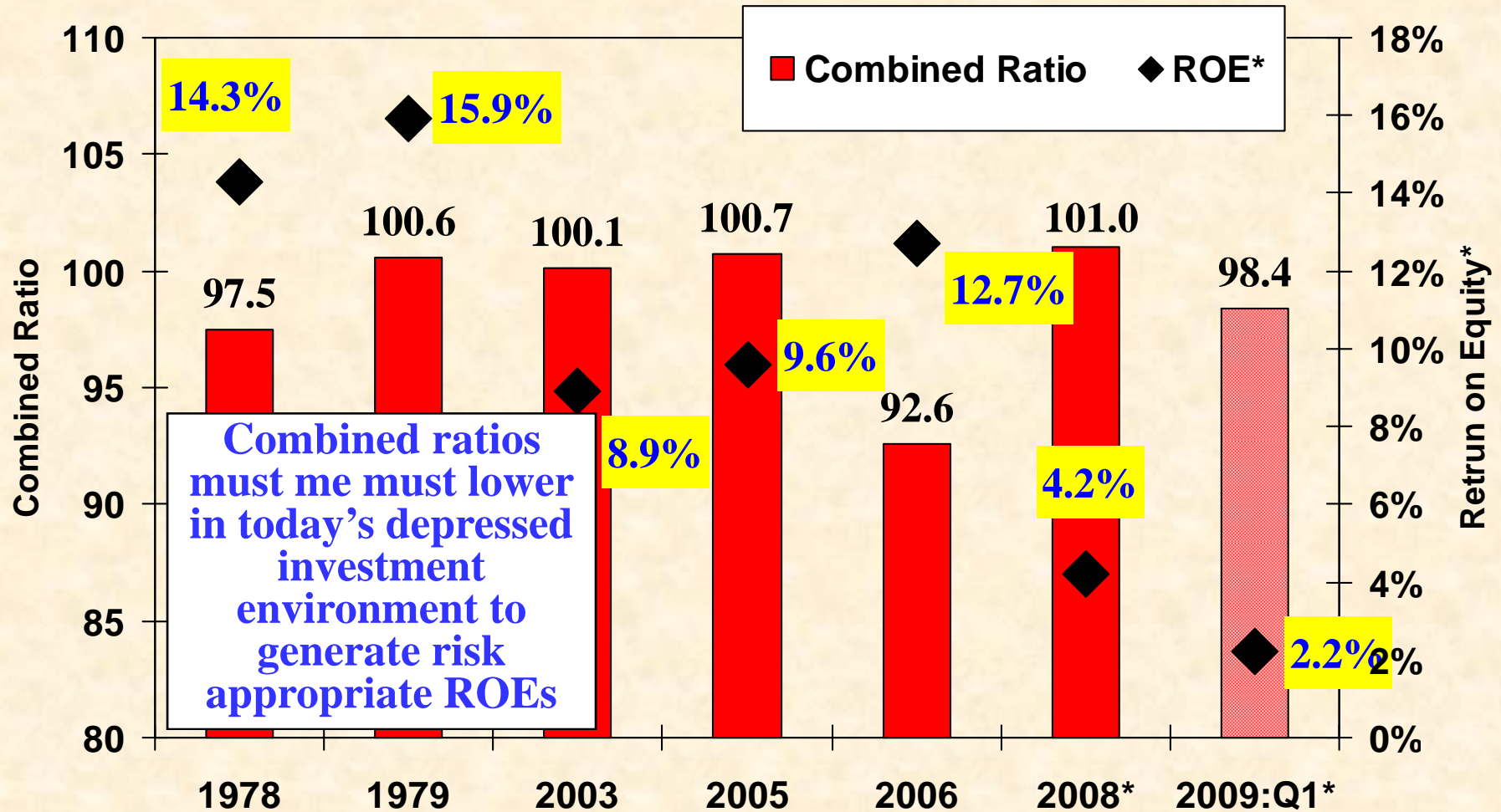


*ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guarantee insurers yields an 4.2% ROAS for 2008 and 2.2%. 2009:Q1 net income was \$2.4 billion excl. M&FG.

Sources: A.M. Best, ISO, Insurance Information Inst.



A 100 Combined Ratio Isn't What it Used to Be: 95 is Where It's At



* 2008/9 figures are return on average statutory surplus. Excludes mortgage and financial guarantee insurers.

Source: Insurance Information Institute from A.M. Best and ISO data.

