ASSURED BRIEFING

June, 2021

What's Inside

The *Assured Briefing* is a monthly research note analyzing business development, financial, legal, or claim matters relevant to property/casualty insurance professionals.

In this edition

In the research pipeline

We'll be hosting a webinar on mobility by mid-June. The webinar will combine our recent *Assured Industry Study* on telematics (featuring work by Cambridge Mobile Telematics) and the mobility work in this Briefing. We expect to release an update to our 2020 *Assured Report*: *In Search of Economic Jet Streams; Avoiding the Tornadoes* (which will also be featured at the upcoming Management Conference sponsored by the National Association of Mutual Insurance Companies in late June).

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Liability Insurance: Looking for Inflation Signals in Macroeconomic Data

Real wage trends show a reasonable signal; when real wages rise, liability inflation goes down

The debate over whether the recent spike in inflation is temporary or our new normal is dominating the financial news. And in a sign supporting the hawk's arguments (those who worry that rising accelerating inflation is taking root) the topic is spilling into the mainstream media as well; no longer is it just the province of the *Wall St. Journal* or *Financial Times*.

In our last *Assured Briefing,* we examined the impact of **rising commodity inflation** on the $100 billion auto physical damage line. Our conclusion – **it's a particular concern for auto insurers because so many enjoyed outsized profits during the pandemic and their ability to pass rising costs on to policyholders is regulated** (in many cases by a *politically* elected or appointed commissioner). Inflation is less worrisome to an industry with pricing power regulated only by the free market.

In this note we turn our attention to liability insurance – specifically the annual statement lines of general and product liability (combined) where we have data going back to the early 1970s. We have to confess – **not only is inflation a multi-headed hydra, but reasoning through its impact on liability claims isn't easy**; and **that's one of the notable concerns for insurers and their underwriters, claims, and actuarial professionals - so few of us have any practical experience contending with inflation that is accelerating.**

Are you an inflation hawk or a dove? There is probably an on-line test to determine, but we'll offer this:

The doves believe that spiking commodity inflation is temporary. Supply chain issues will self-correct and the current excess demand for so many goods and services is a temporary phenomenon driven by post-pandemic euphoria. As to wages and labor, most seem inclined to believe that the expiration of federal, supplemental unemployment benefits in the fall and the reopening of schools will enable millions to reenter the labor force, in turn ameliorating the current labor shortage and blunting wage growth.

The hawks take the other side of those arguments with particular focus on expansive fiscal packages and the Federal Reserve's easy money policies (bond buying and low interest rates). Hawks worry that accelerating inflation will become part of people's expectations, at which point it can become self-perpetuating.

We'll add that ***we only heard two insurers mention inflationary pressures on their 1Q conference calls.*** *Are there a lot of doves out there?*

Looking for Signals in Macroeconomic Data

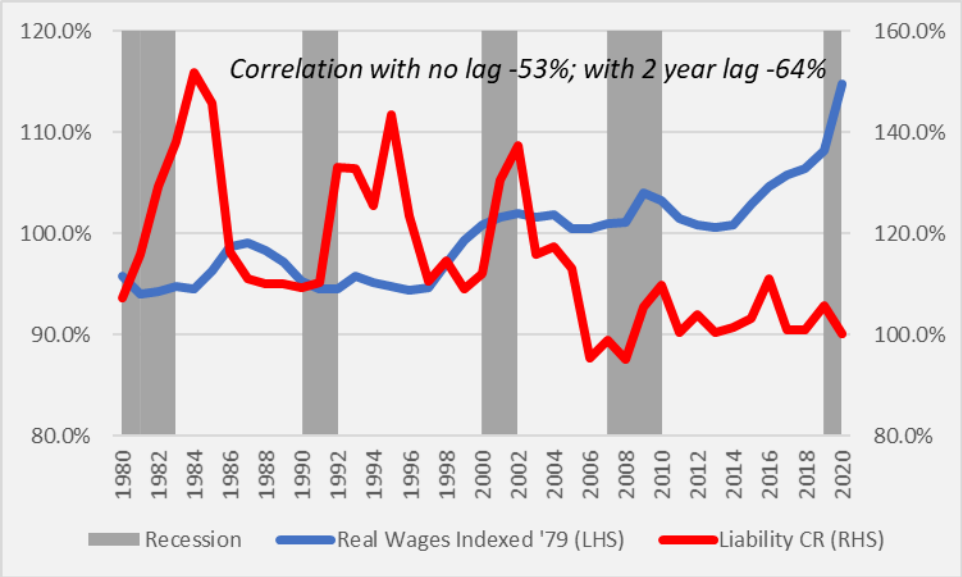
We tend to side with the hawks in this debate but acknowledge the merits of the dove's arguments and will confess to being wrong about inflation after the Financial Recession in 2008/09. So, while we take time to formulate our position more carefully, **we thought it could be valuable to use our nearly**

