Workers Compensation in the Age of Trump
Trends, Challenges and Opportunities

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P/C Insurance Financial Update: An Overview and Outlook

Profitability, Growth, Investments
P/C Industry Net Income After Taxes
1991–2017:Q1

- Net income fell by $14.2B or 25% in 2016 and was down 42.2% in 2017:Q1 vs. Q1:2016

- ROE figures are GAAP; 1Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 8.2% ROAS in 2014, 9.8% ROAS in 2013, 6.2% ROAS in 2012, 4.7% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009; 2016E is annualized figure based actual figure through Q3 of $31.8B.

Sources: A.M. Best, ISO; Insurance Information Institute
Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2017:Q1

*As of Q1:2017; Profitability = P/C insurer ROEs. 2011-16 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers.
Source: Insurance Information Institute; NAIC, ISO, A.M. Best, Conning
P/C Profitability Is Both by Cyclicality and Ordinary Volatility

- Hugo
- Andrew, Iniki
- Northridge
- Sept. 11
- Lowest CAT Losses in 15 Years
- 4 Hurricanes
- Katrina, Rita, Wilma
- Sandy
- Financial Crisis*
- Record Tornado Losses
- Low CATs
- Modestly higher CATs

Sources: ISO, Fortune; Insurance Information Institute.
As Recently as 2001, Insurers Paid Out Nearly $1.16 for Every $1 in Earned Premiums

Heavy Use of Reinsurance Lowered Net Losses

Relatively Low CAT Losses, Reserve Releases

Higher CAT Losses, Shrinking Reserve Releases, Toll of Soft Market

Best Combined Ratio Since 1949 (87.6)

Cyclical Deterioration

Sandy Impacts

Lower CAT Losses

3 Consecutive Years of U/W Profits: First Time Since 1971-73

Elevated CATs


Sources: A.M. Best, ISO (2014-2015); Figure for 2010-2013 is from A.M. Best P&C Review and Preview, Feb. 16, 2016.
Policyholder Surplus, 2006:Q4–2017:Q1

($ Billions)

2007:Q3 Pre-Crisis Peak

Drop due to near-record 2011 CAT losses

Surplus as of 3/31/17 stood at a record high $709.0B

The industry now has $1 of surplus for every $0.76 of NPW, close to the strongest claims-paying status in its history.

2010:Q1 data includes $22.5B of paid-in capital from a holding company parent for one insurer’s investment in a non-insurance business.

The P/C insurance industry entered 2017 in very strong financial condition.

Sources: ISO, A.M. Best.

(Percent)

1975-78 1984-87 2000-03

Net Written Premiums Fell 0.7% in 2007 (First Decline Since 1943) by 2.0% in 2008, and 4.2% in 2009, the First 3-Year Decline Since 1930-33.

Outlook
2017F: 3.1%
2018F: 3.0%

2017:Q1: 4.0%
2016: 2.7%
2015: 3.5%
2014: 4.2
2013: 4.4%
2012: +4.2%

*Q1:2017 over Q1:2016. Shaded areas denote “hard market” periods
Since 2014, personal lines Direct Premiums Written have generally grown faster than commercial lines DPW, and that growth has been less volatile.

Sources: NAIC, via SNL Financial; ISO; Insurance Information Institute calculations.
2016 Growth in Net Written Premium: Personal vs. Commercial

Annual Change in NWP

<table>
<thead>
<tr>
<th>Line</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Lines</td>
<td>5.3%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Predominating</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Diversified</td>
<td>3.3%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Commercial Lines</td>
<td>1.5%</td>
<td></td>
</tr>
<tr>
<td>Predominating</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All Insurers</td>
<td>3.5%</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

The divergence in growth between personal and commercial lines is large and is expanding rapidly.

Source: ISO.
2016: Components of Commercial DWP Growth

- Direct Written Premium (DWP) in US lines covered by ISO MarketStance grew 3.1 percent in 2016.
- Soft market conditions counteracted moderate 4.1 percent exposure growth.