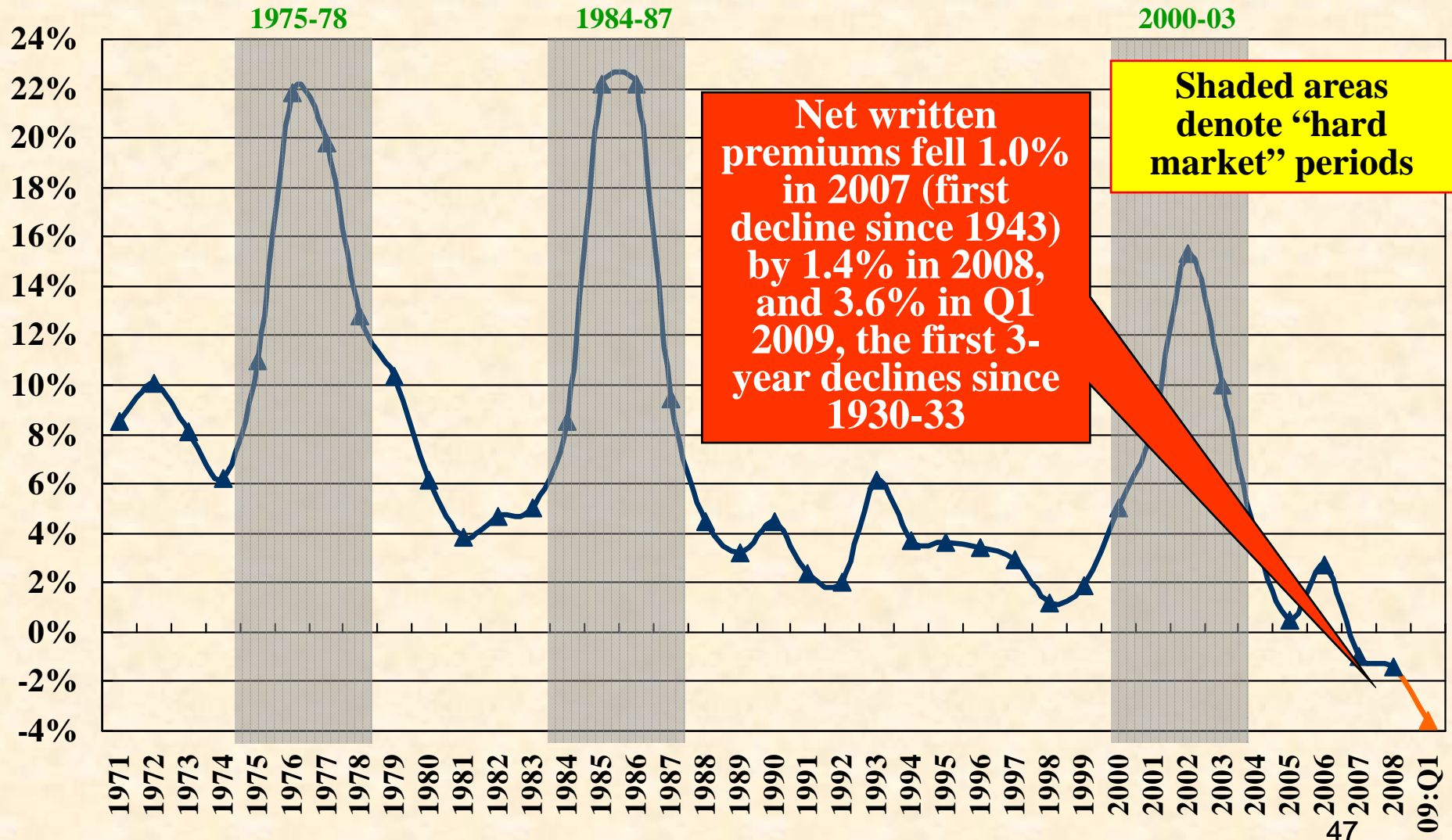
P/C Premium Growth

**Primarily Driven by the
Industry's Underwriting
Cycle, Not the Economy**



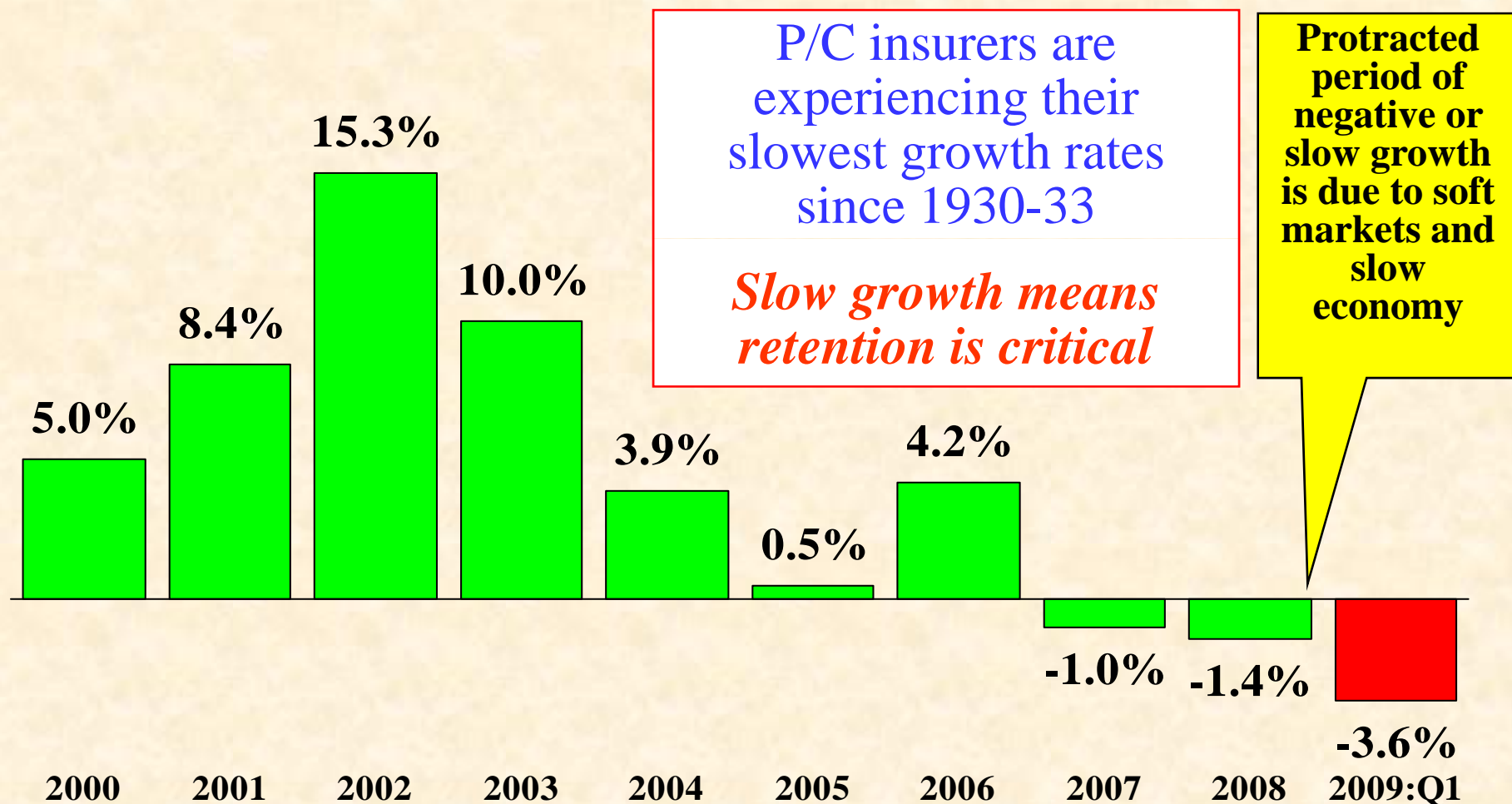


Strength of Recent Hard Markets by NWP Growth



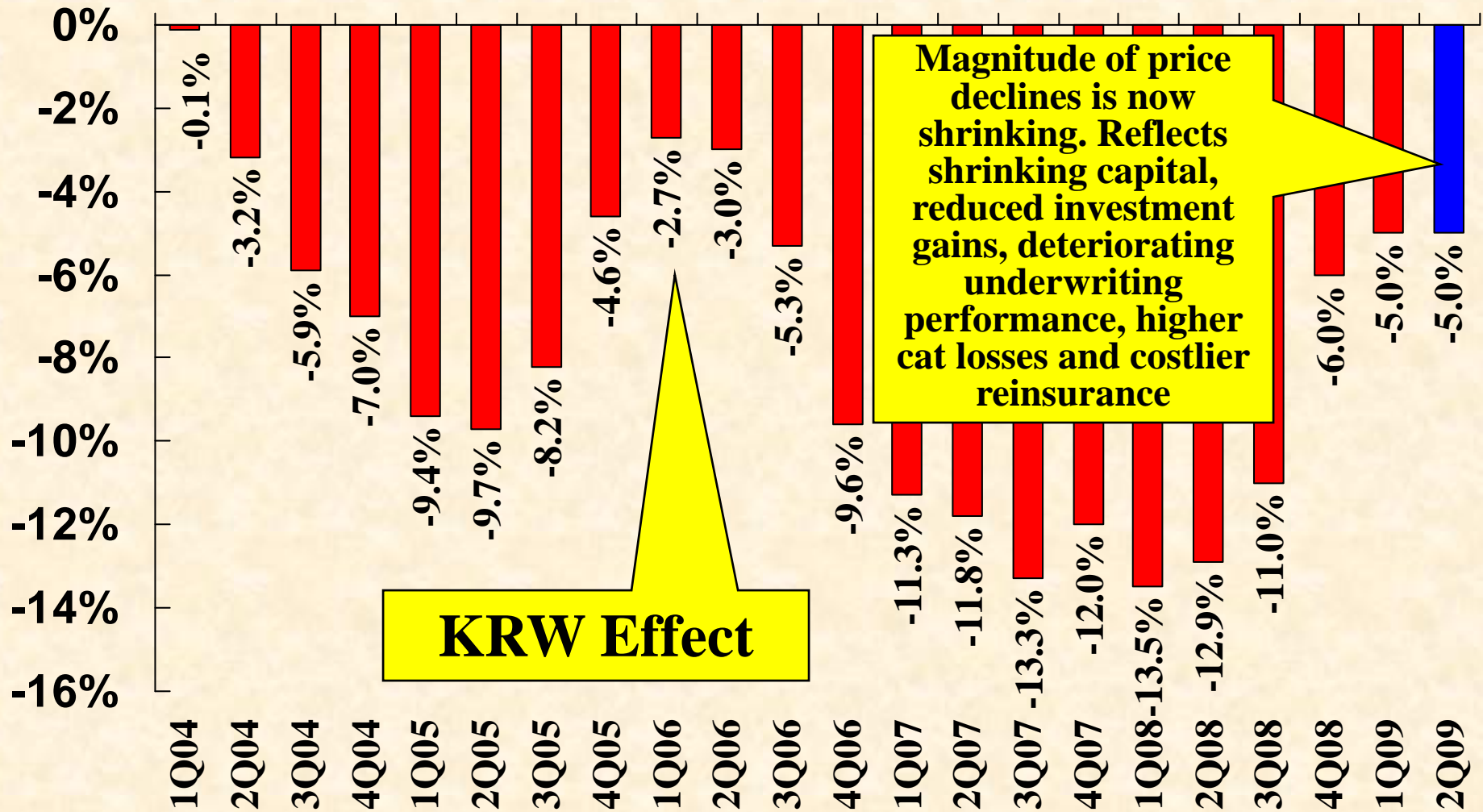


Year-to-Year Change in Net Written Premium, 2000-2009:Q1





Average Commercial Rate Change, All Lines, (1Q:2004 – 2Q:2009)



