Workers Compensation: Emerging Issues

CLRS -- Arlington, Virginia

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Outline

- Federal terrorism legislation
- Implications for WC
- Need for greater industry pooling

Congress continues to deliberate on a federal backstop for terrorist insurance losses

- On November 29, 2001, the House of Representatives passed

  HR 3210, the Terrorism Risk Protection Act

- On June 18, 2002, the Senate passed

  S 2600, the Terrorism Risk Insurance Act

- These two bills differ significantly as to how the federal backstop program would operate

- For a program to be enacted, the two proposals must be reconciled into a program that the House, Senate, and the President can support

The two bills operate on the same general framework, with very different particulars

- In general, both bills provide that, if the aggregate insured commercial P&C losses from terrorist acts exceed some threshold, then the federal government will reimburse commercial lines insurers for a portion of their losses, subject to a maximum federal payout of $100-billion
- The bills differ as to:
  - industry deductibles and coinsurance
  - whether reimbursement is direct or net
  - whether there will be recoupment
  - particulars as to event definition, insurer and product line eligibility, how many years, etc.

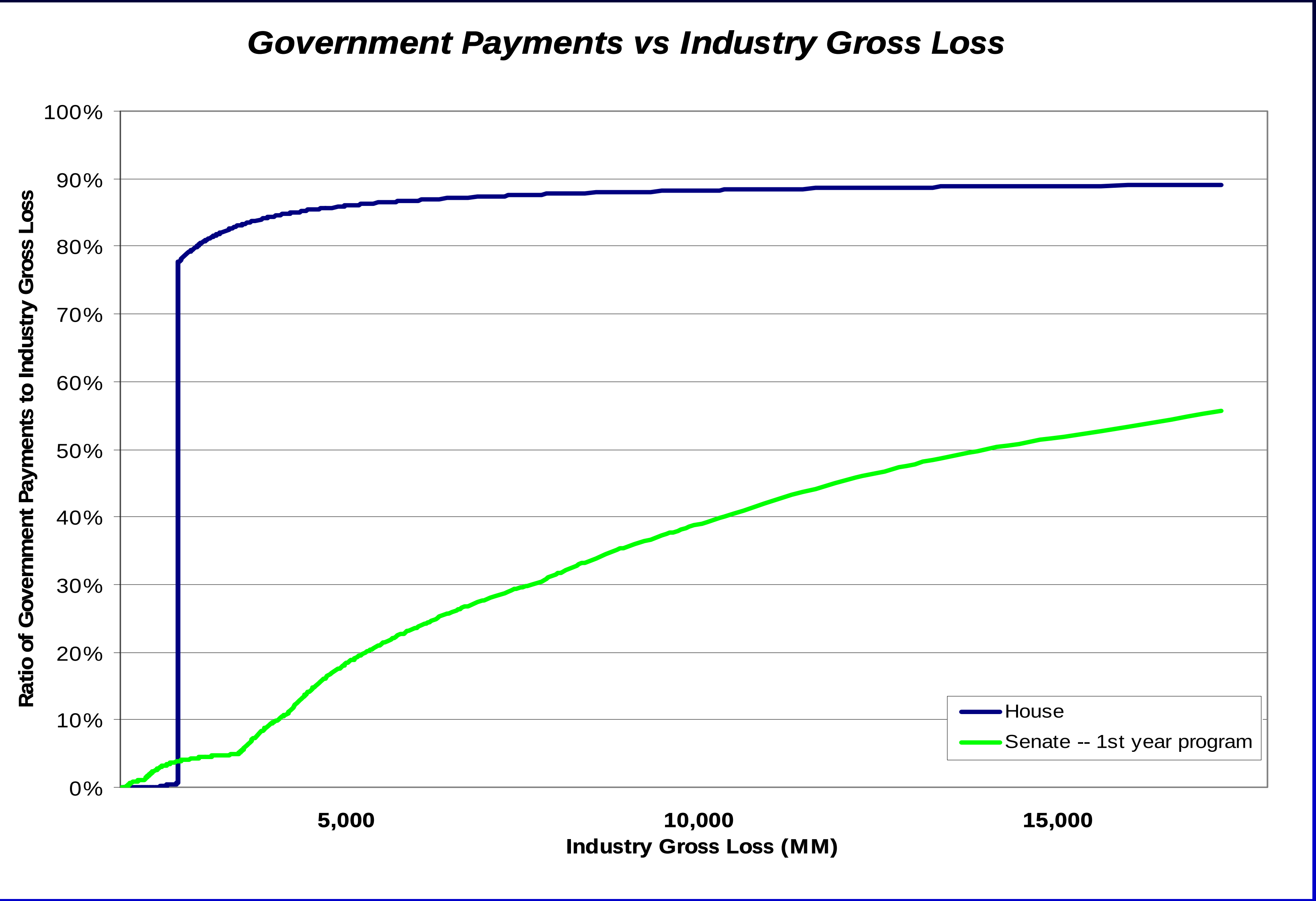
A key difference between the bills is the level of losses that trigger federal reimbursement