Source: Verisk Insurance Solutions.
2016 Commercial Market Composition, Rates by Coverage

- Over 50 percent of 2016 premium volumes were under strong negative rate pressure
- Commercial auto, specialty lines under less pressure

Source: Verisk Insurance Solutions.
2016 Commercial Market Growth by Size Segment

- Small commercial, middle markets DWP growth in 2016 outpaced the market
- 2016 soft market conditions strongly correlated with account size

Source: Verisk Insurance Solutions.
2016 Commercial Market Growth by Industry

- Entertainment, hotel/motel, and other services DWP grew robustly, driven by exposures
- Agriculture and related accounts pressured by shrinking exposures and soft markets
- Soft market conditions were a strong headwind in manufacturing

Source: Verisk Insurance Solutions.
Commercial auto rates increased as carriers reacted to ongoing challenges.

Property, Workers’ Compensation under most severe rate pressures.

Umbrella, excess, specialty lines liability growth may have reflected trading price for quantity (i.e., demand elasticity).

Source: Verisk Insurance Solutions.
INVESTMENTS:
THE NEW REALITY

Investment Performance is a Key Driver of Insurer Profitability

The “Trump Bump” Has Lifted Stock Markets and Interest Rates

Will the Gains Help Insurers?
Stock markets rose sharply following the 2016 election and continued to rise through the first half of 2017. Trump Bump: Sharp surge in stock post-election.

Source: NYU Stern School of Business: [http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html](http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html)
Due to persistently low interest rates, investment income fell in 2012, 2013 and 2014 but showed a small (1.7%) increase in 2015—though 2016 experienced another decline.

Investment gains consist primarily of interest and stock dividends. Sources: ISO; Insurance Information Institute.

Yields on 10-Year U.S. Treasury Notes have been essentially below 5% for more than a decade.

Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

*Monthly, constant maturity, nominal rates, through June 2017.

A full normalization of interest rates is unlikely until the early 2020s, more than a decade after the onset of the financial crisis.

Sources: Blue Chip Economic Indicators (7/17 for 2017 and 2018; for 2019-2021 11/16 issue); Insurance Info. Institute.
The yield on invested assets remains low relative to pre-crisis yields. The Fed’s plan to raise interest rates in beginning in late 2015 has pushed up some yields, albeit quite modestly.

Sources: A.M. Best; 2015-2016 figures from ISO Insurance Solutions; Insurance Information Institute
Average yields in 2016 dropped to 3.1%, their lowest level since the mid-1960s.
Insurers Posted Net Realized Capital Gains in 2010 - 2016 Following Two Years of Realized Losses During the Financial Crisis. Realized Capital Losses Were a Primary Cause of 2008/2009's Large Drop in Profits and ROE.

*Figure is through Q1:2017

Sources: A.M. Best, ISO; Insurance Information Institute.
Workers Compensation
Operating Environment

Workers Comp Results Have Improved Substantially in Recent Years

Can Gains Be Maintained?
Workers Compensation Combined Ratio: 1994–2016P

Workers Comp Results Began to Improve in 2012. Underwriting Results Deteriorated Markedly from 2007-2010/11 and Were the Worst They Had Been in a Decade.

Sources: A.M. Best (1994-2009); NCCI (2010-2016P) and are for private carriers only..
Commercial Lines Combined Ratio, 1990-2016P

*2007-2012 figures exclude mortgage and financial guaranty segments.
Workers Compensation Premium: Flat in 2016 After 5 Years of Increase

Net Written Premium

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>State Funds ($ B)</th>
<th>Private Carriers ($ B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>90</td>
<td>35.3</td>
<td>34.3</td>
</tr>
<tr>
<td>91</td>
<td>35.7</td>
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<td>28.6</td>
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<td>14</td>
<td>32.1</td>
<td>37.7</td>
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<tr>
<td>15</td>
<td>37.7</td>
<td>42.3</td>
</tr>
<tr>
<td>16</td>
<td>42.3</td>
<td>46.5</td>
</tr>
</tbody>
</table>