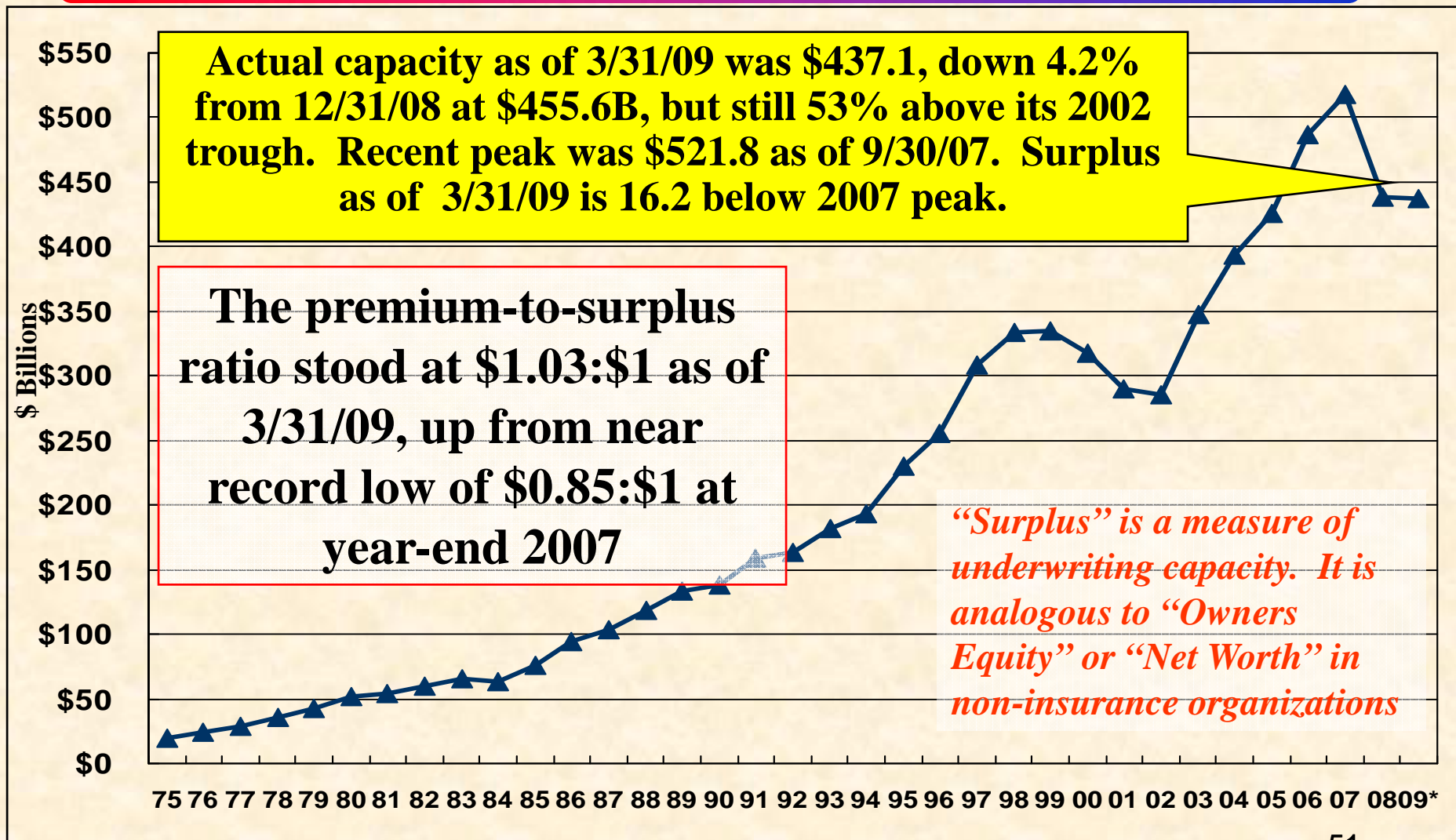
Capital/ Policyholder Surplus

Shrinkage, but
Capital is Within
Historic Norms



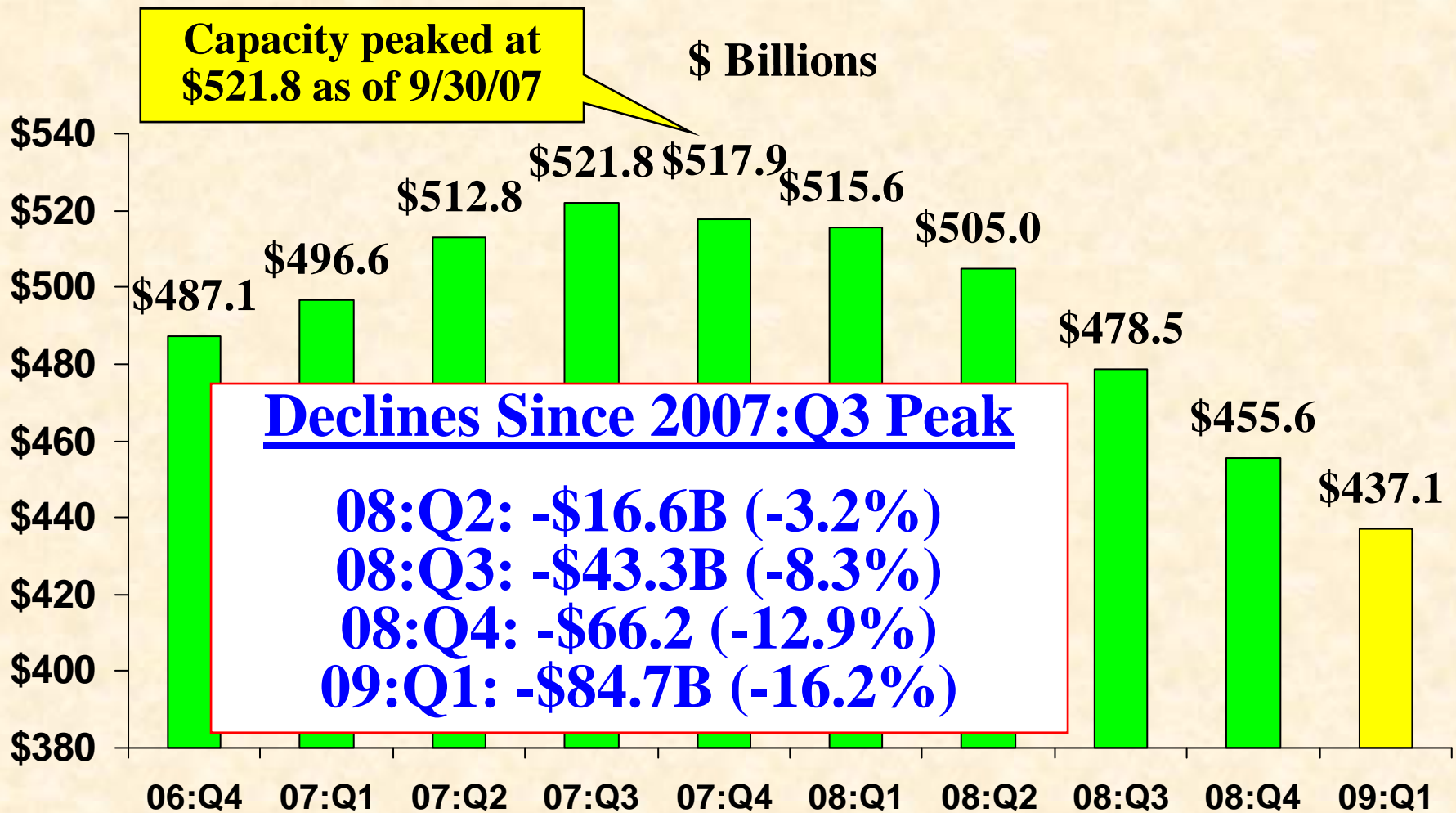


*U.S. Policyholder Surplus: 1975-2009:Q1**



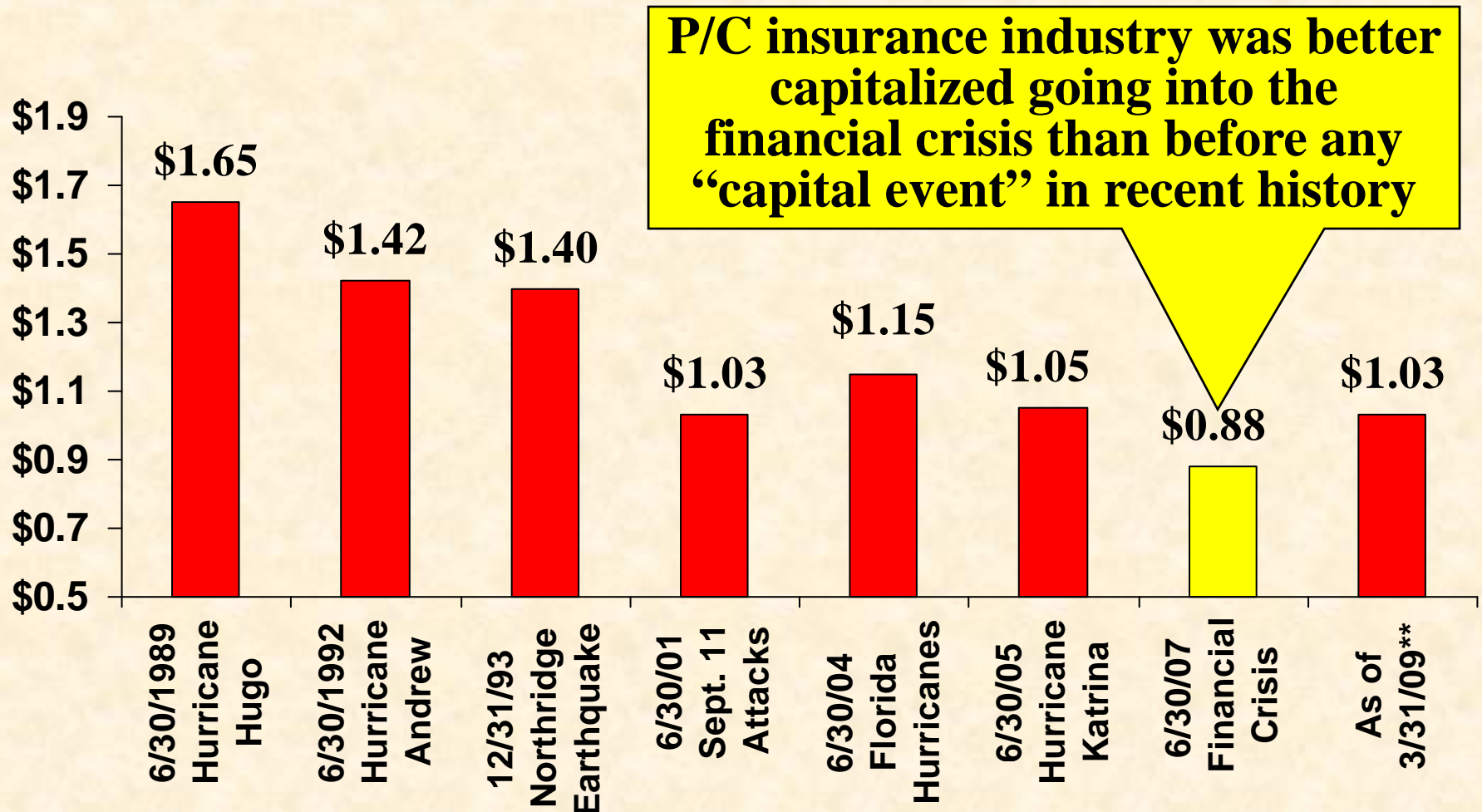


Policyholder Surplus, 2006:Q4 – 2009:Q1





*Premium-to-Surplus Ratios Before Major Capital Events**



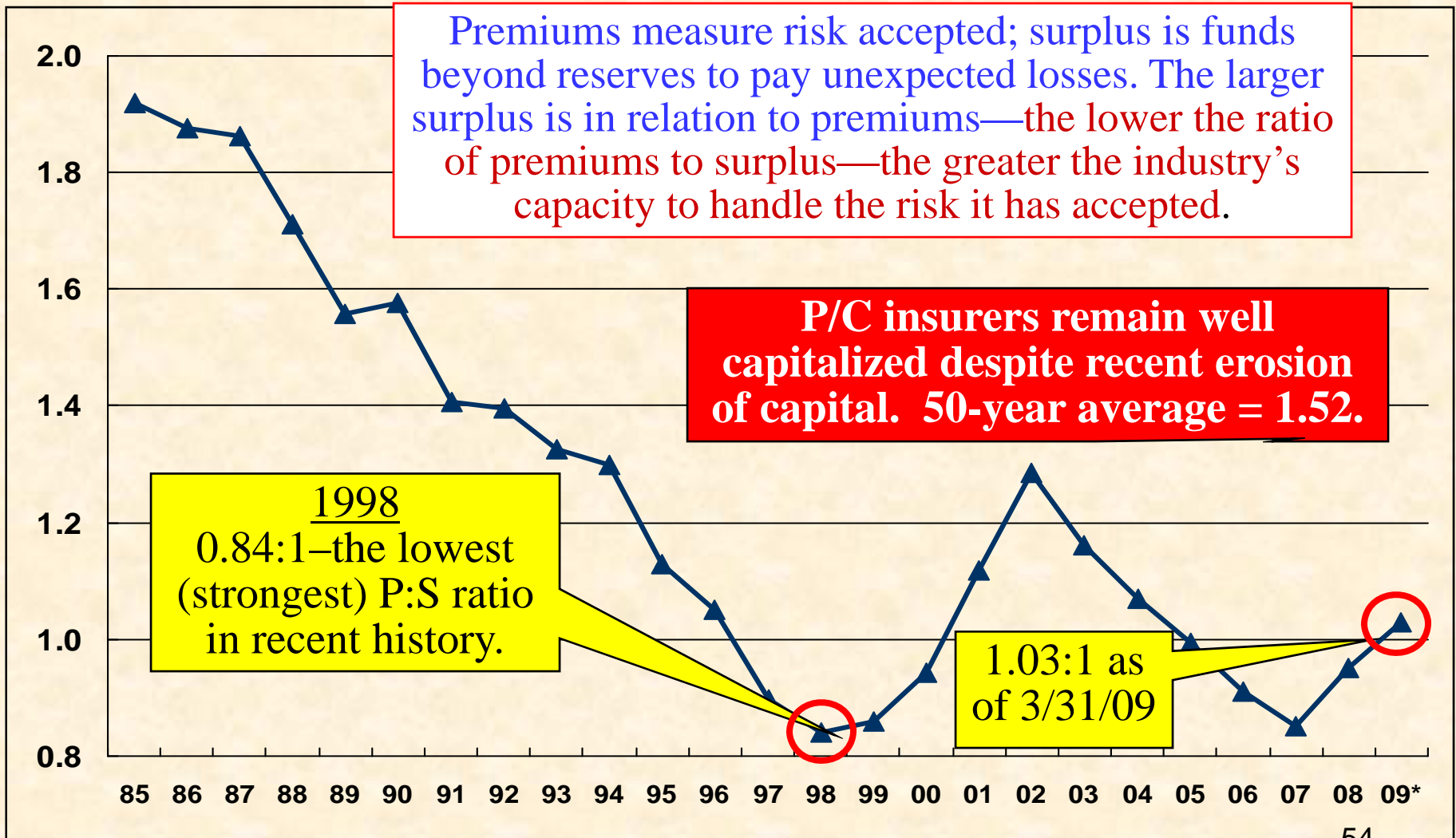
*Ratio is for end of quarter immediately prior to event. Date shown is end of quarter prior to event.

**Latest available

Source: PCS; Insurance Information Institute.