50-year history of liability insurance data to hunt for correlations or signals in the macroeconomy which might both help to formulate a theory as to the impact of rising inflation on liability claims, while also providing a leading indicator useful to insurers.

The bottom line: Traditional measures of inflation don't offer much insight, but changes in real wages (wages after adjusting for inflation as measured by the CPI) **show a reasonable, inverse correlation with the liability combined ratio**. The correlation becomes stronger with a lag of two years. Intuitively, people – representing potential claimants or jurors – become increasingly aware of and frustrated by the erosion of their purchasing power over time; at which point redistribution of wealth through the court system could become more appealing.

But while that bearish scenario has precedent, the situation presently is the opposite: **The tight labor market is putting upward pressure on wages which, at least for now, are outpacing the rising costs of the basket of goods measured by the CPI**. In other words, **real wages were rising through YE2020 and that's an incremental positive for liability insurers!**

Figure 1: Real Wages and Liability Insurance Combined Ratio Are Inversely Correlated



Notice how the liability combined ratio tends to rise after recessions. Real wages recently surged – temporary or longer-lasting? Much remains to be sorted.

Source: BLS via St. Louis Fed, S&P Global, Assured Research. Recessionary periods are approximate.

We appreciate that **financial forecasts can't be predicated on correlations in the 50-65% range, but this indicator does seem like it is worth tracking** since that correlation comes with the previously offered and rather intuitive, we think, explanation. **When real wages are moving higher that could be a tailwind to liability insurers while decreases may add to an inhospitable legal atmosphere**. And we'll mention too our work from 2020 which showed that 'judicial hellhole' states tend to have higher Gini coefficients (a measure of income inequality

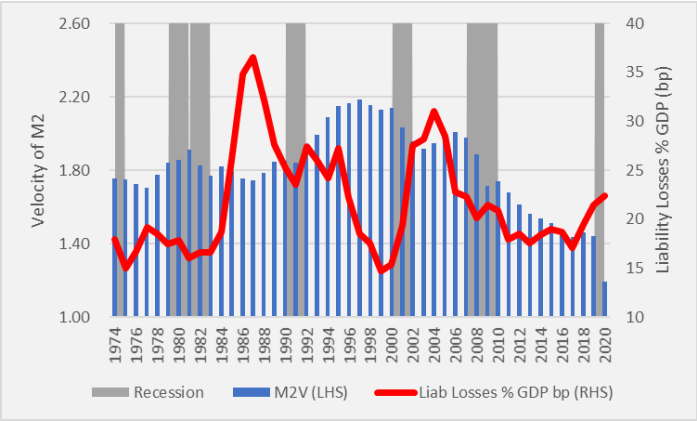
where a higher score points to higher inequality). In short, we've spoken to enough trial attorneys to know that **juror anger, whatever its cause, isn't good for the defense!**

Traditional measures of inflation aren't particularly helpful

As useful as it is to be aware of and consider strong correlations between variables, it can sometimes also be useful to know what doesn't work or is unlikely to be helpful.