Pvt. Carrier NWP growth was 0% in 2016, +2.9% in 2015, +4.3% in 2014, +5.1% in 2013 and 8.7% in 2012

Source: NCCI from Annual Statement Data.
Includes state insurance fund data for the following states: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT.
Each calendar year total for State Funds includes all funds operating as a state fund that year.
## Workers Compensation Components of Written Premium Change, 2015 to 2016

### Written Premium Change from 2015 to 2016

<table>
<thead>
<tr>
<th>Component</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Written Premium—Countrywide</td>
<td>+0.0%</td>
</tr>
<tr>
<td>Direct Written Premium—Countrywide</td>
<td>+0.0%</td>
</tr>
</tbody>
</table>

### Components of DWP Change for NCCI States

<table>
<thead>
<tr>
<th>Component</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in Carrier Estimated Payroll</td>
<td>+4.0%</td>
</tr>
<tr>
<td>Change in Bureau Loss Cost and Mix</td>
<td>-2.7%</td>
</tr>
<tr>
<td>Carrier Discounting</td>
<td>-1.4%</td>
</tr>
<tr>
<td>State Fund Converting to Private Carrier</td>
<td>+1.0%</td>
</tr>
<tr>
<td>Other Factors</td>
<td>-0.8%</td>
</tr>
<tr>
<td><strong>Combined Effect</strong></td>
<td>+0.0%</td>
</tr>
</tbody>
</table>

Sources: Countrywide: Annual Statement data.  
NCCI States: Annual Statement Statutory Page 14 for all states where NCCI provides ratemaking services.  
Components: NCCI Policy data.
2016 Workers Compensation Direct Written Premium Growth, by State*

PRIVATE CARRIERS: Overall 2016 Growth = +1.0%

While growth rates varied widely, overall growth for private carriers was up very slightly in 2016.

*Excludes monopolistic fund states (in gray): OH, ND, WA and WY.
Source: NCCI.
WC Return on Net Worth, 2006-2015 Average Highest 25 States

Profitability in the WC lines varies tremendously. Among non-monopolistic fund states, Alaska had the highest average RNW at 12.8% while Oklahoma ranked last at 2.5%.
WC Return on Net Worth, 2006-2015 Average Lowest 25 States

Sources: NAIC data, sourced from S&P Global Market Intelligence, Insurance Information Institute.

RI’s profitability ranked in the bottom 1/3 of states from 2006 - 2015.
Direct Premiums Written Growth: WC
Percent Change by State, 2007-2016*

*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period

Sources: NAIC data, sourced from S&P Global Market Intelligence, Insurance Information Institute.

22 states showed positive growth in the workers comp line from 2007 – 2016

RI was “growth leader” over the past decade!
Direct Premiums Written Growth: WC
Percent Change by State, 2007-2016*

Lowest States

Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: NAIC data, sourced from S&P Global Market Intelligence, Insurance Information Institute.
Direct Premiums Written: Comm. Lines
Percent Change by State, 2007-2015

Top 25 States

44 states showed commercial lines growth from 2007 through 2015

Growth Benchmarks: Commercial
US: 9.0%

Commercial lines growth in RI has been on par with the US overall

Sources: NAIC via SNL Financial; Insurance Information Institute.
Direct Premiums Written: Comm. Lines
Percent Change by State, 2007-2015

Bottom 25 States

Eight states write less commercial business than they did in 2007

Sources: NAIC via SNL Financial; Insurance Information Institute.
2016 Components of WC Payroll Exposure, by Industry

Forecast Change 2015-2016

- **WC is the most direct beneficiary of expanding payrolls, but virtually all gains are erased as rates fall.**

  - **Wage Rate**: +2.5%
  - **Payroll**: +4.5%
  - **Employment**: +1.9%

**Construction** leads in wage and employment gains.

Source: Moody’s Analytics, NCCI.
Workers Comp Approved Changes in Bureau Premium Level, 2000-2017p

Note: Bureau premium level charges reflect approved changes in advisory rates, loss costs, assigned risk rates relative to those approved in NCCI states only IN and NC are filed in cooperation with state rating bureaus.

