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Viewpoint

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Portfolio Opportunities in the Workers' Compensation Industry

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Conning has analyzed the market of insurers specializing in workers' compensation coverage to identify portfolio investment opportunities for this niche group of carriers. Our general findings are below and we offer individual companies the option of learning more about their market position relative to peers, along with portfolio suggestions that might help them strengthen their business.

Market Comparison

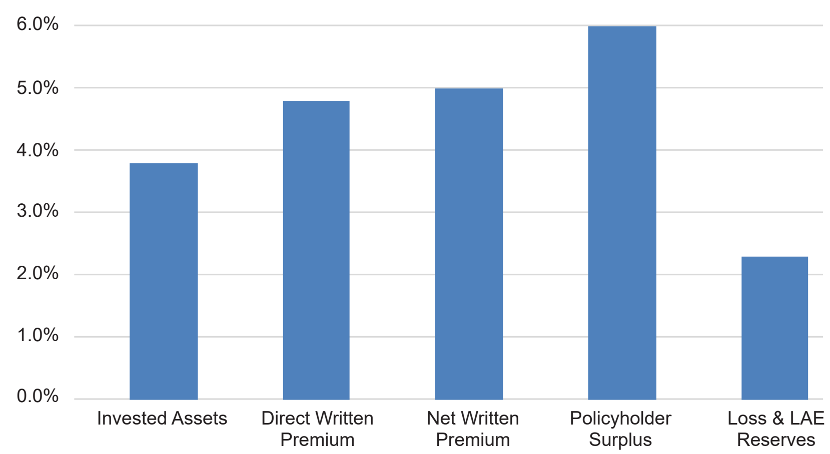
There are 58 firms designated as workers' compensation specialist according to A.M. Best data. We separated them into four bands based on portfolio size and compiled average figures for each band on invested assets, direct and net written premium, surplus, and loss and loss-adjustment expense (LAE) reserves (see Figure 1).

Figure 1* - Carrier Financial Summary by Invested Assets (Averages, in 000s)

Invested Assets Range	Number of Companies	Invested Assets	Direct Written Premium	Net Written Premium	Policyholder Surplus	Loss & LAE Reserves
Greater than $1BN	16	3,806,407	623,642	616,039	1,477,976	2,154,255
$250mm - $1BN	18	516,218	174,568	150,176	216,554	255,040
$100mm - $250mm	10	157,171	50,070	48,376	60,378	74,489
$50mm - $100mm	14	64,104	24,593	22,844	34,392	28,239

During the last five years, overall growth among workers' compensation specialists has varied by company and size band but overall has been strong, as seen in Figure 2.

Figure 2* - Workers' Compensation Industry Compound Annual Growth Rates, 2013 - 2018



Underwriting Results and Investment Income

Figure 3 shows that the two smaller bands of workers' compensation companies experienced lower loss ratios in 2018, signaling stronger underwriting performance, while the larger companies' scale advantage in underwriting operations resulted in lower expense ratios. The lower loss and dividend ratios for the smaller specialists has led to persistently lower combined ratios (see Figure 4). However, as Figure 5 illustrates, the larger companies - especially those with $1 billion in assets or more – have an advantage in investment income ratio, or the amount of investment income earned per dollar of premium. This is driven by higher investment yields and greater balance-sheet leverage and helps counter the weaker underwriting performance. Accounting for investment income ratio shows that all the workers' compensation carriers in our study are, on average, very close in operating ratio (Figure 6).

