

BOARD OF DIRECTORS (OPEN)

AGENDA ITEM 21

ATTACHMENT 21-I  
*(Anticipated Handout at Meeting)*

U.S. ECONOMIC OUTLOOK and IMPACT on CALIFORNIA

PRESENTED BY: Peter Guastamachio and General Re—  
New England Asset Management

September 10, 2010

**Presentation For**  
**State Compensation Insurance Fund**  
*U.S. Economic Outlook and Impact on California*

*Open Board of Directors Meeting*  
*September 10th, 2010*



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## Topics

### ❖ Economy

- Housing
- Employment

### ❖ 2009 Workers Comp Market Review

### ❖ Outlook of Workers Comp Market

### ❖ Outlook of California Workers Comp Market

## Housing

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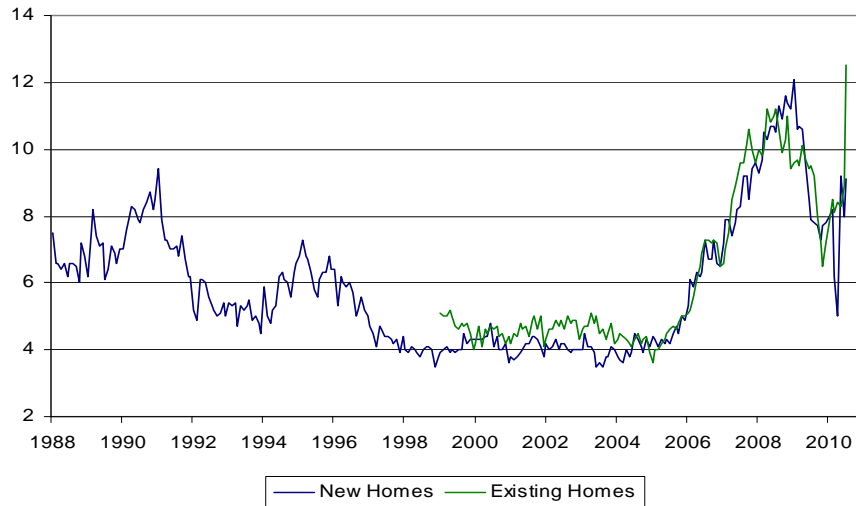
## Why Housing Is So Important

- **The Largest Asset Class**  
2006 (peak) \$25 trillion  
2010 (Q1) \$18 trillion
- **The Primary Middle Class Asset**
- **Often Levered, Especially in this Cycle**

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## Months' House Sales in Inventory



Source: Bloomberg L.P., Census Bureau and GR-NEAM Analytics  
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## Government Subsidies

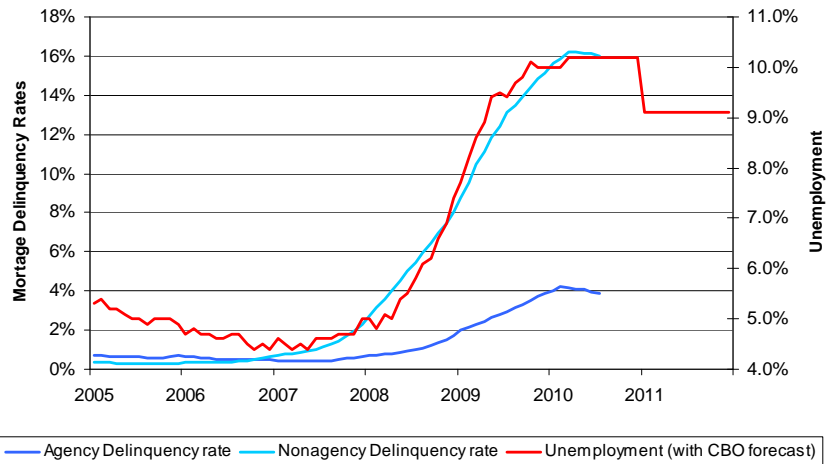
- ✓ Home Buyer Tax Credit
- ✓ Federal Reserve Mortgage Purchases
- ✓ FHA Role in Mortgage Market Expanding Rapidly
- ✓ Additional Mortgage Modification Assistance/Principal Balance Reduction?