Source: NCCI
Most Recent WC Approved Changes in Bureau Premium Level, by Industry

By Effective Year for NCCI States

Most states experience rate declines over the past year

RI: -2.6%

Note: Bureau premium level charges reflect approved changes in advisory rates, loss costs, assigned risk rates relative to those approved in NCCI states only IN and NC are filed in cooperation with state rating bureaus.


Source: NCCI
WC Approved or Filed and Pending Change in NCCI Premium Level by State*

Latest Change for Voluntary Market

*Many states have seen rates drop recently*

*As of 4/15/16. Excludes monopolistic fund states (in gray): OH, ND, WA and WY.
Source: NCCI.*
Workers Compensation Lost-Time Claim Frequency Declined in 2016

Average Annual Change = –3.5% (1994–2016)

*Adjustments primarily due to significant audit activity.


Source: NCCI Financial Call data, developed to ultimate and adjusted to current wage and voluntary loss cost level; Excludes high deductible policies; 1994-2014: Based on data through 12/31/14. Data for all states where NCCI provides ratemaking services, excluding WV.

Frequency is the number of lost-time claims per $1M pure premium at current wage and voluntary loss cost level

-6.5 -4.5 -3.9 -4.5 -6.9 -4.5 -4.1 -3.7 -6.6 -4.5 -4.3 -4.9 -0.9 -3.9 -3.3 -2 -4.6 -4.0

94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16p
WC Lost-Time Claim Frequency: Average Annual Change 2011-2015

Lost-time claim frequency is falling across the country

Source: NCCI’s Financial Call data, developed to ultimate, premium adjusted to current wage and voluntary pure premium level, excludes high deductible policies. Based on data through 12/31/15 and for states in which NCCI provides ratemaking services.
Workers Comp Indemnity Claim Costs: Sharper Increase in 2016

Average Indemnity Cost per Lost-Time Claim

Average indemnity costs per claim were up 3% in 2016 to $23,900, the largest increase since 2008

Cumulative Change = 144% (1991-2016p)

1991-2015: Based on data through 12/31/2015, developed to ultimate
Based on the states where NCCI provides ratemaking services including state funds, excluding WV; Excludes high deductible policies.
Workers Comp Medical Claim Costs: 2016 Was Sharpest Increase Since 2007

Average Medical Cost per Lost-Time Claim

Average indemnity costs per claim were up 5% in 2016 to $29,100, the largest increase since 2007

Cumulative Change = 259% (1991-2016p)

1991-2015: Based on data through 12/31/2015, developed to ultimate
Based on the states where NCCI provides ratemaking services including state funds, excluding WV; Excludes high deductible policies.
Workers Compensation
Change in Medical Severity
Comparison to Change in Medical Consumer Price Index (CPI)

Percent Change

![Bar chart showing the comparison between Change in Lost-Time Medical Claim Severity and Change in US Medical CPI over the years 1995 through 2016. The chart highlights the average annual change: Lost-Time Medical Severity: +5.8% and US Medical CPI: +3.7%.

Sources: Severity: 1995-2015: Based on data through 12/31/2015, developed to ultimate
Based on the states where NCCI provides ratemaking services including state funds, excluding WV; Excludes high deductible policies.
WC Medical Severity Generally Outpaces the Medical CPI Rate, 1995 – 2016p

Average annual increase in WC medical severity from 1995 through 2016 was well above the medical CPI (5.8% vs. 3.7%), but the gap has narrowed. Lost-time medical severities appear to on the rise again.