In Figures 2 and 3 we show the lack of correlation between more traditional measures of inflation and liability losses (expressed as % GDP to normalize for their changes in relation to the economy).

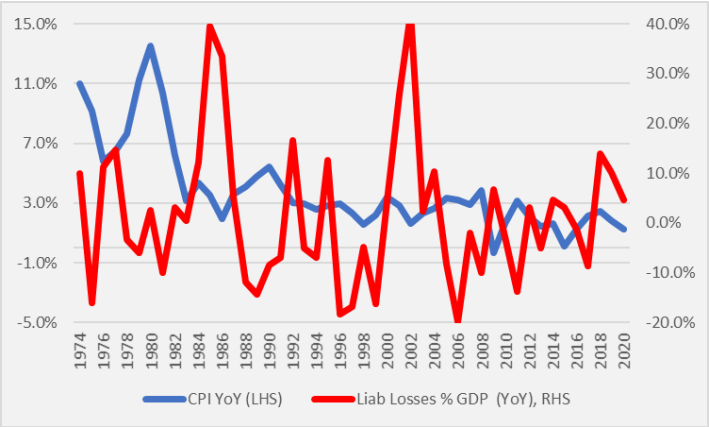
Figure 2: No Material Correlation between Liability Losses and the Velocity of Money



The velocity of the money (M2) refers to the rate of turnover in the money supply. It can be thought of as a broad measure of inflation. Our work here shows a very low positive correlation – just 14% since the early 1970s.

Source: St. Louis Fed (FRED), S&P Global, Assured Research. Recessionary periods are approximate.

Figure 3: No Material Correlation between Liability Losses and the Traditional CPI



The CPI has been drifting lower since Paul Volcker busted inflation in the early 1980s. Since then, liability losses have spiked several times so watching traditional measures of inflation probably won't provide much insight to insurance professionals.

Source: St. Louis Fed (FRED), S&P Global, Assured Research

But accelerating inflation can't be good for liability insurers, right?

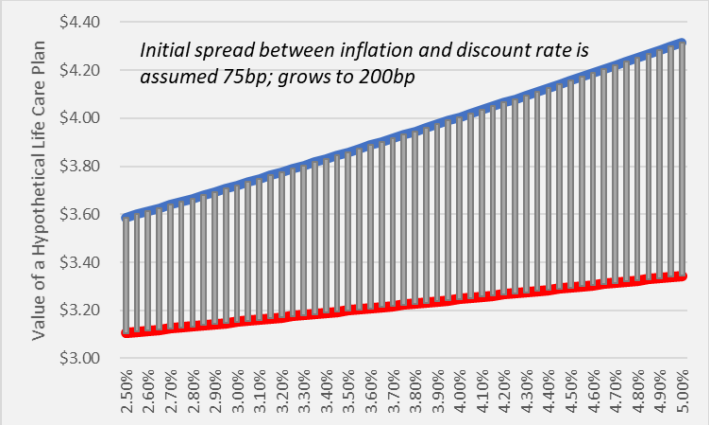
No, we wouldn't think so. **Our take from the last several decades is that liability losses can spike despite a benign inflationary environment**. Again, we revert to the observation that so few professionals today have experience with rising inflation that while academic arguments (and even ours!) may prove interesting and sometimes persuasive, **it only makes sense for all insurance professionals to be on guard in today's turbulent economic environment**.

We estimated the industry had over-reserved by $28 bil. at YE20. There were myriad drivers for the redundancy, but maybe some of it will be used to cover rising inflation. Will insurers be proven right, even if for the wrong reasons?

Life Care Plans an example of how inflation could permeate tort awards and settlements

Life care plans (LCP) form the basis for estimating the economic costs of an injured claimant. Following a back surgery, for instance, someone will need ongoing medical treatment, their ability to return to the same salary could be impaired, while in serious cases a home health aide might be required, home modifications necessary…the list goes on (and on, and on, as claim professionals know well). **What happens when inflationary pressures on the goods and services included in a life care plan accelerate? Costs rise**, and fast, as Figure 4 shows.

