Atlantic Charter’s remarks to TRIA Federal Advisory Committee

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Who is Atlantic Charter

- Small mono-line workers' compensation insurer headquartered in Boston, MA
  - 2016 DWP of $65.311,034
  - 2016 C&S of $64.633,061
  - Combined Ratios of 86% (2016), 88% (2015), 88% (2014), 91% (2013)
  - 97% account retention ratio
  - Have earned an underwriting profit in each year we have been in business (28 yr.)
  - A-rated by A.M. Best
- 6th largest workers compensation writer in Massachusetts with a 5% market share
- Voluntary Direct Assigned Carrier for the MA Residual Market
- Specialize in health care risks with a large concentration in Metro-Boston area
  - hospitals, nursing homes, VNAs, home health agencies
- Due to our size and exposed lives in Metro Boston area were targeted, along with 30 other small/medium workers compensation carriers by AM Best as being at-risk of a downgrade should TRIA not be reauthorized in 2014.

Thesis: Congress should consider strengthening TRIA's protections for Workers' Compensation insurers

- Workers' Compensation plays a special role in society and is dominated by medium and small carriers whose financial fates are intertwined.
- As currently designed, TRIA's escalating program trigger leaves medium and small carriers with significant exposure – esp. to an event that impacts workers compensation carriers but fails to trigger federal payments.
- Due to the unique role that Workers' Compensation plays in our society as well as the profiles of the insurers that write it, any future revisions to TRIA should ensure that Workers' Compensation insurers are not over-exposed to terrorism risk.

Uniqueness of Workers Compensation

- Alternative to tort liability, workers' compensation laws make the employer (and therefore its insurer) fully responsible for all lifetime medical expenses and wage replacement to injured workers, and their dependents, for any injury arising out of the workplace.
  - Purchased voluntarily or involuntarily through a residual market mechanism or a quasi-public state fund.
  - Benefit levels and coverage are prescribed by state law – which cannot be altered by the buyer (employer) or the seller (insurer) due to the critical role that workers' compensation plays in society.
  - Benefits are potentially unlimited; medical care and wage replacement benefits can last for as long as the injury itself lasts.
    - A serious burn, for example, involving skin grafts and years of rehabilitation can result in a claim costing tens of millions of dollars.
    - An amputation, for example, involving long periods of rehabilitation and multiple prosthetics that must be adapted as the individual ages can result in a claim that costing tens of millions of dollars.
    - Compensable Injuries may also include psychological pain from experiencing a traumatic event occurring at work

Uniqueness of Workers Compensation

- Only line of TRIA exposed insurance that cannot use traditional mechanisms to manage accumulation risk.
  - Unlike, other TRIA eligible lines of insurance, workers' compensation insurers may not exclude or limit coverage for acts of terrorism whether conventional or involving nuclear, biological, chemical or radiological (NBCR) weaponry.
  - Similarly, workers compensation insurers are capped at a $0.03 per $100 payroll premium pass through for terrorism coverage.
  - If risk is declined in the voluntary market because of it's high risk nature, it is guaranteed coverage in the involuntary market – where the loss exposures are shared by the very insurers seeking to limit their TRIA risks.

Purpose of TRIA – Stabilization and Broad Risk Spreading Mechanism

- TRIA mitigates impact of terrorism on insurance markets by transferring the catastrophic risk first to the federal government and then spreading the losses broadly across the entire P&C policyholder base in order to reduce the solvency impact a large attack would have on any particular insurance company.
- Individual insurers have exposure through the program design
  - deductibles (20% prior year DEP);
  - co-insurance (15-20%)
- Risk spreading mechanism applies to the tranche of risk between individual insurer's deductibles and $100Bbn industry wide loss.
- The mandatory recoupment mechanism protects taxpayers from first tranche of terrorism cover, which is spread nationally to P&C policies over multiple years.
- In this way TRIA functions mainly as a liquidity loan and post event market stabilization tool.

Medium & Small Insurers In Comp Space

- Inject critical diversity into the marketplace
  - Regional in nature, but significant player in local markets
  - Generally highly specialized service specific niche market, writing coal mines, long term care continuum, construction, medical institutions, etc.
  - Focused customer service and knowledge of risk are competitive advantages
- Nationally, comprise 78% of all Companies writing Workers' Comp (2015)
  - 56 Large Insurers (C&S over $1bn)
  - 123 Medium Insurers (C&S $50M-$1bn)
  - 77 Small Insurers (C&S under $50M)
- Nationally, Comprise 24.5% of Workers' Comp premium (2015)
  - Large Insurers 75.5%
  - Medium Insurers 22.1%
  - Small Insurers 2.4%
- Note: Excludes WC state funds with no surplus (NY, OK, FL, MT, PA) & based on DEP(as TRIA is based on DPE).