The Strength of the Economy Will Greatly Influence Insurer Exposure Base Across Most Lines, Especially Workers Compensation
US Real GDP Growth*

Real GDP Growth (%)

The Q4:2008 decline was the steepest since the Q1:1982 drop of 6.8%

Recession began in Dec, 2007

2017/18 GDP forecast revised upwards by ~0.2% following Trump election

Demand for Insurance Should Increase in 2017-18 as GDP Growth Continues at a Steady, Albeit Moderate Pace and Gradually Benefits the Economy Broadly

* Estimates/Forecasts from Blue Chip Economic Indicators.
Source: US Department of Commerce, Blue Economic Indicators 7/17; Insurance Information Institute.
Animal Spirits: Unleashed from the Oval Office?

Source: https://twitter.com/realdonaldtrump
Direct Written Premiums track Nominal GDP—not quarter by quarter but overall fairly well.

Sources: SNL Financial; U.S. Commerce Dept., Bureau of Economic Analysis; I.I.I.
Outlook: Consumers are optimistic about the future, which is consistent with expectations for stronger economic growth (consumers account for nearly 70% of all spending in the economy). Should positively influence business investment.

Source: The Conference Board; Wells Fargo Research.
Outlook: Small businesses are much more optimistic about the future
Insurers Are Continue to See Meaningful Exposure Growth in the Wake of the “Great Recession” Associated with Home Construction: Construction Risk Exposure, Surety, Commercial Auto; Potent Driver of Workers Comp Exposure

ISM Manufacturing Index: Jan. 1990 – May 2017

The ISM Manufacturing Index stood at 54.9 as of May 2017, down from recent highs but still solidly in growth mode.

Outlook: Modest strength (1-4 years). Will benefit from Trump policies, but employment as a share of US employment will continue to shrink due to automation.

Source: Institute of Supply Management; Wells Fargo Research.
The Labor Market Drives WC Exposures—Strength Is (Mostly) Great News for WC Insurers
US Unemployment Rate Forecast

2007:Q1 to 2018:Q4F*

Rising unemployment eroded payrolls and WC’s exposure base.

Unemployment peaked at 10% in late 2009.

Unemployment forecasts have been revised modestly downwards. Optimistic scenarios put the unemployment as low as 3.9% by Q4 2017 and 3.7% by Q4 2018.

Jobless figures have been revised downwards for 2017/18

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (7/17 edition); Insurance Information Institute.

Rhode Island Labor Market Facts

Unemployment Rate: 4.3% (6/17)
Cyclical Peak: 12.2% (1/10)
Employment: 661,501 (6/17) (highest since 12/07)
+56,764: Jobs added since 12/10
+11,860: Jobs added over past year (June 2016 - June 2017)
Emboldened workers make seek become more aggressive in seeking raises, increase wage pressure.

Source: The Conference Board; Wells Fargo Research.
New Record: Job openings stood at a record 6.16 million in June.
Job Openings and Hires: 2001 – June 2017

New Record: Job openings stood at a record 6.16 million in June.

Millions of Workers (3-month Moving Average)

Openings now exceed hires, suggesting meaningful labor market tightening.

Source: US Department of Labor; Wells Fargo Research.
Quits vs. Layoffs: 2001 – June 2017

The strong labor market has emboldened workers to quit in greater numbers than at anytime since the Great Recession.

Source: US Department of Labor; Wells Fargo Research.
Number of Unemployed Persons Per Every Job Opening: 2001 – June 2017

There are now just 1.1 unemployed persons for each job opening, the lowest figure on record. Indicates tight labor market conditions.

By the end of the Great Recession, there were nearly 7 unemployed workers for each available job.

Source: US Department of Labor; Wells Fargo Research.
POSITIVE LABOR MARKET DEVELOPMENTS

Key Factors Driving Workers Compensation Exposure
Average Weekly Hours of All Private Workers, March 2006—July 2017*

*Seasonally adjusted

Note: Recessions indicated by gray shaded columns.


Hours worked totaled 34.5 per week in July, just shy of the 34.6 hours typically worked before the “Great Recession.”