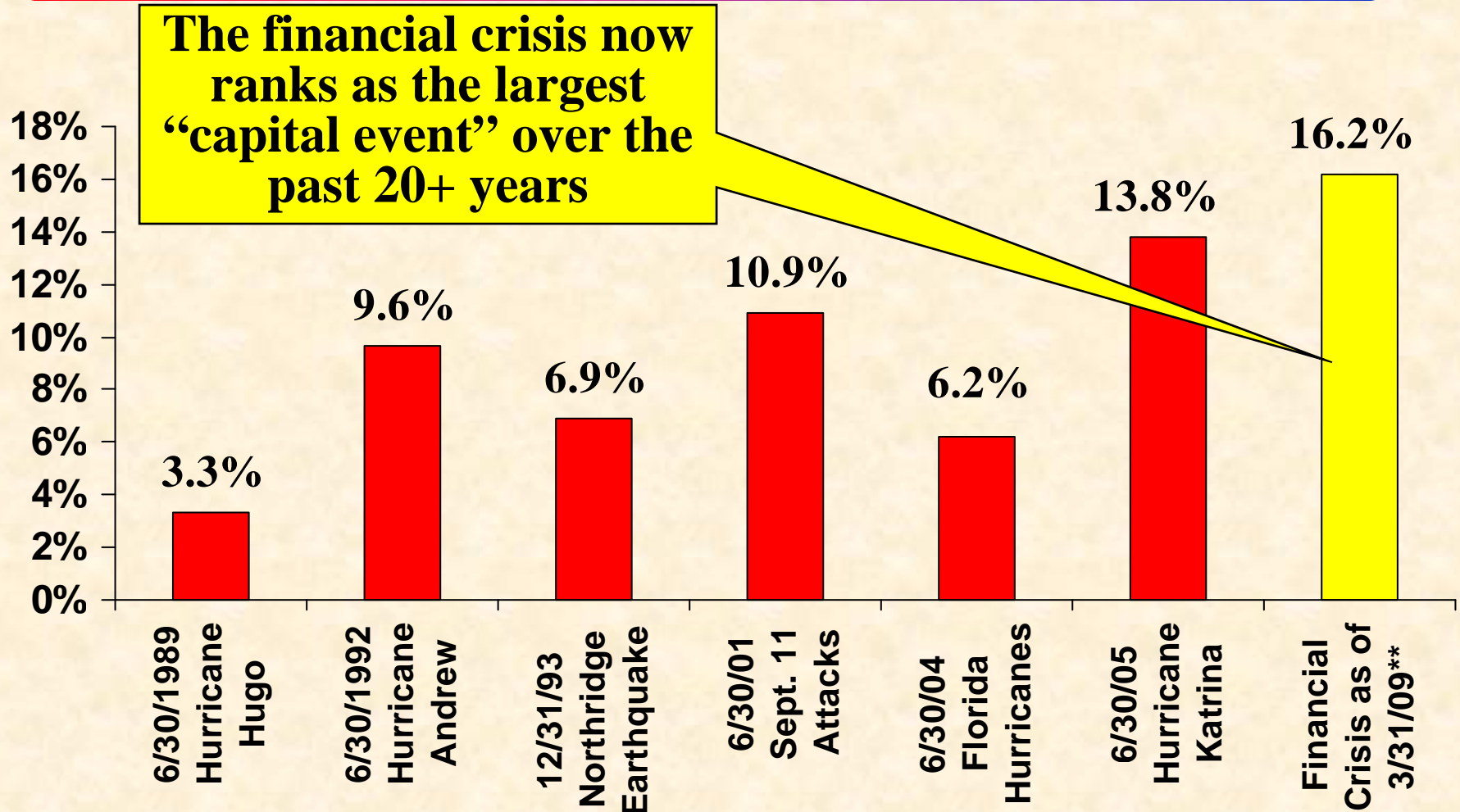


U.S. P/C Industry Premiums-to-Surplus Ratio: 1985-2009:Q1





*Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989**



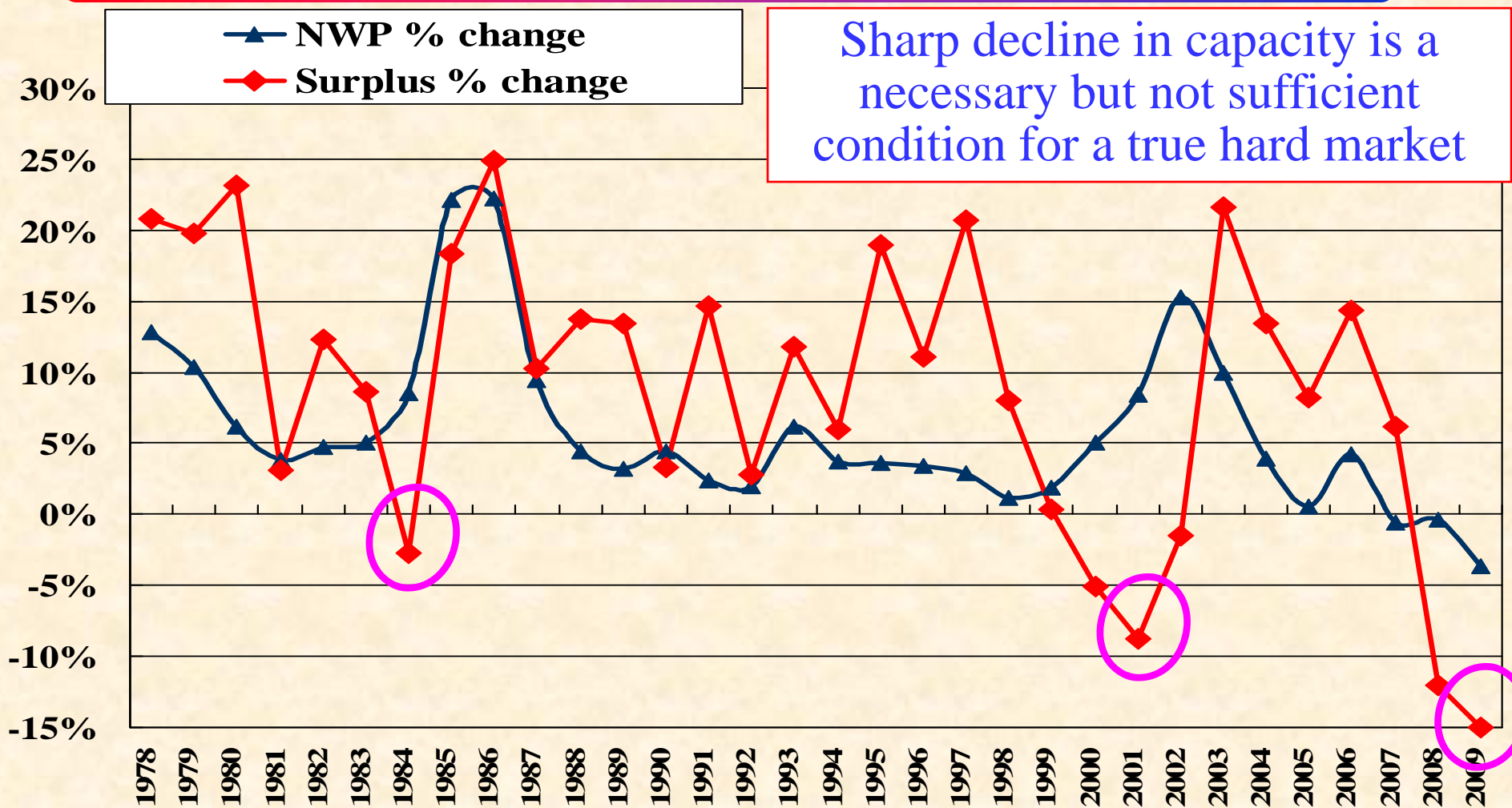
*Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event.

**Latest available

Source: PCS; Insurance Information Institute.