- Under HR 3210, there is a dual trigger
  - The main trigger is industry-wide annual insured losses from terrorism in excess of $1 billion
  - A secondary trigger is industry-wide annual insured losses in excess of $100 million, and losses for at least one insurer in excess of both 10% of surplus and 10% of CL premium
- Under S 2600, an insurer can only recover to the extent that their losses from terrorist attacks exceed a deductible equal to their commercial market share times $10 billion

The share of losses reimbursed by the government varies

- Under HR 3210, if the *industry-wide trigger* of $1 billion is reached, then the federal government will reimburse insurers for 90% of their losses in excess of $5 million
- Under S 2600:
  - If aggregate industry losses for the year are below $10 billion, then the federal government will reimburse insurers for 80% of their losses above their deductible
  - If aggregate industry losses for the year are above $10 billion, the government’s share increases from 80% to 90% on the excess above $10 billion

The government's share of the losses will generally be lower under S 2600



Another key difference between the two bills is in the mechanics

- Under HR 3210, insurer losses are net, after outward reinsurance
  - All insurers and reinsurers globally are eligible for reimbursement, to the extent they insure/reinsure US exposure
- Under S 2600, insurer losses are direct basis, prior to reinsurance
  - Only direct insurers (including surplus lines insurers) are eligible for federal reimbursement
  - However, reinsurers can participate indirectly -- the direct insurers are to share their recoveries with their reinsurers in the same proportion as their share of the losses

Under HR 3210, federal payments are to be recouped over time via assessments

- S 2600 has no provisions for recovery of federal payments
- Under HR 3210 federal payments are to be recovered via assessments on commercial insurers and earmarked surcharges on policyholders
- Assessments/surcharges in any calendar year are limited to 3% of CL net written premium
  - Translates into an industry-wide overall annual dollar cap on recoveries of roughly $3.6 billion
  - The Secretary of the Treasury is granted latitude on the pace of recoupment, so as not to disrupt the economy

Our costing of the two proposals indicates that HR 3210 is more expensive

Costing of Alternative Programs		
	HR 3210	***S 2600***
Expected Terrorist Losses	9,000	9,000
Federal Disbursements	7,620	3,200
NPV Cost of Fed Disbursements	6,259	2,639
NPV of Fed Recoupments	3,220	
	3,038	2,639

- Costing paper is available on *tillinghast.com*

Workers Compensation insurers will have substantial terrorism deductibles under S 2600

- Deductible is based on total commercial lines DWP
- Largest five insurers have deductibles over $500 million; largest ten have deductibles over $250 million

Company Rank by WC DWP	***Estimated Terrorism Deductible***
1	424,023
6	213,525
11	93,988
16	303,319
21	61,470
26	32,226
31	82,987
36	17,940
41	25,717
46	45,853
51	10,412

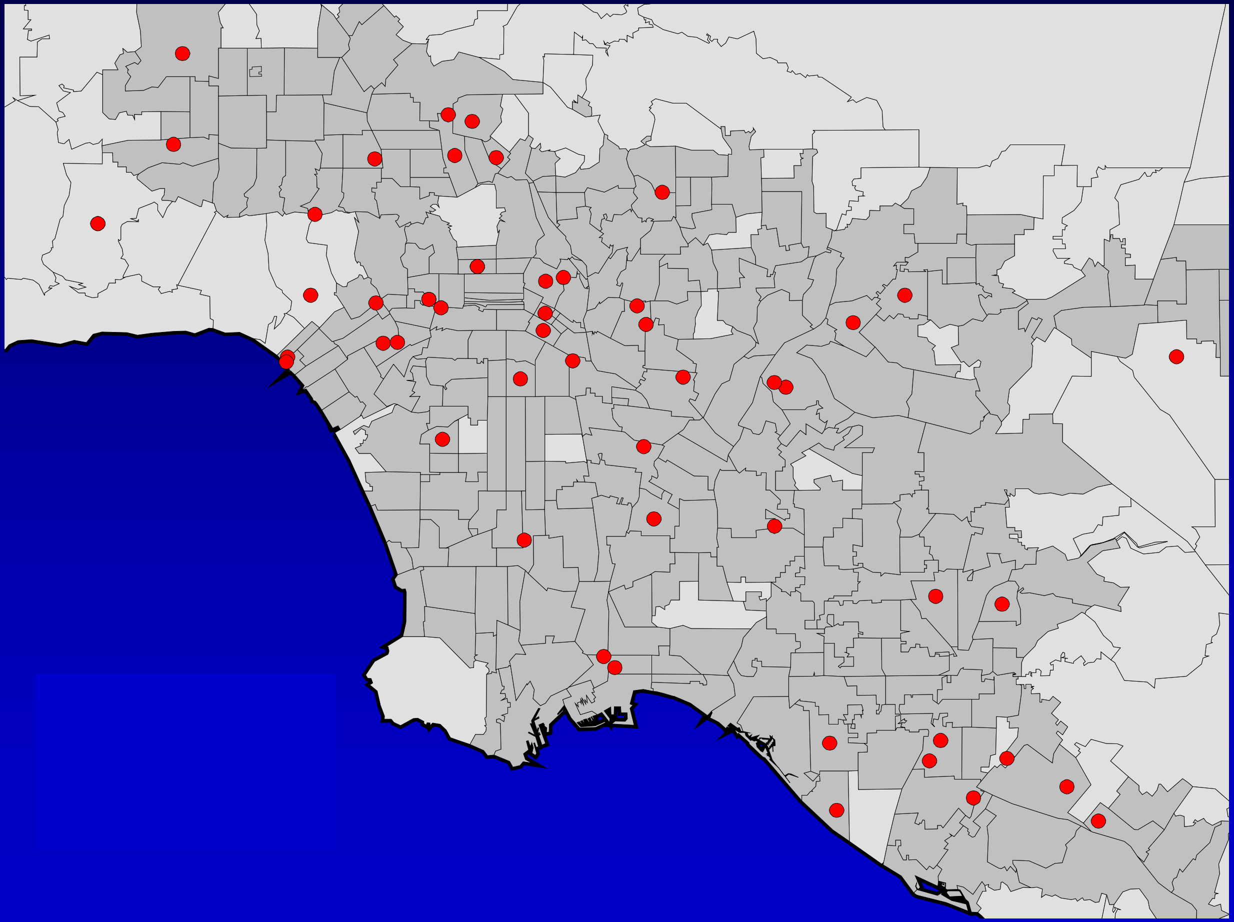
WTC defined terrorism workers compensation exposure; redefined catastrophe exposure