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# Mortgage Delinquency Rates and Unemployment

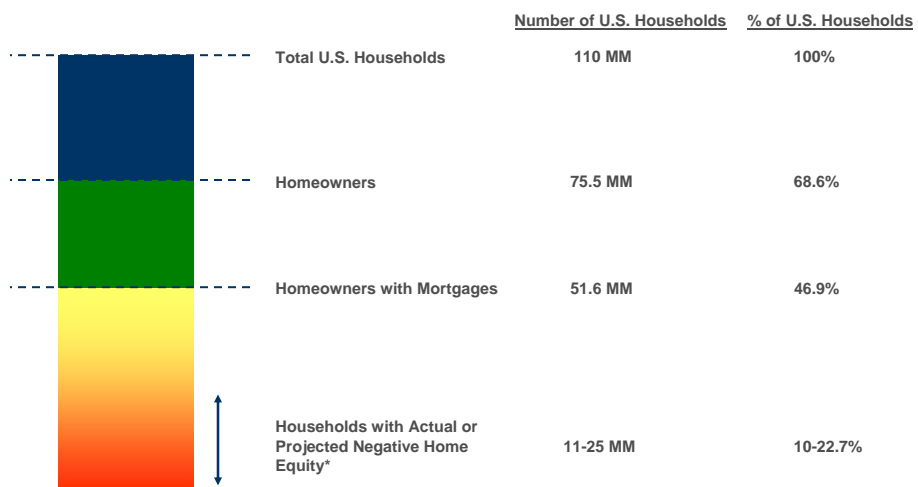
Mortgage Delinquency Rates and Unemployment



Source: Bloomberg L.P., Fannie Mae, and Freddie Mac  
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# U.S. Housing Market Equity Position



Source: Deutsche Bank

\*Based on estimates from Deutsche Bank, Moody's Economy and American Core Logic

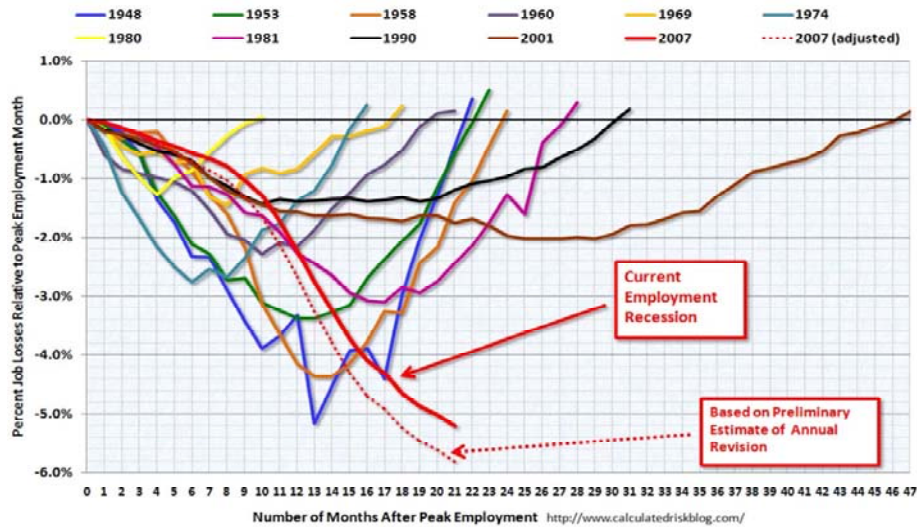
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# Employment