Figure 4: Nominal and PV Cost of a Hypothetical LCP Under Different Inflation Scenarios



For illustration, we assume someone with a 15-year life expectancy requires $200K initially, and that is inflated annually in scenarios ranging from 2.5% to 5.0%. The good news – the present value sum grows more slowly than the notional amount, but….

Source: Assured Research assumptions

…our scenario illustrates that **inflationary pressures on the specific types of goods and services included in a LCP are likely to outstrip the CPI**, and therefore rise faster than the 'risk free' interest rates embedded in the discount rate. In other words, **inflationary pressures are uneven across the economy and that's why inflation warrants our careful attention!**

Summary

We'll be watching the real wage index, but that's just one threat on a multi-headed hydra.

Auto Insuranace: Mobility Rising as People Return to Daily Activities

But the real risk to insurers is when employees return to offices

While driving mileage has increased in recent months it is mainly because people have resumed shopping trips and other daily activities. But, this type of diving generally has a lower level of accident frequency. **The real risk to auto insurers will begin in September when we expect more employees will be returning to offices.** And, by looking at the levels of teleworking as well as the characteristics that make working from home possible, **we can get some idea of the states where driving is most and least likely to increase**.

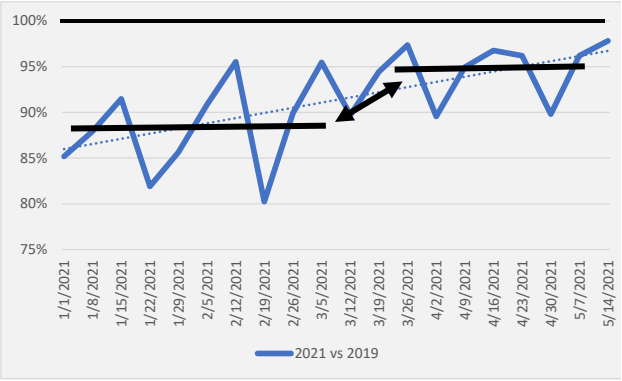
Anyone who has been on the roads lately can see that driving is nearly back to normal. Various mobility and gasoline consumption indexes confirm this. But the recovery is largely from people being "out and about" rather than from a return to commuting.

By using various activity surveys, we believe we can get an idea of what states will see more changes in driving patterns when the return-to - the-office movement resumes.

Driving mileage has risen consistently since the start of the year and particularly over the past two months (see Fig. 1), chiefly because people have resumed making shopping trips and doing errands and generally going about their daily lives as the vaccines have generally taken hold and mask mandates have recently eased. This is also confirmed by various non-driving-related surveys and is consistent with what most insurers are seeing based on their quarterly commentaries. For the month of April, for instance, **Progressive reported a 4.2 point increase in their auto loss ratio (ex. cats) compared to the 1Q21**. Their modest rate decreases and rising inflation are also acting as headwinds, we suspect, but **increased mobility from people being 'out and about' is probably the driving force**.

Still, accident frequency will probably increase at a lower rate than driving levels – for the next few months - because driving during non-commuting hours is generally safer than during rush hours. But the **low frequency levels of the last year+ will rise as we get into the fall when, we expect, more people will be returning to offices**.

Fig 1. Gas Consumption: 2021 vs. 2019



Source: EIA, Assured Research.