Hours worked plunged during the recession, impacting payroll exposures.

Hours worked totaled 34.5 per week in July, just shy of the 34.6 hours typically worked before the “Great Recession.”

*Seasonally adjusted

Note: Recessions indicated by gray shaded columns.

The average hourly wage was $26.36 in July 2017, up 24.2% from $21.22 when the recession began in Dec. 2007.

Wage gains continued during the recession, despite massive job losses.

Wage growth has remained stubbornly slow, but there is some evidence of that faster wage gains are likely going forward.

*Seasonally adjusted
Note: Recessions indicated by gray shaded columns.
ADVERSE LONG-TERM LABOR MARKET DEVELOPMENTS

Key Factors Harming Workers Compensation Exposure and the Overall Economy
Labor Force Participation Rate, Jan. 2002—July 2017*

*Defined as the percentage of working age persons in the population who are employed or actively seeking work.

Note: Recessions indicated by gray shaded columns.

In recent good times, the number of discouraged workers ranged from 200,000-400,000 (1995-2000) or from 300,000-500,000 (2002-2007).

Notes: Recessions indicated by gray shaded columns. Data are seasonally adjusted.
Profitability & Politics

How Is Profitability Affected by the President’s Political Party?
P/C Insurance Industry ROE by Presidential Administration, 1950-2016*

OVERALL RECORD: 1950-2016*
Democrats 7.60%
Republicans 7.85%

Party of President has marginal bearing on profitability of P/C insurance industry

*Truman administration ROE of 6.97% based on 3 years only, 1950-52.
Source: Insurance Information Institute
Trumponomics, Insurance and Politics

How Might the Trump Presidency Impact the Insurance Industry?
Trumponomics: The Essential Elements

5 Elements
- Fair Trade
- Deregulation
- Tax Reform
- Infrastructure Investment
- Immigration Reform/Enforcement

NOTE: Unclear what the impact of current political developments will be on Trump’s economic agenda
Trump Tax Proposal Implications

**Move from 7 Federal Brackets to 3: 10, 25 and 35%**
- High earners also benefit from elimination of ACA taxes
- Increase standard deduction
- Eliminate most deductions except for mortgage interest, 401(k) and charitable contributions

**For Businesses/Business Owners**
- Lower corporate income taxes to restore international competitiveness on tax rates, perhaps to 15%, but…
- Adoption of “border adjustments” on imported goods, services and capital;

**Insurer Implications**
- Lower corporate taxes would directly benefit insurers directly & indirectly through resulting economic stimulus
Trump Administration: Likely Issues Impacting Insurers

**Dodd-Frank**

- **TRUMP DODD-FRANK QUOTES**
  - Dodd-Frank is a “disaster”
  - Vowed to “do a big number” on the Act

- **NEW: Financial CHOICE Act (June 2017 in House)**
  - Ends authority of the FSOC to designate non-bank SIFIs
    - Likely that MetLife, Prudential and even AIG will see their SIFI designations rescinded
  - Repeal Volker Rule
  - Some loosening of liquidity requirements for well-capitalized financial institutions; Less frequent stress tests
  - Weaken Consumer Financial Protection Bureau
  - NOTE: No mention of FIO, but Office of Financial Research would be eliminated
Trump Administration: Likely Issues Impacting Insurers

■ Trade

❖ Has vowed to be tough in (re)negotiating trade deals

❖ Unlikely there is any stomach in Congress for all out trade wars with Mexico, China or other major trading partners

❖ A crescendo in protectionist sentiments would be a net negative for all industries, including (re)insurance and financial services in general (and trucking)

❖ Despite his election rhetoric, Trump is neither a protectionist nor an isolationist

❖ More localization of supply chains, incl. capital & ins.

❖ Likely to be hostile to Corporate Inversions?