*Historically, Hard Markets Follow When Surplus “Growth” is Negative**

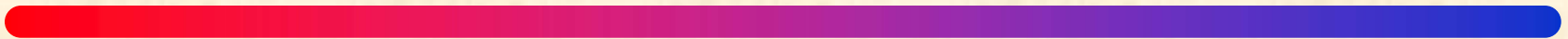


*2009 NWP and Surplus figures are % changes for Q1:09 vs Q1:08

Sources: A.M. Best, ISO, Insurance Information Institute

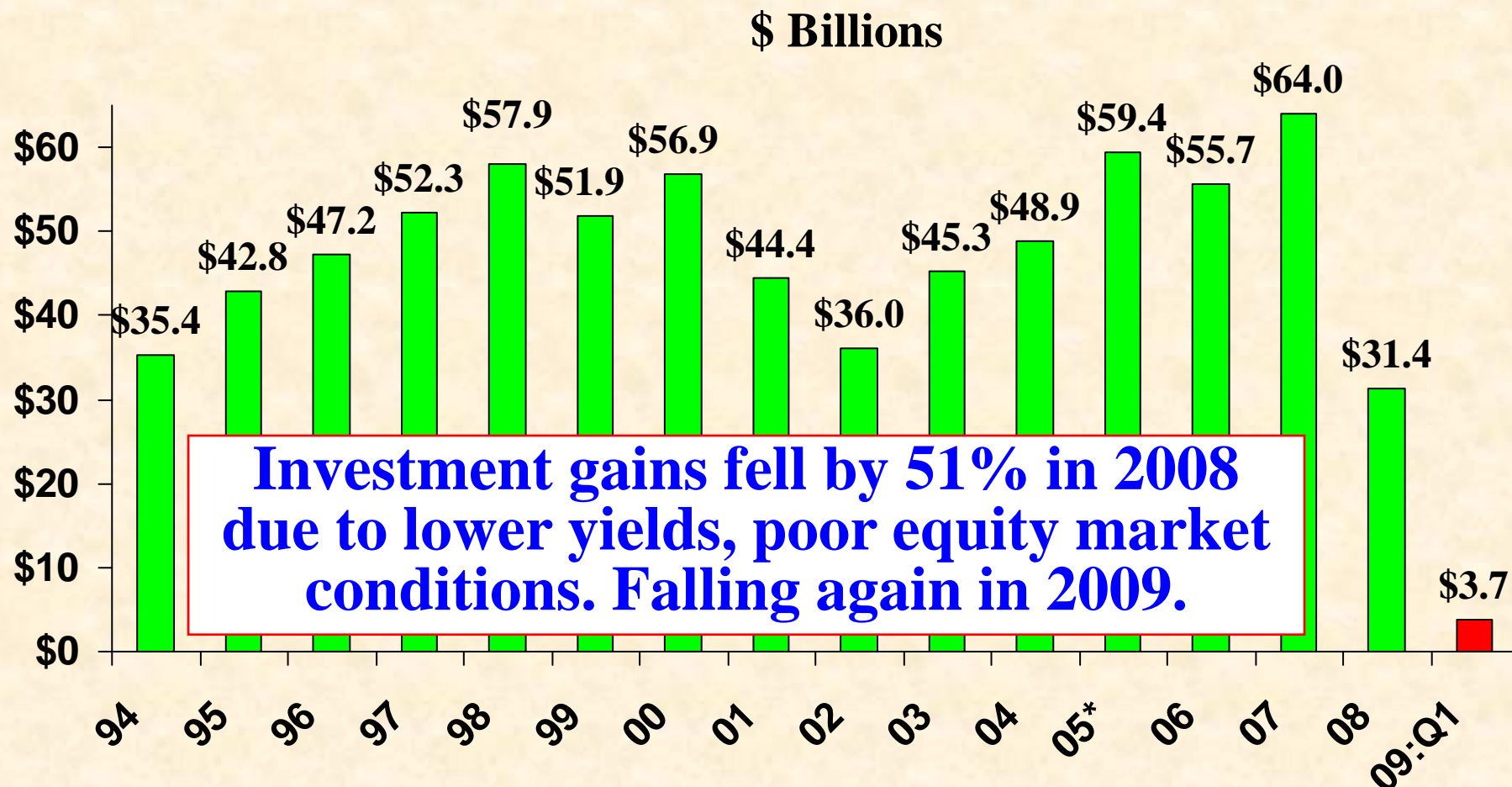
Investment Performance

*Investments are the Principle
Source of Declining
Profitability*





Property/Casualty Insurance Industry Investment Gain: 1994- 2009:Q1¹



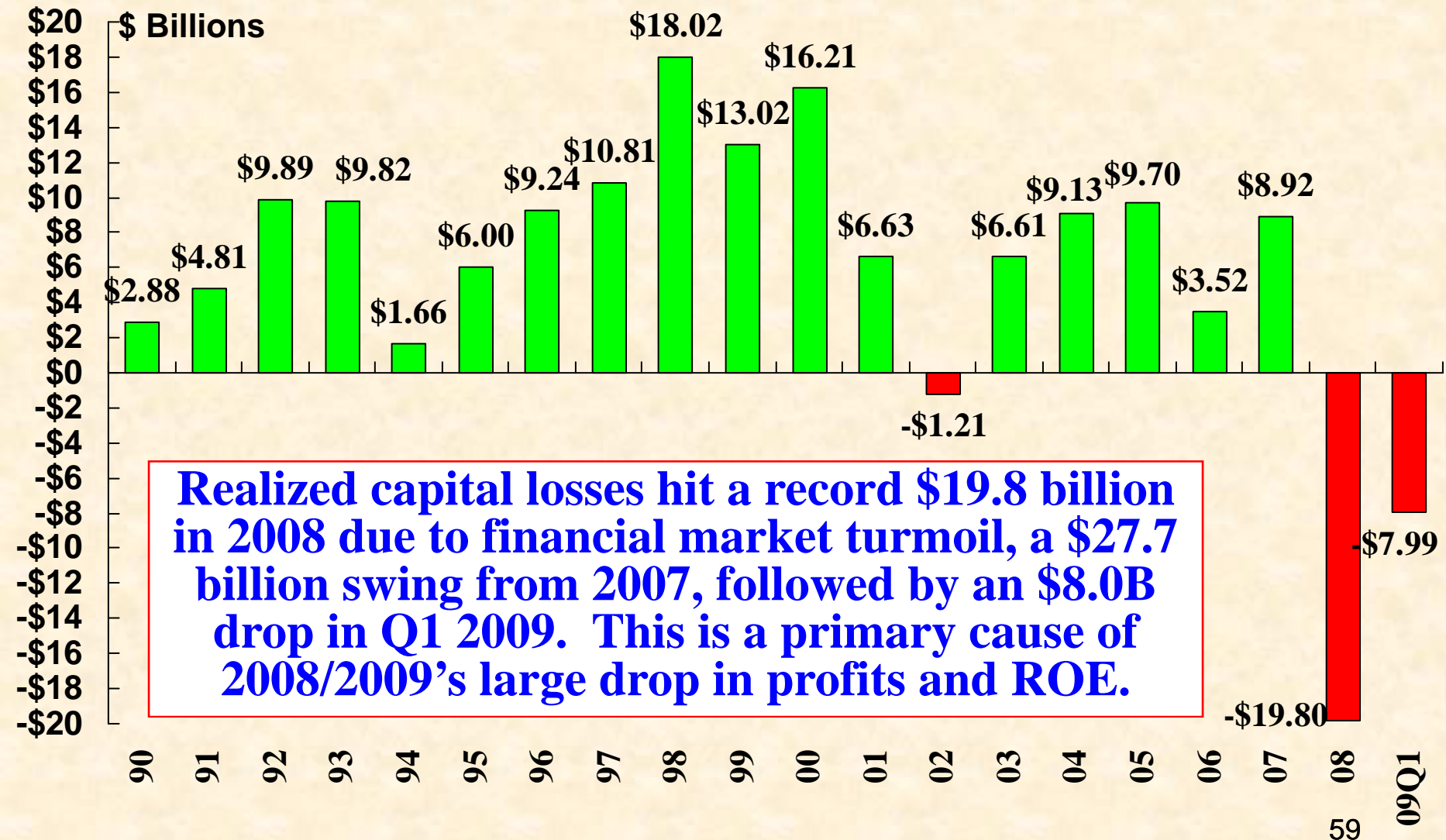
¹Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of \$52.3B net investment income and \$3.4B realized investment gain.

*2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.