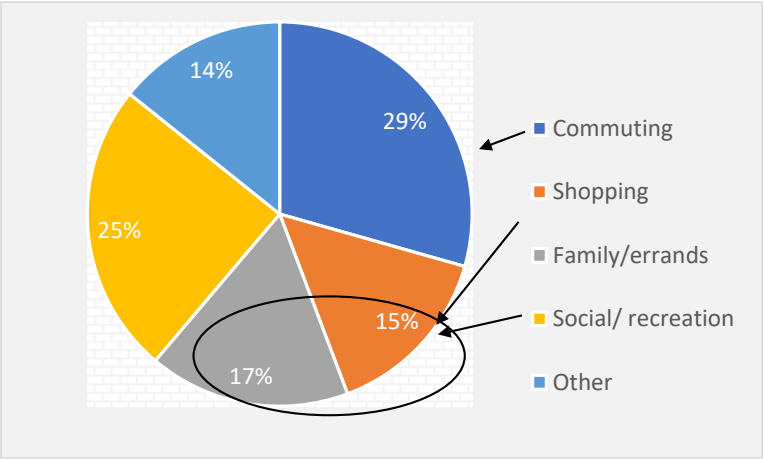
We don't expect the country to go back to 100% of workers in the office all of the time, but definitely there will be some increase from the current levels. **Increased commuting will have a disproportionate impact on accident**

frequency because driving during rush hours has a relatively higher accident frequency rate than other times of the day. And will fewer people use public transportation when they do return? So many unanswered questions…

Setting the Stage: Why People Drive

The most comprehensive data on driving patterns comes from the National Household Travel Survey which the Federal Highway Administration has conducted periodically since 1969. Data from the most recent (2017) survey is shown in Figure 2 and highlights that **commuting represents 29% of annual vehicle miles travelled (VMT)** and that the combination of **shopping and errands (which we refer to as the "out and about" factor together represent 42%**.

Figure 2: Annual Trip Miles by Purpose: 2017 (% of VMT)



While accidents vary over a wide range of factors including region, season, and day of the week, one thing seems clear – A disproportionate number of accidents (particularly non-fatal) occur during commuting times.

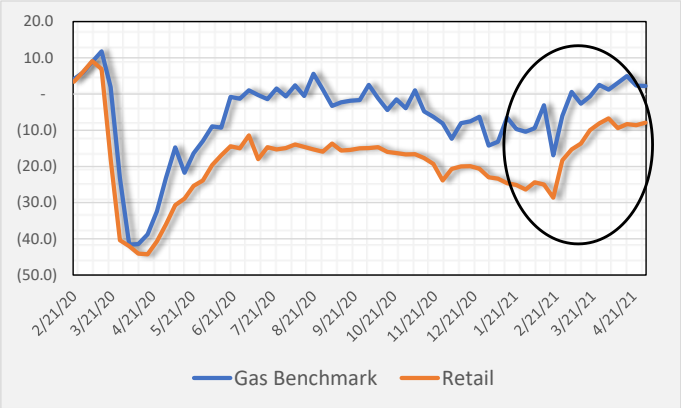
Source: Federal Highway Administration, Bureau of Transportation Statistics, Assured Research

Much of the increase in driving during the past two months has occurred because people are taking more shopping trips. Support for this point comes from two unrelated data sources that are focused on activity rather than driving, but which reach the same conclusion that shopping activity has increased in the last two months.

Google Community Mobility Reports These reports track people movements across a wide spectrum of activities including retailing visits, recreation, grocery and pharmacy visits, transit, and workplaces. The data is collected globally down to regions including the county level in the U.S. A benchmark is established for each activity based on the January-February 2020 period and changes are measured against that standard.

In Figure 3 we show the Google index for the retailing and recreation category and compare that to a national index of gasoline consumption, which we have found to be a reasonable proxy for miles driven. (The Google data are provided daily, but we have calculated weekly averages to present a more normalized index). Both indexes declined at the onset of the virus, and after being flattish for almost a year, **the data show that there has been a noticeable spike in the last two months.** ***This is significant as it indicates many people are out and about.***

Figure 3: Retail Mobility Benchmark vs. U.S. Gasoline Consumption: February 2020-Present

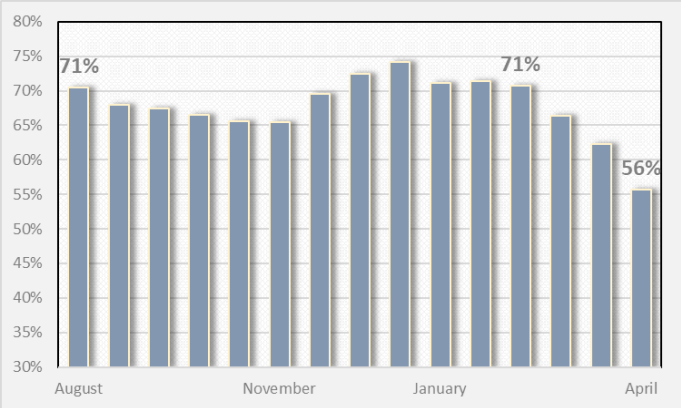


Note the similarity between increased shopping and higher gasoline consumption.

