COVID -19 Workers' Compensation Market Update

While we are only a couple of weeks into our widespread social distancing measures related to this historic pandemic, the COVID-19 outbreak and the measures to contain its spread have already created profound effects to the Workers' Compensation insurance and reinsurance markets. The transmission of the virus has led to coverage questions for both insurance and reinsurance. Meanwhile, the government mandates to contain the spread of the disease has led to considerable operational and economic hardships for businesses around the U.S. (and the world at large).

BMS Re US' Workers' Compensation Specialty Practice Group has spent the past few weeks discussing these matters with our clients and reinsurance markets in order to make sense of this extraordinary time, and have compiled our view of the short-term and long-term market implications of the COVID-19 pandemic and the effects to the Workers' Compensation (Re)-Insurance market.

Short-Term Implications

How are Workers' Compensation insurance and reinsurance companies currently operating amid the government mandates related to COVID-19?

Insurance: Most of BMS' Workers' Compensation clients are fully operational on a remote or mostly-remote basis. Some of our clients had still have employees in offices to perform essential functions (e.g. mail, check drafting, and deposits). However, most operations are working remotely. A handful of companies did not have a smooth transition plan in place, but have since become operational with some/all employees working from home.

Reinsurance: As many reinsurance underwriters travel extensively for work, many have transitioned rather smoothly into a remote set-up. BMS has generally found our reinsurance partners to be operational and responsive during this difficult time. In addition, we have found that our reinsurance partners are willing to talk to BMS brokers about the market and discuss solutions for some of the challenges ahead. With that said, the sudden change in working has slightly delayed 4/1 placements, though 5/1 placements seem to be in order.

Bottom Line: BMS clients are currently operational, and so are reinsurers. We do not expect the changes in work environments to be a reason to extend upcoming renewals of Workers' Compensation reinsurance treaties.

Are COVID-19 cases compensable events for employers?

Insurance: The answer is a mixed one. Some state statutes exclude "Ordinary Diseases of Life" (like a cold or influenza), for Workers' Compensation. The novel coronavirus could be similarly categorized; requiring an employee be tested positive by a medical professional and provide proof that the disease was acquired through their working environment. With that said, certain states are making exemptions for certain occupational groups (e.g. first responders, healthcare providers, and potentially others that are required to work outside of their home). Several state legislative committees are reviewing these provisions right now and their enactment remains to be seen.

Employers Liability cases are also a concern, where claimants allege that an employer did not provide a safe work environment to their employees.

Reinsurance: While the COVID-19 pandemic has disastrous consequences within and outside the insurance market, it remains to be seen if Workers' Compensation losses will hit catastrophe excess of loss (XOL) layers.

Most excess of loss treaties include Occupational Disease and/or Cumulative Trauma (OD/CT) within the definition of Loss Occurrence. To be combined into a single occurrence, OD/CT claims must take place within a certain number of hours. These hour windows can range from 48-120 hours, therefore the infection of an Occupational Disease (which COVID-19 could be considered) would need to occur within a 2-5 day window. Despite the infectious nature of this coronavirus, this is a tight window in which to fit claims.

Bottom Line: BMS does expect a frequency of claims activity from COVID-19, though currently do not expect significant severity emanating from these claims as few aggregated, "Loss Occurrences" (as defined by XOL reinsurance treaties), should emerge.

Are we seeing any proposed changes in Terms and Conditions over the past few weeks?

In our discussions with numerous reinsurers, BMS is not seeing any major wording changes, yet, for Workers' Compensation treaties. However, reinsurers are proposing several wording clarifications as a method to limit their exposure to the current COVID-19 outbreak and potential future pandemics. These include applying COVID-19 claims on a per employee basis (essentially taking them out of OD/CT provisions) or implementing a per employee sublimit on COVID-19/pandemic type claims.