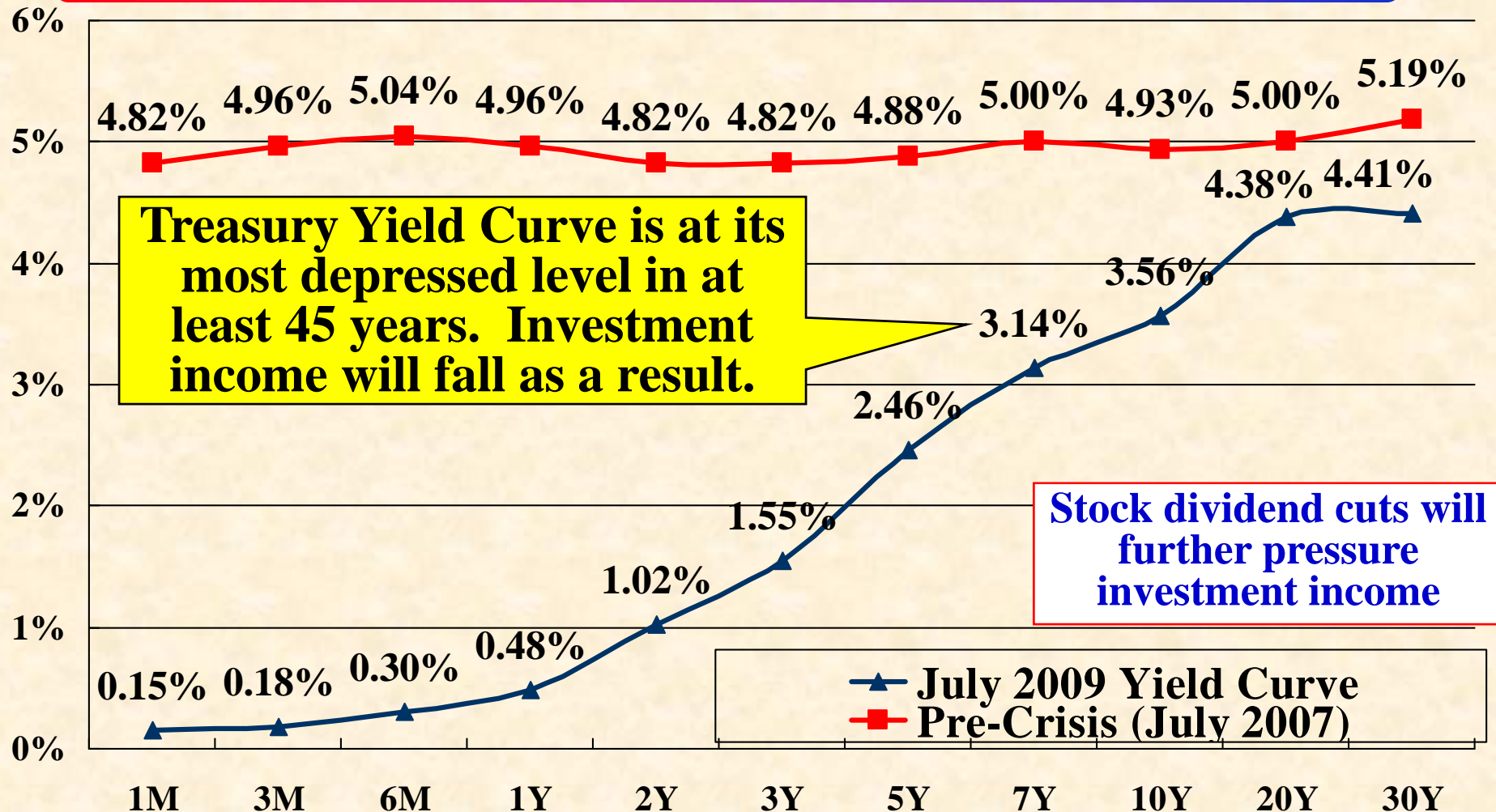


P/C Insurer Net Realized Capital Gains, 1990-2009:Q1





Treasury Yield Curves: Pre-Crisis (July 2007) vs. July 2009



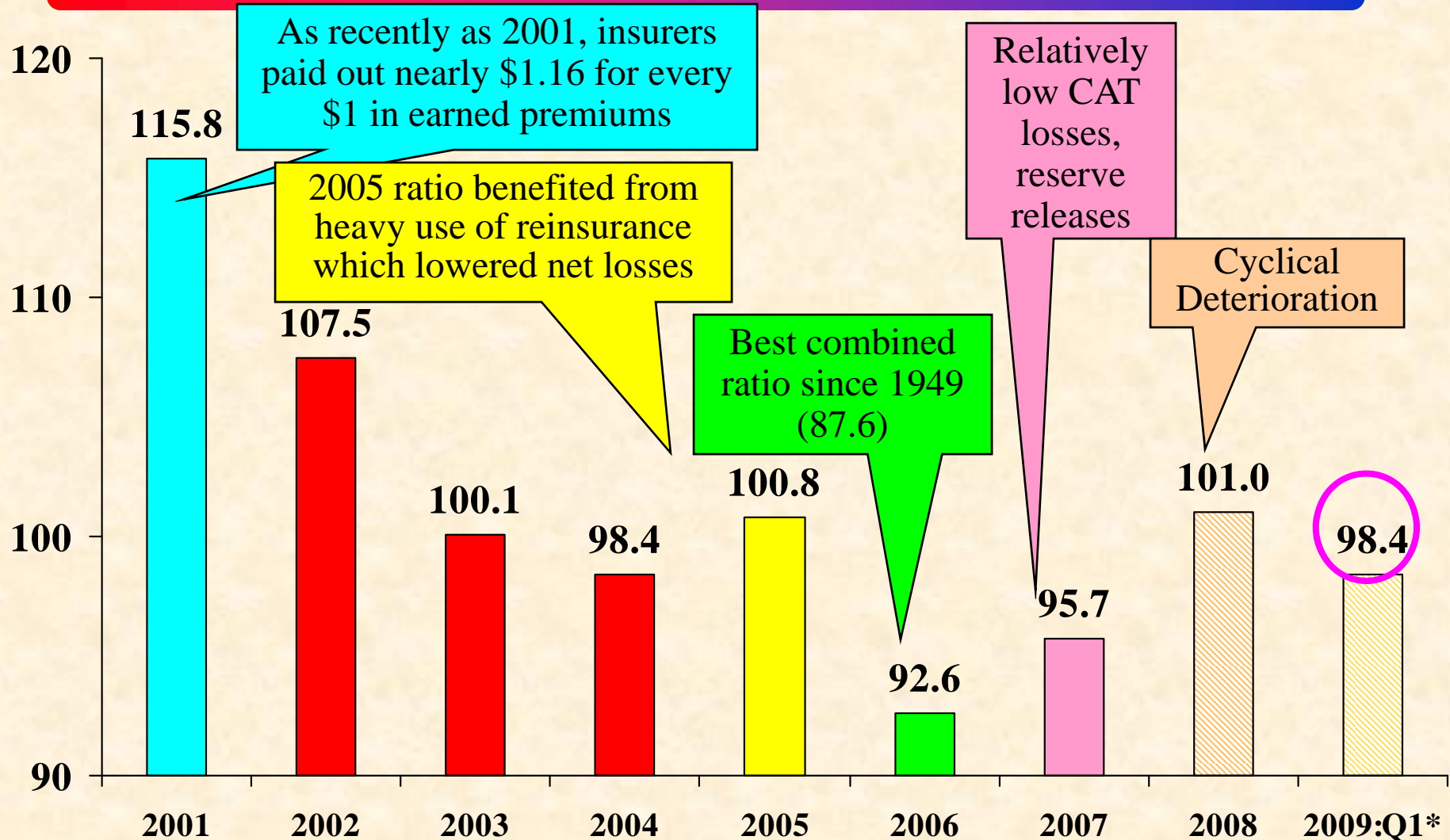
Underwriting Trends

**Financial Crisis Does Not Directly
Impact Underwriting
Performance: Cycle, Catastrophes
Were 2008's Drivers**





*P/C Insurance Industry Combined Ratio, 2001-2009:Q1**



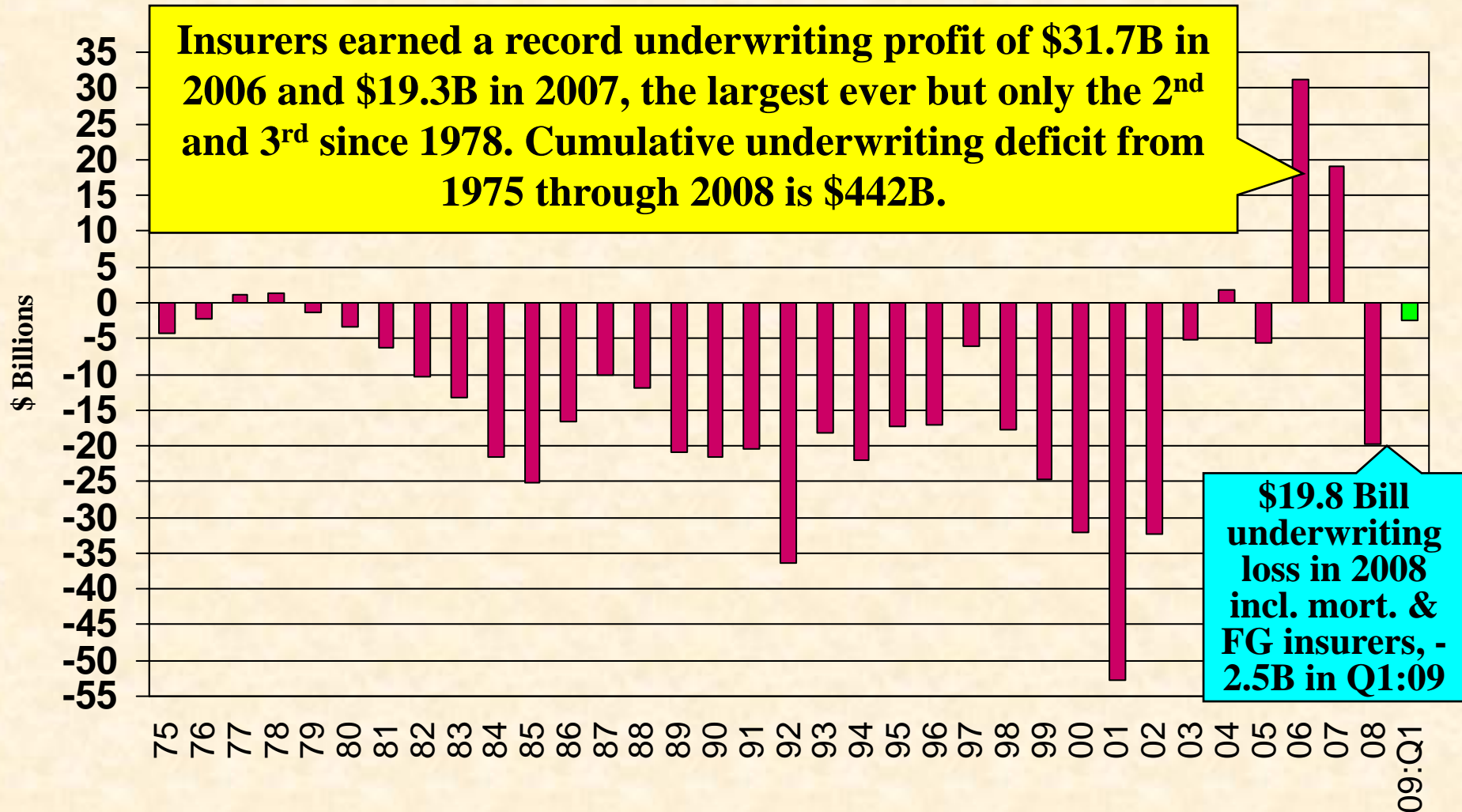
*Excludes Mortgage & Financial Guarantee insurers in 2008/09. Including M&FG, 2008=105.1, 2009=102.2