Figure 3* - Average 2018 Combined Ratio Components

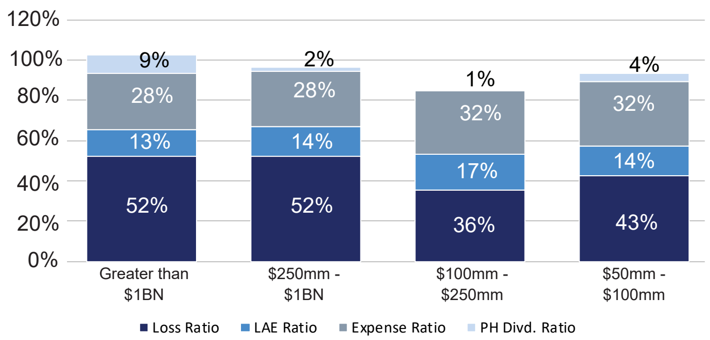
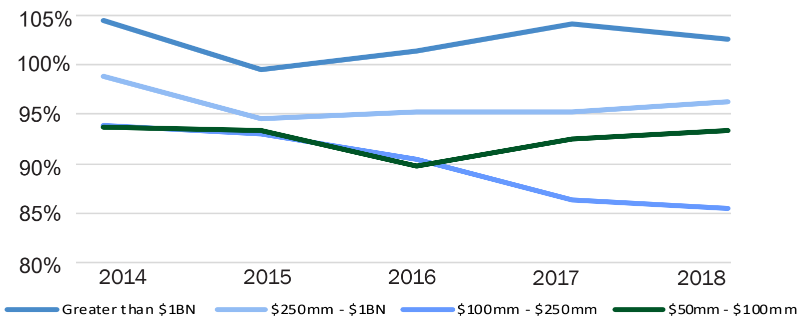


Figure 4* - Average Combined Ratio†, 2014 - 2018



†Includes dividends.

Figure 5* - 2018 Investment Income Ratio

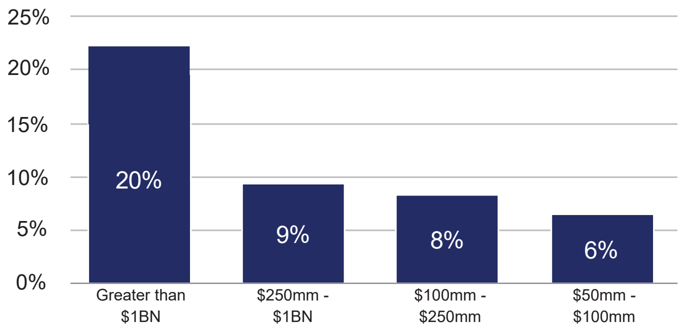
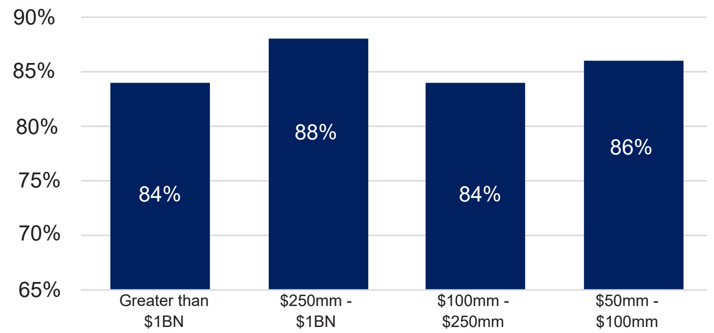


Figure 6* - Average Operating Ratio, 2014 - 2018



Larger Firms Have Advantage in Investment Performance

Larger companies have the advantage in investment performance, both on a total return and income measure (see Figures 7 and 8). Examining their bond portfolios reveals why. Larger firms' bonds on average have longer duration and maturity (as seen in Figure 9), have a greater exposure to non-public bonds (Figure 10), and on average are of lower quality (Figure 11). *Conning believes there are no fundamental reasons that limit these exposures to just the larger companies. Companies of all sizes, in fact, might benefit from a thorough analysis of market opportunities.*