Some reinsurers have proposed pandemic/infectious disease exclusions in wordings, though we are not seeing them being incorporated into BMS wordings. These exclusions are complicating for several reasons. First, primary Workers' Compensation carriers are not able to exclude this exposure, therefore implementation of these terms is counter to the nature of an insurance company's partnership with its reinsurer. Secondly, the implementation of an exclusion in a future renewal may signal that coverage exists now, while the historic pandemic is playing out. It is uncertain how that would play out in a reinsurance arbitration.

Long-Term Implications

While new terms and conditions may take beyond April 1 and May 1 placements to emerge, the economic fall-out from the government mandated closures related to the containment of COVID-19 is happening now and will be felt for some time in the future. This is not an original idea. This week, Goldman Sachs' economists revised their Q2 2020 GDP forecast to a 34% drop (annualized).

What is happening to Payroll/Premiums?

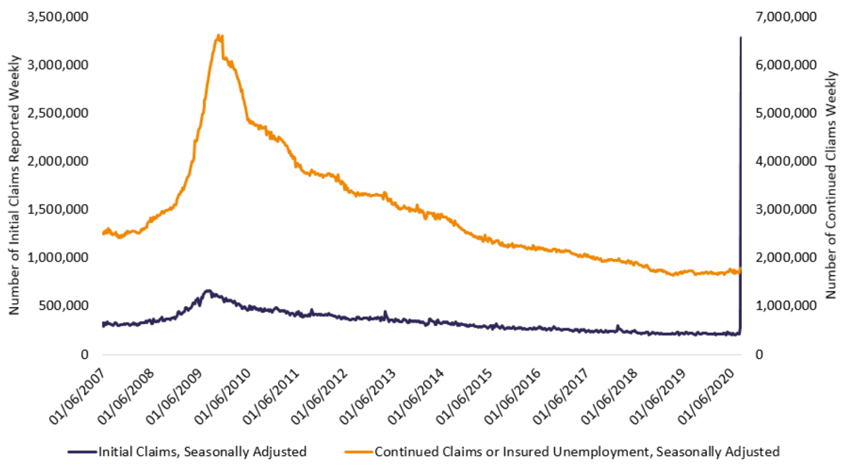
While there are a few types of industries that may not see much downturn (e.g., trucking and healthcare), many are at a virtual standstill, due to government mandates. Risks such as restaurants & hospitality have significantly cut payroll, leading to per account payroll drops in the range of 40-70% during this shut-down period. As Workers' Compensation is rated off of payroll, we expect large drops in premium per account at audits and/or renewals.

Reinsurance Effect: Similarly, most excess of loss treaties have contractual minimum premiums that are typically set anywhere between 80-100% of deposit premiums (usually contractual rate times projected subject premium). With the payroll drops currently taking place, BMS expects that many buyers of Workers' Compensation XOL reinsurance will be at risk of a minimum premium "penalty" (where adjusted reinsurance premium falls below the contractual minimum). The major Workers' Compensation reinsurers are aware of this challenge and are welcome to discussing proposals to solve for this challenge, as long as they are aware of the specific challenges faced by the cedant. BMS' Workers' Compensation brokers are well versed on this challenge and are ready to help our clients.

Will rising unemployment affect Workers' Compensation profitability?

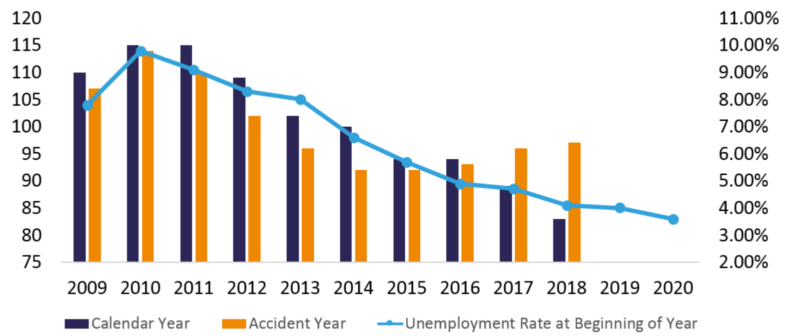
With the economic slowdown, employment drops have been a headline many are following. Last Thursday, the Department of Labor reported weekly unemployment claims for the week ending on March 21st, at over 3.2M claims. This far exceeded records set in the Great Recession in 2008-2009.