Sources: A.M. Best, ISO.



Underwriting Gain (Loss)

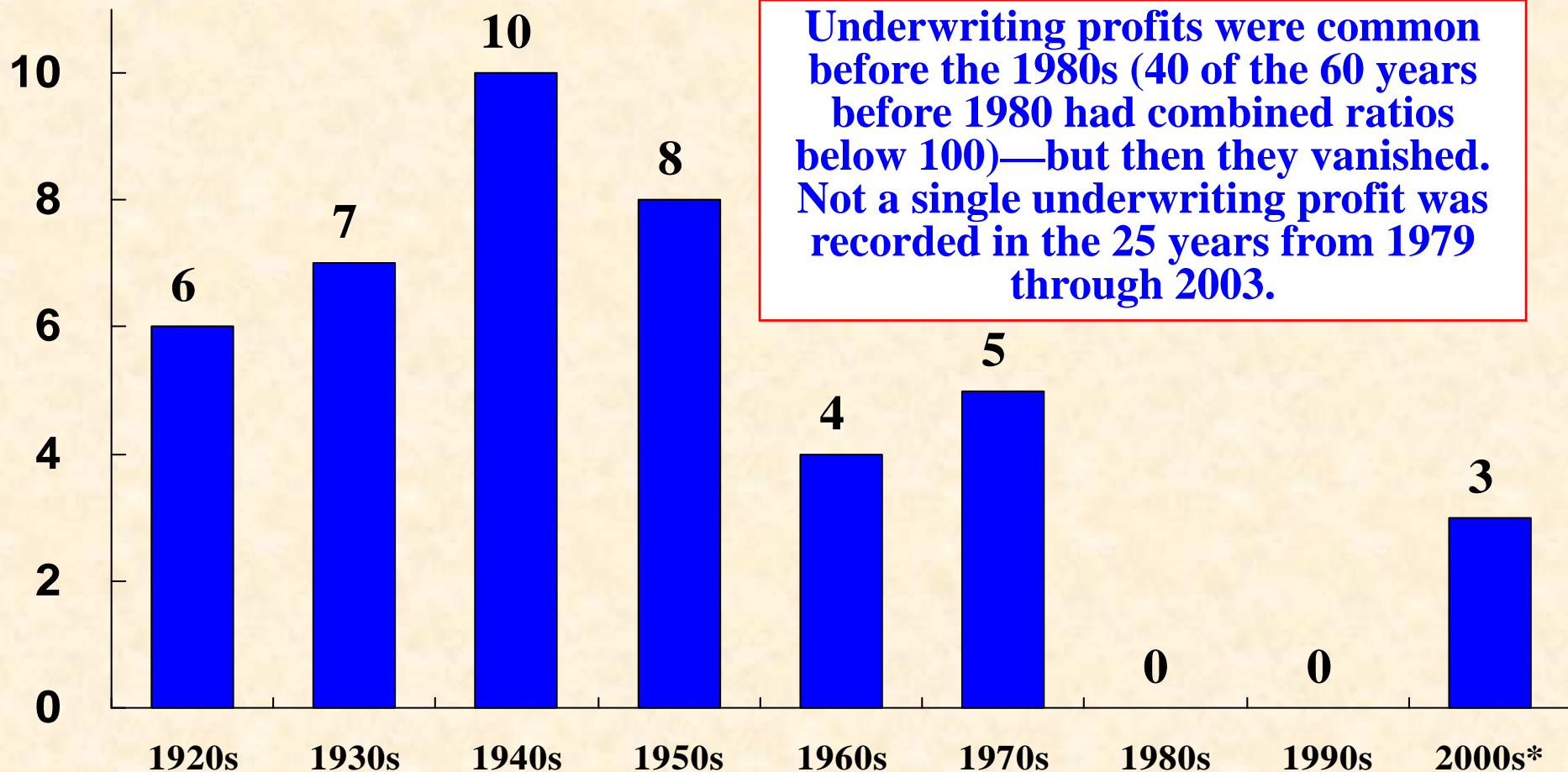
*1975-2009:Q1**





Number of Years With Underwriting Profits by Decade, 1920s – 2000s

Number of Years with Underwriting Profits



Underwriting profits were common before the 1980s (40 of the 60 years before 1980 had combined ratios below 100)—but then they vanished. Not a single underwriting profit was recorded in the 25 years from 1979 through 2003.