# Employment

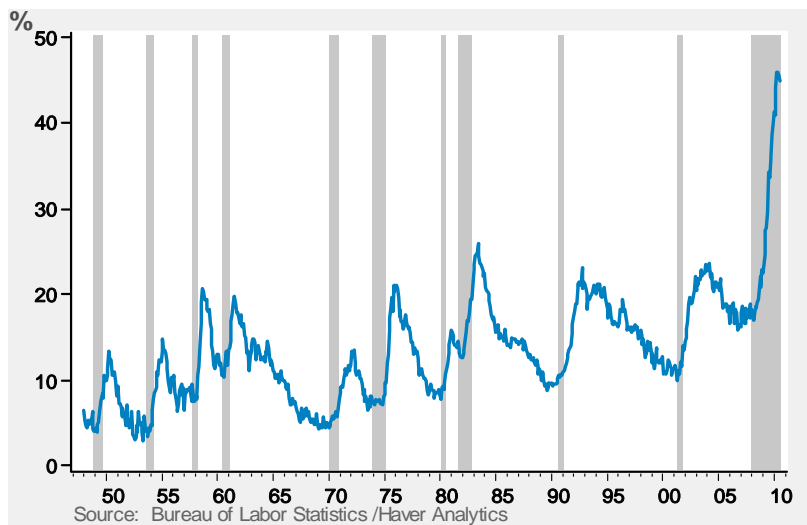
## Percent Job Losses in Post WWII Recessions



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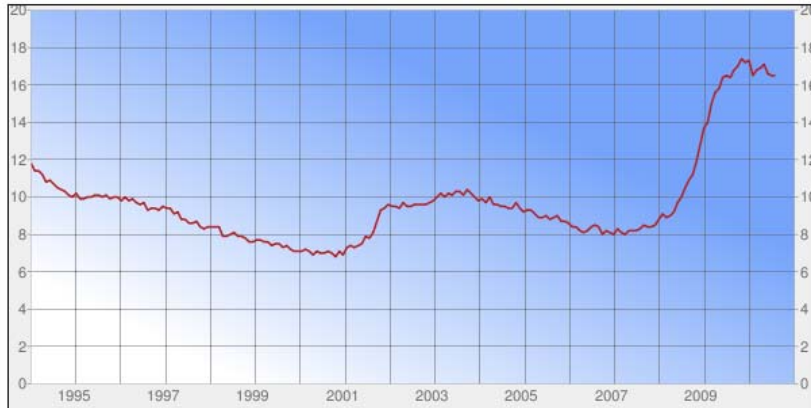
## U.S.: Percent of Unemployed 27 Weeks and Over



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## Structural Unemployment – U6 % Unemployed



Source: Bureau of Labor Statistics

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## Overview of 2009

- 110% Combined Ratio on a calendar year basis
- 107% Combined Ratio on an accident year basis (deteriorated by 9.2% over past 24 months)
- 12% decline in Net Written Premium
- Weakening payrolls have eroded \$13.7B in WC Premiums since 2005 (28.7%)
- The December 2007 to Mid 2009 Recession caused the Largest Impact on WC Exposure in 60 years (No Wage Inflation as in Prior Recessions)
- 4.5% increase in average Indemnity claim costs
- 5% increase in average Medical claim costs (down from 6.7% in 2008)
- Declines in frequency of all injury claims except Permanent Total Disability
- Discretionary pricing decreased 7.9% in 2009, compared with 7.4% decrease in 2008

Summary: Very difficult year as workers compensation insurers were faced with lower employment levels, state rate pressures and depressed investment income.

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## The Outlook For The WC Market

### Positives

- Continued decline in claim frequency
- Depopulation of residual market
- Stable claim severity

### Negatives

- Low Investment return
- Potential erosion of prior reforms
- Uncertain impact of healthcare reform (Medicare reimbursements, black lung)
- Unknown scope of future federal legislation
- Underwriting cycle pressure

## The Challenges for the California Workers Compensation Market

- California economy and state budget issues
  - housing
  - state/local budget deficits
    - layoffs
    - reduced hours
- Declining levels of net investment income
  - Bonds
  - Stocks
- Rate pressure from government owned entity (AIG – 7.9% market share – 2009)
- Medical cost inflation above levels of core inflation
  - Pain Management – Over 7,000 Pain Management Specials in US up from 400 in 1990
- Almaraz/Guzman and Ogilvie decisions could boost system-wide costs unless reversed by the Supreme Court
- “Holding rates firm while being flexible ....”
  - New markets and products (Employment Practices Liability Insurance (EPLI))