Number of Initial Claims and Continued Claims Reported Weekly from 2007-2020
Data Source: United States Department of Labor



Insurance Impact: Historically, Workers' Compensation results have been directly correlated to trends in unemployment. A higher unemployment rate has typically brought on poorer Workers' Compensation results. This can be evidenced by the graph below.

NCCI Combined Ratio (%) and Unemployment Rate
Data Source: NCCI Results: 2019 State of the Line Report, Unemployment Data: Bureau of Labor Statistics



Workers' Compensation has enjoyed historic levels of profitability in the past few years, and we expect the NCCI to report favorable results for 2019. However, we do expect 2020 to be more challenging (in terms of both Calendar and Accident Year results). As rating bureaus tend to have a retrospective view when setting rates, it will be interesting to see if there are further rate decreases throughout this year.

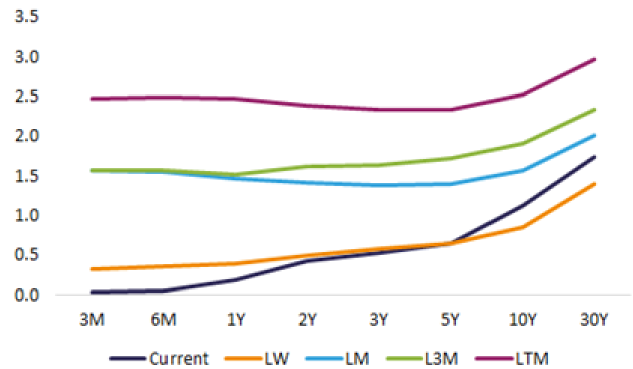
Given the employment situation, could 2020 be the bottom for loss costs?

Reinsurance Impact: BMS has been seeing a hardening market for excess of loss covers for the past 6-9 months. In our discussions with reinsurers, we expect that this space may continue to modestly harden. While the industry has been reporting good results in recent years, excess of loss reinsurers have not enjoyed profitability in a similar proportion. The line of business has enjoyed favorable frequency trends, while severity has trended slightly upward. Therefore, the rating bureau (NCCI, WCIRB and others) rate decreases have impacted the profitability of writing XOL reinsurance. However, BMS does expect a potential benefit to arise for reinsurers, due to the current "lock-down" mandates. Motor vehicle accidents (MVAs) have been a major driver of severe losses in recent years. With fewer cars on the road, and fewer passengers in each vehicle (particularly workers traveling together, due to social distancing), we should see fewer MVAs impacting XOL treaties during this period.

In discussions with several markets, BMS expects a firming for proportional business as well. The recent drops in bureau rates in many states is thought by some to have gone too far. While the benefits from frequency drops and reforms (such as California's SB 863, enacted a few years ago) are real, the consensus view is that the reserve redundancies existing in accident years 5-6 years ago are not present in more recent years. This is increasing reinsurers' loss picks on quota share business, pressuring quota share ceding commissions.

Another concern is investment income, or claims discounting. In order to combat the economic effects of COVID-19, the Federal Reserve has enacted a "whatever it takes" easy monetary policy to support the functioning of the credit market. This has caused interest rates (as measured by US Treasury) to fall to historic lows. Based on the chart below, there is an approximate 200-250 basis point drop on treasuries with maturities between 3 months and 10 years. This drop in interest rate reduces return assumptions for reinsurers, pressuring underwriters to require more margin on proportional Workers' Compensation deals.

US Treasury Curve (% yield)
Data Source: Refinitiv



Summary

While this report highlights uncertainties and issues unique to the current environment, we do expect that this similarly presents opportunity for the expert operators in the Workers' Compensation space to shine. Despite recent events, capacity remains plentiful. Those that have a plan for operational excellence, expert underwriting and good claims handling will be rewarded with capacity and flexibility from their reinsurance underwriting partners. This is the time for the best Workers' Compensation companies in the market to tell their story. Let BMS help you tell that story in the market!

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