❖ Treatment of offshore tax havens in future tax reforms will be of interest
Trump Administration: Likely Issues Impacting Insurers

Infrastructure Spending

- Insurance industry could benefit from stepped-up infrastructure spending as promised by Trump
- Competition for federal dollars will be fierce
- Privatization of government infrastructure could provide growth opportunity for commercial insurers
- If infrastructure spending materializes, will benefit all major commercial lines:
  - WC
  - Commercial Property
  - Commercial Liability
  - Surety
  - Commercial Auto
Trump Administration: Likely Issues Impacting P/C Insurers

- Terrorism & Cyber: Terrorism Risk Insurance Act (TRIA)
  - Expires 12/31/2020 → Administration views uncertain
  - Favors free markets but Trump’s NYC real estate experience gave him a front row seat to 9/11’s impact’s on commercial property insurance markets
  - When TRIA expires, Trump will either have just secured his second term as president or will be a lame duck
  - Expect some opposition in Congress, assuming both House and Senate remain under Republican control

- Cyber: Strong growth for commercial insurers for the indefinite future—barring a major cyber cat
M&A Trends

Consolidation Among P&C (Re)Insurers and Within Distribution Channels Will Likely Continue

(1) Includes transactions where a U.S. company was the acquirer and/or the target.

Source: Conning proprietary database.
M&A activity in the Distribution sector in 2016 totaled $4.2B, a steep (73.5%) drop from $18.7B in 2015.

USI announced the acquisition of Wells Fargo Insurance Services on June 26.

(1) Includes transactions where a U.S. company was the acquirer and/or the target.

Source: Conning proprietary database.
### Drivers of M&A Activity

<table>
<thead>
<tr>
<th>P/C Insurers</th>
<th>Distribution Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Soft Market Conditions/Limited Organic Growth Opportunities:</strong> Mostly commercial lines and reinsurance</td>
<td><strong>Slow Growth:</strong> Acquisition provides surest and fastest path to growth</td>
</tr>
<tr>
<td><strong>Expense Ratios:</strong> Desire to lower ERs via realization of economies of scale</td>
<td><strong>Diverse Universe of Buyers:</strong> Agencies, brokerages, MGAs/MGUs, insurers, private equity firms, banks</td>
</tr>
<tr>
<td><strong>Interest Rates:</strong> Low yields continue to pressure longer-tailed lines but can encourage debt-financed M&amp;A</td>
<td><strong>Lack of Succession:</strong> Avg. age of an insurance agent is now 59 and rising. Difficulty attracting younger generation of talent.</td>
</tr>
<tr>
<td><strong>Capital Management/Valuations:</strong> Prevalence of excess capital even after share repurchases; View that M&amp;A may be more accretive to earns than share repurchases</td>
<td><strong>Scale and Efficiency:</strong> Need/desire to improve efficiency; New InsurTech start-ups active in the distribution segment.</td>
</tr>
</tbody>
</table>

Source: Adapted from Conning "Global Insurance Distribution & Services Sector: Mergers & Acquisitions, 2017."
Commercial Lines Growth and Pricing Trends

Survey Results Suggest Commercial Pricing Has Flattened Out, with Impacts on Growth
CIAB: Average Commercial Rate Change, All Lines, (1Q:2004–1Q:2017)

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1Q:2004</td>
<td>-3.2%</td>
</tr>
<tr>
<td>2Q:2004</td>
<td>-5.9%</td>
</tr>
<tr>
<td>3Q:2004</td>
<td>-9.4%</td>
</tr>
<tr>
<td>4Q:2004</td>
<td>-11.7%</td>
</tr>
<tr>
<td>1Q:2005</td>
<td>-7.0%</td>
</tr>
<tr>
<td>2Q:2005</td>
<td>-11.8%</td>
</tr>
<tr>
<td>3Q:2005</td>
<td>-13.5%</td>
</tr>
<tr>
<td>4Q:2005</td>
<td>-11.0%</td>
</tr>
<tr>
<td>1Q:2006</td>
<td>-11.3%</td>
</tr>
<tr>
<td>2Q:2006</td>
<td>-13.5%</td>
</tr>
<tr>
<td>3Q:2006</td>
<td>-13.9%</td>
</tr>
<tr>
<td>4Q:2006</td>
<td>-11.0%</td>
</tr>
<tr>
<td>1Q:2007</td>
<td>-16%</td>
</tr>
<tr>
<td>2Q:2007</td>
<td>-11%</td>
</tr>
<tr>
<td>3Q:2007</td>
<td>-6%</td>
</tr>
<tr>
<td>4Q:2007</td>
<td>-1%</td>
</tr>
<tr>
<td>1Q:2008</td>
<td>4%</td>
</tr>
<tr>
<td>2Q:2008</td>
<td>9%</td>
</tr>
</tbody>
</table>

