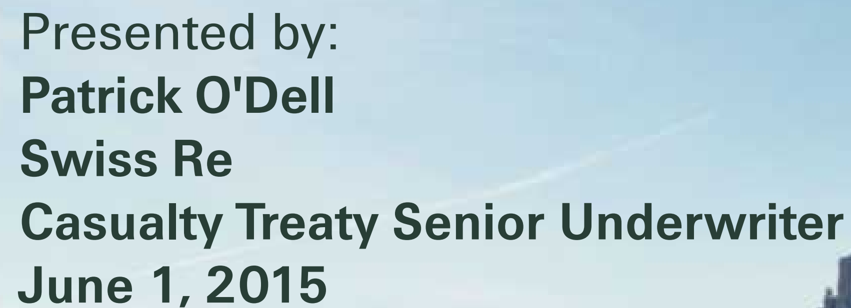
Swiss Re

WC Underwriting Considerations



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P/C Industry Investment Yields And Results

- The gap between embedded yields and new money yields is starting to shrink. This will likely continue, and probably at a faster pace, as the bond portfolios mature and the proportion of embedded yields to new money yields shifts. This is not necessarily a good thing.
- It will be difficult to maintain the 2014 investment income level in the next few years due to the expected continuation of low interest rates / bond yields. Volatility and uncertainty in realized capital gains portion of investments also expected to continue. Lower combined ratios (loss and/or expense) will be required to offset the expected decrease in investment returns to maintain the 2014 P/C financial results (8.4% return on surplus).
- The P/C industry's premium to surplus ratio is at a historic low of 0.74 to 1. e.g., $497B premium to $675B surplus. The significant excess surplus is likely to cause continued pressure on rates and fuel an increasingly competitive market.

WC Combined Ratio / UW Gain

- Components of 2014 calendar year Combined Ratio (98%*):
  - Loss: 58% = -2.9%
  - LAE: 14% = -0.4%
  - U/W Expense: 24% = -1.0%
  - Dividends: = -0.3%

  *Rounded to nearest full % for 2014

- The majority of the ~4% points reduction is due to an almost 3% points decrease in the loss ratio.
- Although the LAE ratio to earned premium remained almost flat, the ratio to incurred losses increased from 23.7% to ~25%, which is the highest since 1998. This was mainly due to increased claim cost containment practices. Also, CA had a material impact on the LAE ratio produced by implementation of recent tort reforms.
- The recent WC market cycles are not as dramatic as in the past. Smaller CR increases and decreases and shorter duration.

Calendar Year vs Accident Year WC Combined Ratios

- Accident Year has out-performed Calendar Year for each of the past 4 years, mainly as a result of reserve strengthening / deficiencies for prior years. The variance between the AY and CY CR's has remained consistent for each of the past 3 years at 3% points.
- From 2007 through 2010, the AY was higher than the CY CR (with the exception of 2009 when they were the same). This was due mainly to loss reserve take-downs / redundancies for prior years.
- From an underwriting perspective, AY results are more important than CY results. Analyzing the drivers of the results by AY enables companies to measure the relative quality of the portfolio and adequacy of the pricing by year, identify trends and take any necessary corrective action. Underwriters can not change the risk selection or pricing of business written in prior years.

Changes in Bureau Premium Level

- Please be aware that these are approved changes in advisory rates, loss costs, etc. They are not the actual Company filed and approved changes. However, they do provide a consistent benchmark for measuring WC market rate / loss cost changes and trends.
- The 2015 preliminary change of -2.2% (total market as of 4/24/2015) is the first negative change since 2010. (Does not include the -10.2% decrease recently approved by CA effective 7/1/2015). The 2015 voluntary market approved or filed & pending rate/loss cost changes are -4.8% as of 4/24/2015. The latest changes for NCCI states reflect 30 states with approved or filed decreases, only 7 states with increases and 1 with no change.
- The general trend of WC rate / loss cost reductions appears to be accelerating and will need to be closely monitored for the remainder of 2015 and subsequent years. Appropriate underwriting and pricing actions will be required to ensure proactive cycle management and to maintain acceptable results.

Impact of Premium Discounting

- Premium discounting via schedule rating (credits and debits) plays a major role in the pricing and profitability of WC. Historically, schedule credits have had more impact than deviated rates/loss costs. For example, every year from 2006 through 2014 had more schedule credits than rate/loss cost deviation, with very little rate deviation from 2008 through 2011 but material schedule credits. – The main driver of the soft market cycle pricing.
- Schedule rating should be closely monitored, as it is a good indicator of changes and trends in the market cycle. In a market transitioning from hard to soft, rate / loss cost reductions and a downward trend in deviations are generally accompanied by larger schedule credits. In a market transitioning from soft to hard, the opposite is true. e.g., Rate / loss cost increases, an upward trend in deviations and smaller schedule credits.

Indemnity Frequency

- Indemnity frequency continues to decrease, but at a reduced rate.
- CA is reporting an increase in frequency.

Medical Severity

- Medical severity increased by 4% in 2014, which is the largest increase since 2009.
- However, medical severity remains at a very modest level and significantly below historical averages.
- Continued need to monitor medical inflation carefully, particularly as the U.S. economy continues to recover, advances in medical technology persist and the unknown impact of the Affordable Care Act on WC (both on medical costs and utilization).
- Medical severity has a leveraged impact on very large WC claims and XOL and reinsurance pricing. This is due to the long-tail nature and resulting significant lag patterns for these claims and the large amount of ongoing medical costs over the duration of the claims.

Evolving Workplace

- There is a developing and potentially significant shift in the workplace away from traditional employment and towards more contracted or "on demand" workers. Currently, it is particularly affecting services, such as transportation (Uber) and home and personal services (Angie's List and Amazon Home Services).
- This will create fewer "employees" by the traditional definition and more contracted and/or self-employed workers. The WC industry, in collaboration with state governments, will need to adapt and adjust to the impacts of this evolving change. For example: Who is considered an "employee"? Should WC coverage to be expanded to "on demand" workers? Did the injury to the worker arise out of and in the course of their job? – Potentially more difficult to determine this for "on demand" workers. How will this change impact WC costs and rates?