Note: Data for 1920 – 1934 based on stock companies only.

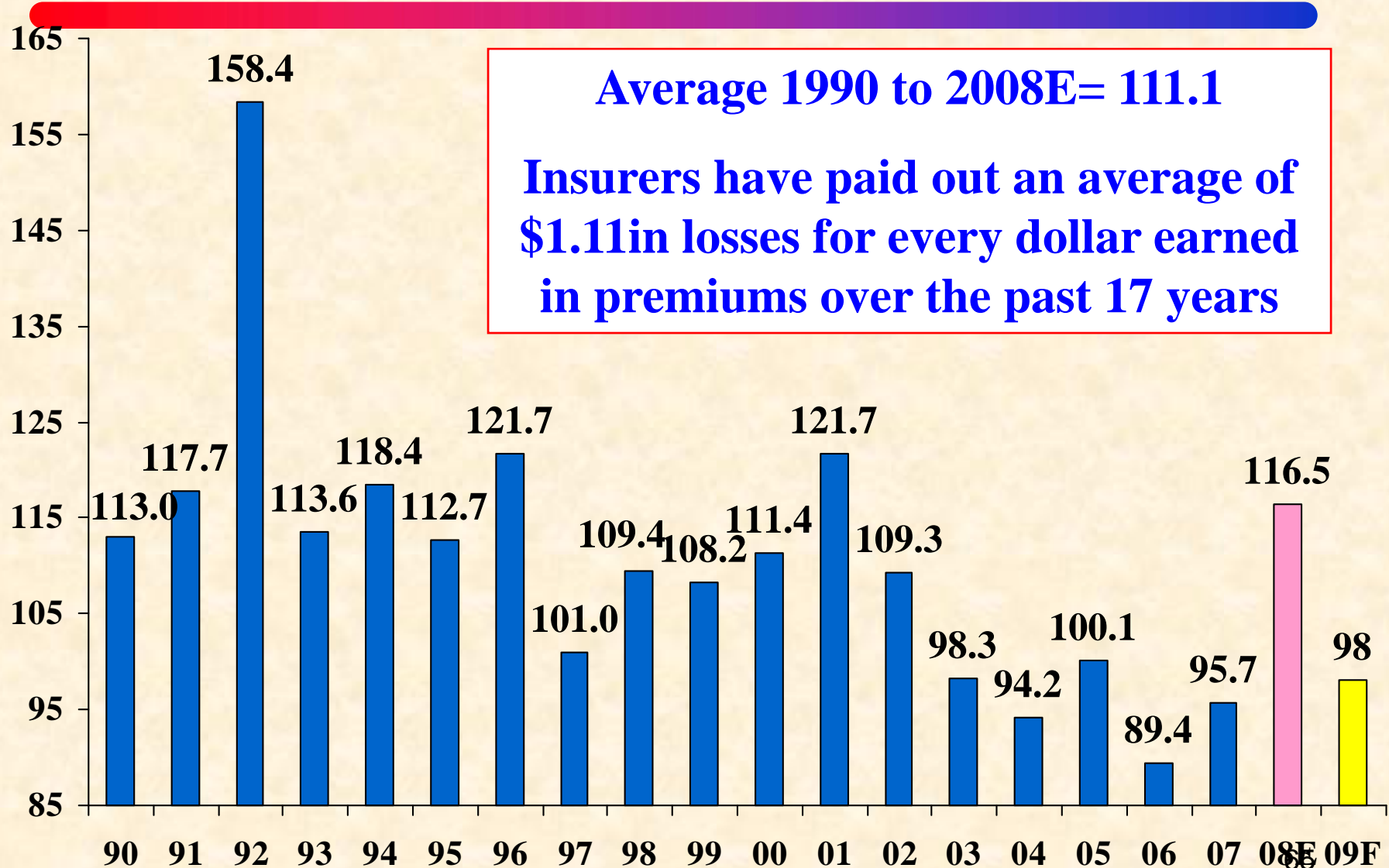
Sources: Insurance Information Institute research from A.M. Best Data.

64

*2000 through 2008.



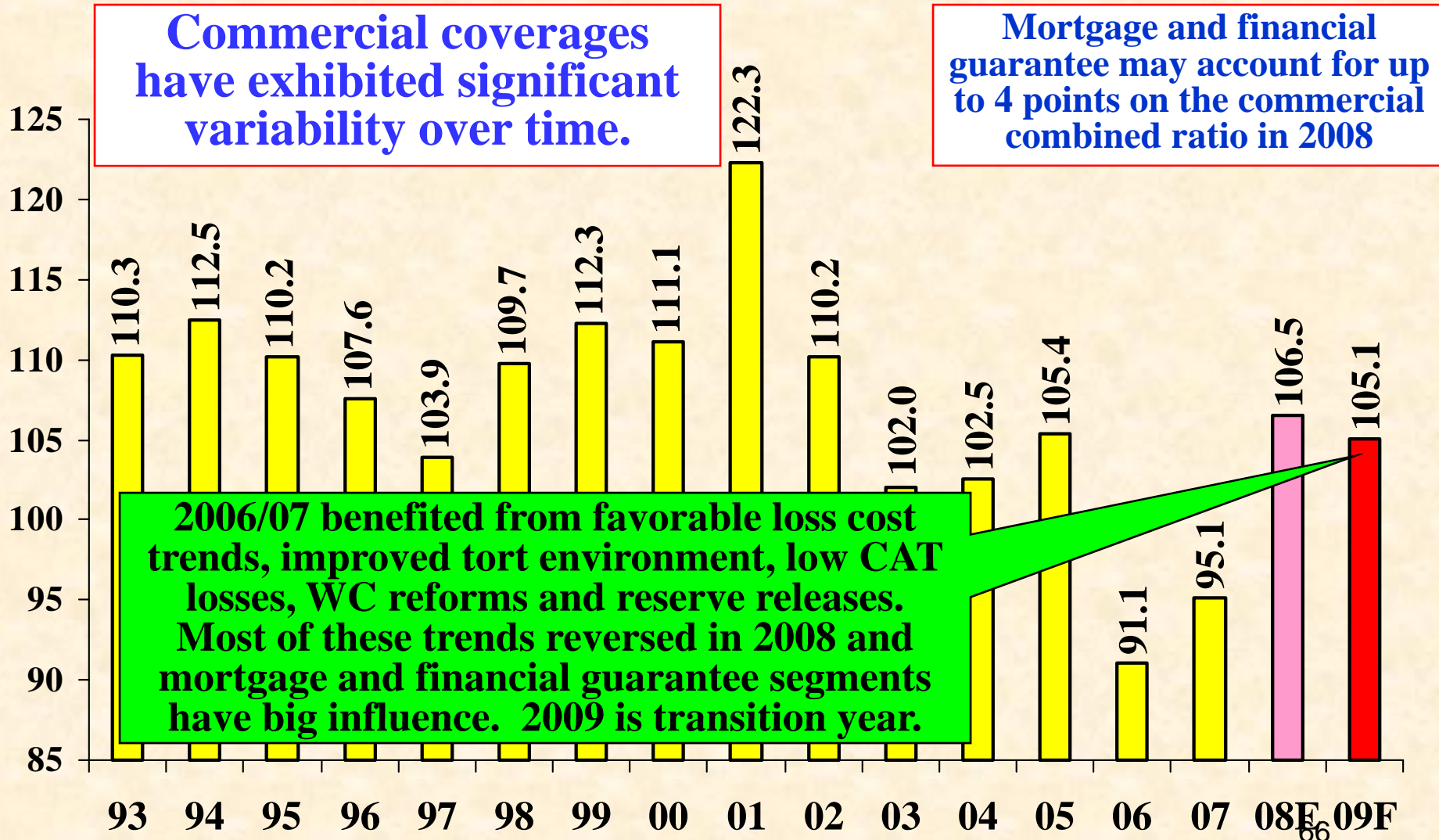
Homeowners Insurance Combined Ratio



Sources: A.M. Best (historical and forecasts)



Commercial Lines Combined Ratio, 1993-2009F





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YOUR ATTENTION!***

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