Figure 7* - Estimated Portfolio Total Return

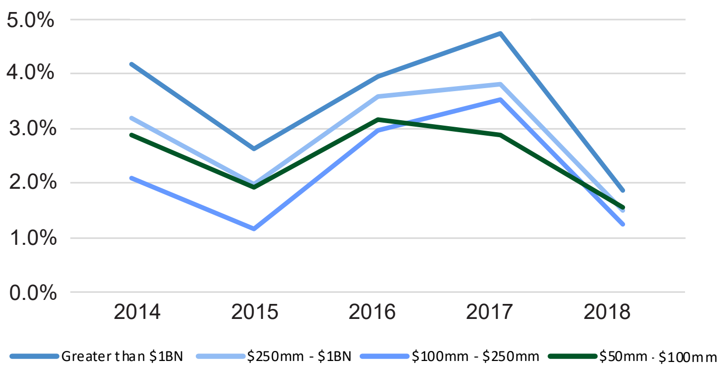


Figure 8* - Estimated Tax-Equivalent Bond Investment Yield

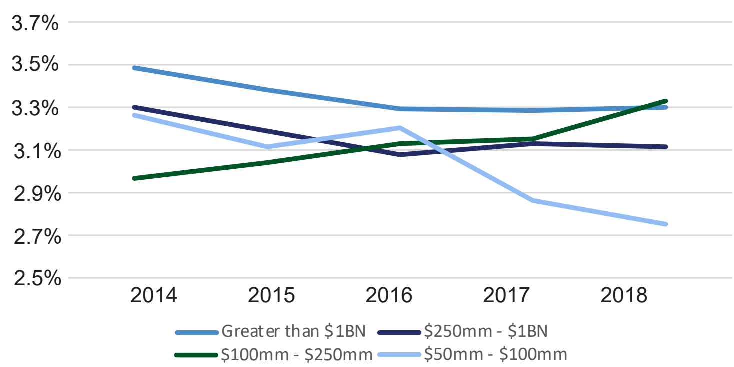


Figure 9* - Bond Maturity and Duration Estimates, 2018

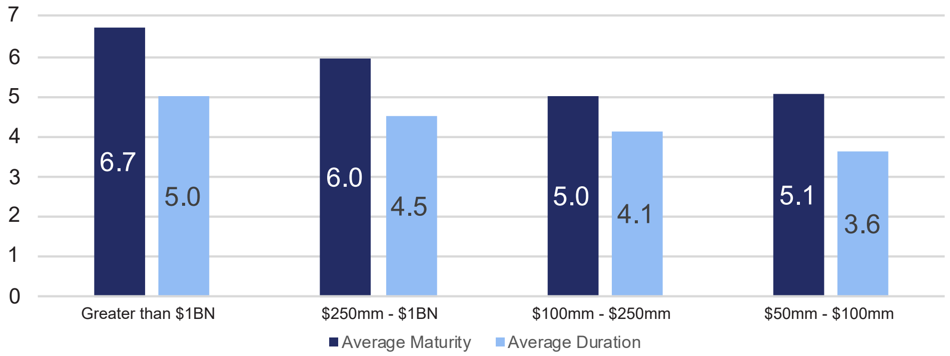


Figure 10* - Exposure to Private Bonds, 2018

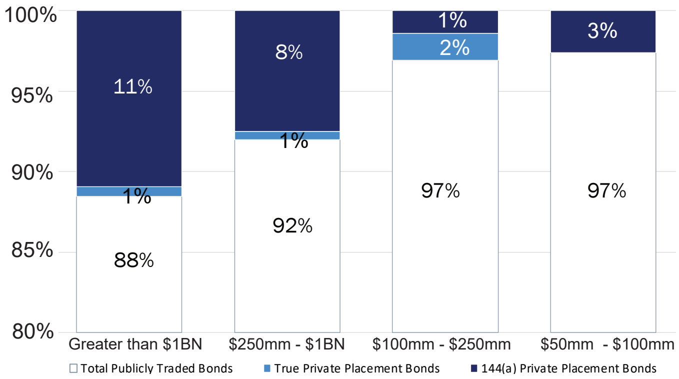
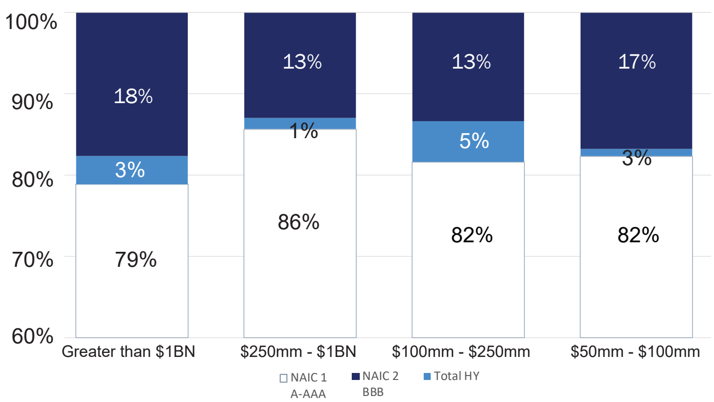