- Approximately 3,000 workers died
  - 25 fatalities no longer “worst case scenario”
  - Loss from one account over $250 million
- Federal terrorism reinsurance proposals suggest greater need for industry pooling

Company	Estimated Employees at WTC	Reported Dead or Missing
Cantor Fitzgerald	1000	662
Marsh	1900	275
Aon	1350	170
Port Authority of NY & NJ	3000	74
Windows on the World	75	72
CARR Futures	141	69
Keefe, Bruyette, Woods	171	67
Sandler O'Neill		66
Euro Brokers/Maxcor	285	60
Fiduciary Trust	645	57
New York State Tax Dept	224	38
Fred Alger		36
Forte Food Service		21

While modeling may help, exposure data alone is useful in understanding concentrations

- Accounts in Los Angeles area with more than 250 lives

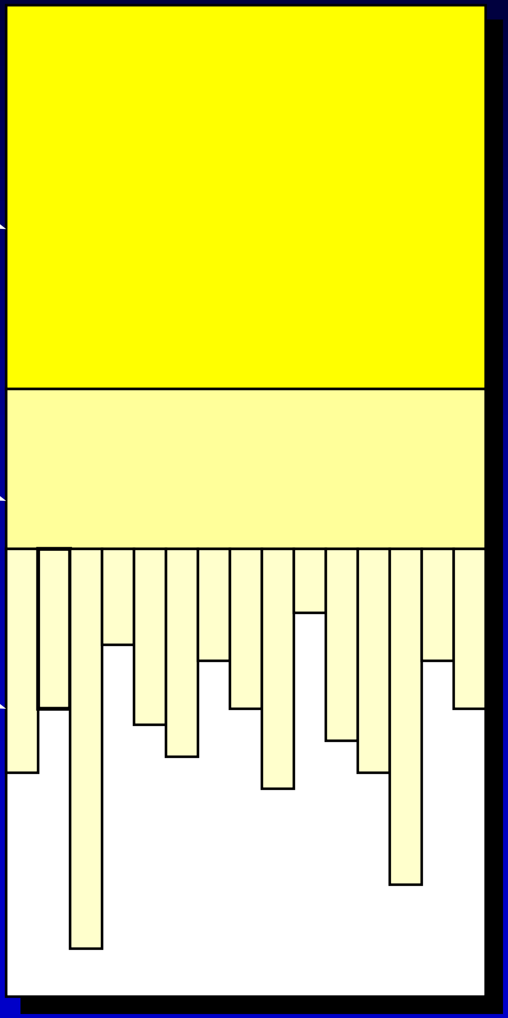


A pool structure that mixes pre-event and post-event funding might serve the industry

The second pool layer is “post-funded”

The first pool layer is “pre-funded”

Companies set their own retentions by purchasing reinsurance commercially



Fundamental purpose of pool is mutualisation of risk across the industry

Pool covers all WC catastrophe losses -- not just terrorism

Attachment is above the point where difference in underwriting “matter”

Pool could operate as the “window” to a federal program for extreme events