Past Rating Warnings by A.M. Best & Fitch

- In 2013, AM Best estimated that 3.8% of companies it rates failed the simple stress test ($1.250M x #lives) and warned that absent TRIA's reauthorization, these carriers would face downgrades.
  - AM Best later affirmed that the preponderance of these carriers are concentrated in workers compensation
- Fitch similarly warned in 2013 that due to the inability to exclude losses due to terrorism related perils, including NBCR, workers compensation carriers were particularly vulnerable to ratings downgrades should TRIA not be re-authorized.
- Ratings down grades, due to terrorism exposure, will change the landscape of the workers compensation market in many states. As the regionals pull back, the nationals with their own limited risk appetites will not be able to absorb all these risks in the voluntary market.
- Employers will be forced into the residual market where they will pay higher premiums, for reasons other than their claims history and premium size.
- As residual markets grow, losses (or exposures in the case of VDACs) are redistributed back to the very voluntary writers seeking to shed that risk exposure in the first place.

Increasing Aggregate Industry Loss

- Increasing the program trigger from $100m to $200m causes great risk to small and medium insurers should a regional event occur where the aggregate loss fails to trigger the limit, but the company loss exceeds their deductible, reinsurance and surplus.
  - For Atlantic Charter, this trigger is nearly 3 times our current surplus level and as such, will leave us exposed to 100% of the terrorism risk beyond our reinsurance limit.
- With over 80% of the companies writing workers compensation having less than $1bn in surplus, and 35% with less than $50M in surplus, it is possible that such a scenario results in an insolvency or two, not to mention the immediate reduction in ongoing capacity.
- An insolvency of a workers compensation insurer results in excess pressure on the remaining comp writers to pick of the failed insurer's residual market share as well as the guaranty fund costs for unlimited workers compensation benefits.
- Such a regional event that impairs the workers compensation market, means that losses from a catastrophic terror attack would largely be financed by businesses and taxpayers throughout the state in which the attack occurs, adding to the challenge of rebuilding in that state rather than spreading the risk across the country as TRIA was designed to do.

TRIA thresholds for Workers' Compensation insurers

- From our perspective, TRIA is working well at a small cost to taxpayers. Insurers have skin in the game – the 20% DEP deductible and the increasing co-insurance of 15-20% keeps the industry fully engaged, and the mandatory recoupment mechanism protects taxpayers.
- Given the lack of underwriting and rating flexibility for workers compensation, the preponderance of small to medium sized carriers writing this line, the value that they bring to their local markets with their specialized writings, and the degree to which they rely on TRIA to backstop their own reinsurance program and capital and surplus, workers' compensation should not be subject to additional increases to the program trigger, the insurer deductible, or the insurer co-insurance rate, and strong consideration should be given to allowing for TRIA activation for a substantial regional event, one where some number of carriers exceed their deductible.

Key Questions for the Advisory Committee to consider re: Workers Compensation Reinsurance

- Workers' compensation carriers have a statutory obligation to provide terrorism coverage for unlimited amounts and an unlimited number of occurrences; would reinsurers provide coverage for those same statutory obligations on an unlimited basis for an unlimited number of events?
- Workers' compensation carriers are constrained on how much they may charge the employer for that unlimited terrorism coverage ($0.03/$100); would reinsurers limit the cost for that capacity to what can be collected from the policyholder?
- How much capacity are reinsurers willing to dedicate to the workers compensation line of insurance.
  - Would they reinsure workers' compensation carriers with large employers in metropolitan areas or other target rich risks? Would you follow the underlying state contract terms without exclusion or limitation? Would they cover all of their residual market exposures?

Additional considerations for the Advisory Committee to consider re: Workers Compensation Reinsurance

- While we are currently in a soft market with excess capacity, what happens when that capacity dries up – either due to global non terrorism events or in the wake of a substantial U.S. terrorism event?
  - Stability and cost predictability is a key component of the TRIA program for insurers and their policyholders.
- If our underlying business profile isn't changing (that is we are not doubling our policy count or moving into new classifications with which we have little experience), purchasing reinsurance simply for the sake of keeping up with an escalating TRIA gap, makes little commercial sense – especially if we cannot pass along the cost of that capacity cover.