Figure 11* - Bond Quality Distribution, 2018

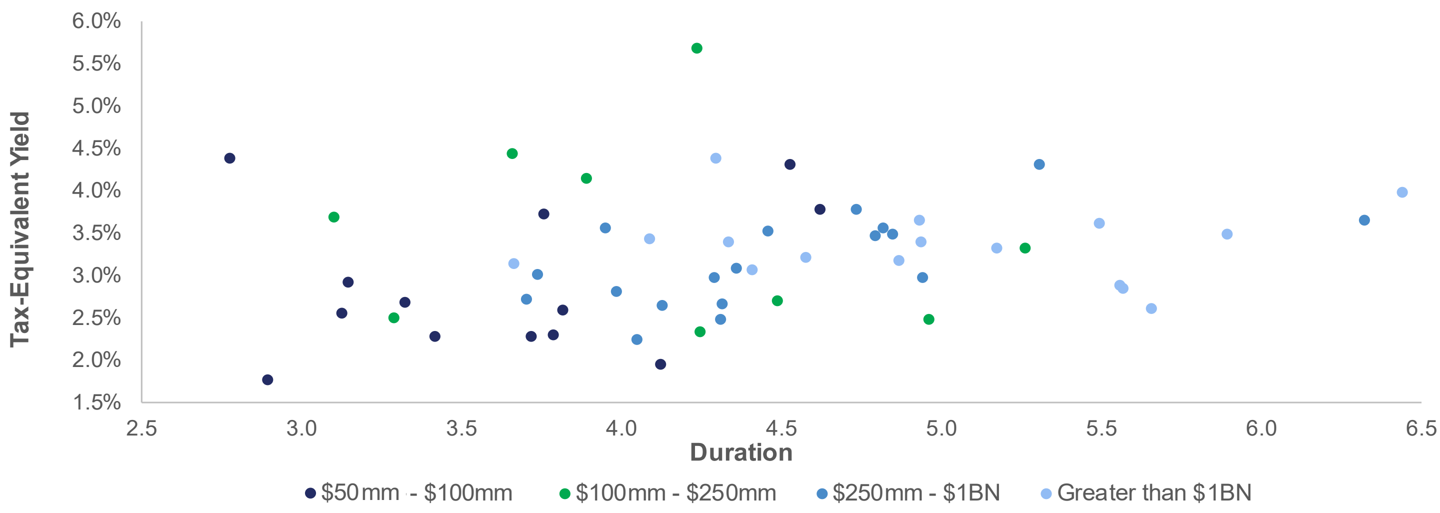


Room for Investment Improvement Across Size Bands

However, when we analyze results on a reward-risk basis, such as comparing tax-equivalent yield to average portfolio duration (see Figure 12), results are spread across a wide spectrum with no discernable patterns. That suggests portfolio inefficiencies among workers' compensation specialists in all the size bands. Where does your firm fall in this array? Who are your closest competitors in terms of portfolio investment performance? And how do you improve your position?

Conning is prepared to help you better understand your position in these categories and to model strategies that can help you improve your portfolio, all the while working within your tolerance for risk.

Figure 12* - Portfolio Reward-Risk Varies Among All Size Bands (2018)



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ABOUT CONNING

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