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially.
Source: Council of Insurance Agents & Brokers; Insurance Information Institute
Change in Commercial Rate Renewals, by Line: 2017:Q1

Major Commercial Lines Renewals Were General Down in Q1:2017; Only Commercial Auto Saw Material Gains

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
Rate Changes by LOB Thru Q4 2016

Slight Softening, Though Local Markets Vary

U.S. Casualty

-2.1%

U.S. Property

-4.8%

U.S. Financial and Prof Liab

-2.5%

U.S. Cyber

20.0%

1.4%

SOURCE: Marsh Insurance Market Index, Q4 2016
INDUSTRY DISRUPTORS

Technology, Society and the Economy Are All Changing at a Rapid Pace

*Reality vs. Drinking the Silicon Valley Kool Aid*
INSURANCE TECHNOLOGY:
FIN TECH ZEROES IN

Number and Value of Deals Is Increasing

In Search of the Elusive Insurance ‘Unicorn’
Insurance tech deals reached a new record in 2016 but funding was higher in 2015.

2 out of every 3 InsurTech deals in 2016 was at the early stage!
Early Stage InsurTech Financing (Seed/Series A), 2011 – 2016

There was a sharp increase in early stage InsurTech financing in 2016, increasing to $508 million, a 56% increase over 2015.

2 out of every 3 InsurTech deals in 2016 was at the early stage!

Sources: CB Insights at https://www.cbinsights.com/blog/2016-insurance-tech-funding/
Launches of Insurance Corporate Venture Capital Units, 2015 – 2017 YTD*

<table>
<thead>
<tr>
<th>2015</th>
<th>2016</th>
<th>2017 YTD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allianz</td>
<td>FAIRFAX</td>
<td>Aflac</td>
</tr>
<tr>
<td>XL Catlin</td>
<td>IAG</td>
<td>Liberty Mutual</td>
</tr>
<tr>
<td>AXA</td>
<td>annexus</td>
<td></td>
</tr>
<tr>
<td>AVIVA</td>
<td>CUNA Mutual Group</td>
<td>Northwestern Mutual</td>
</tr>
</tbody>
</table>

VC arms of insurers launched since 2015 have provided more than $500 million in funding.

Top 25 P/C Insurers by Direct Written Premium, 2015

Are large P/C insurers more likely to invest in InsurTech start-ups?

Sources: NAIC from CB Insights at https://www.cbinsights.com/blog/largest-pc-insurers-rank-startup-investments/
10 of the Top 25 P/C insurers have made InsurTech start-up investments since 2015.—but there is little correlation between size and number of investments within this group.

USAA and AmFam lead in P/C InsurTech investment.

*As of June 23, 2017.
Sources: NAIC from CB Insights at https://www.cbinsights.com/blog/largest-pc-insurers-rank-startup-investments/
Distribution Trends

Distribution by Channel Type Continues to Evolve Around the World
Commercial Lines Distribution Channels, Direct vs. Independent Agents, 2011-2015

Independent agent market share in commercial lines has held steady in recent years.

Source: Calculations based on data from A.M. Best.
Thank you for your time and your attention!

Twitter: twitter.com/bob_hartwig

For a copy of this presentation, email me at robert.hartwig@moore.sc.edu