Source: Google Community Mobility Reports, Energy Information Administration, Assured Research

Household Pulse Survey The U.S. Census Bureau has been surveying households across a wide range of topics to measure how family lives have been affected by the pandemic. One transportation question they have asked is whether shopping trips had been postponed as a result of the pandemic. And, as Figure 4 shows, the answers were strongly "Yes" at the outset of the surveys in August 2020, but the number of people citing postponments dropped considerably over the past two months. *Interestingly, this coinsides with the Google data showing the increase in retailing traffic*.

Figure 4: Number of People Citing Retail Trip Postponements: August 2020-Present



The decline in trip postponements coincides with the increase in retail traffic as measured by Google.

Source: U.S. Census Bureau Household Pulse Survey, Assured Research

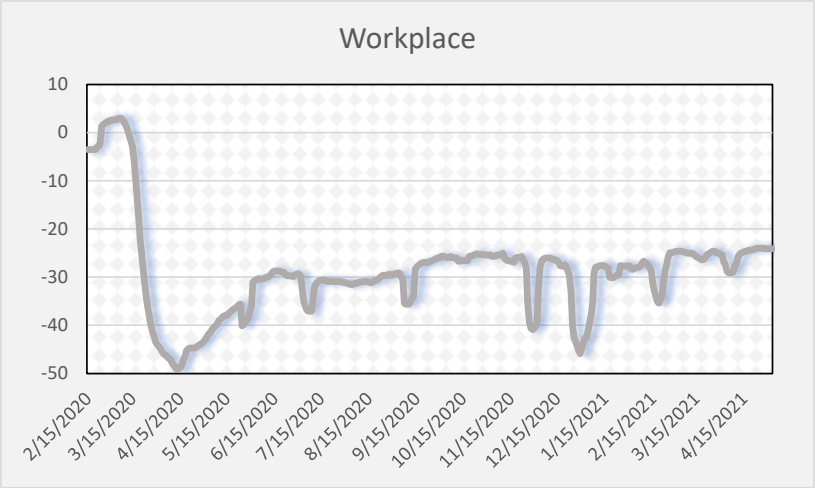
Auto Insurers Should be Wary of the Return-to-Work Trend (which isn't yet underway)

Without doubt, as we look to the reopening of the economy, **the biggest unknown is how and when people will return to their offices**. At present, by way of anecdotes, many employers seem to be pushing for some level of return by the end of the summer. We believe this push will gain momentum now that indoor mask mandates are gradually being eliminated. Although we will say this again for emphasis: We don't expect there will be a return to the previous pattern of almost all employees in the office five days a week.

Commuting accounts for about 30% of driving, but it accounts for a disproportionate percentage of crash frequency because of the high volume of cars on the road. The accidents tend be less severe, but inflationary pressures may add to cost trends.

While the outlook is still unsettled, numerous studies document that **the return is not yet happening**. As one example, the Google Mobility Benchmark regarding workplace activity shown in Figure 5 indicates that there has been little change over the last year. Numerous other surveys show similar patterns.

Figure 5: Google Mobility Workplace Benchmark: February 2020-Present



There hasn't been any meaningful change in the office movements since the original uptick a year ago.

Source: Google Community Mobility Reports, Assured Research

Surveys may provide some clues as to which locations will see higher/lower RTW

Assuming there will be some increased level of office returns in the fall, **an interesting and vital question becomes whether we can identify where activity might change the most, or conversely, where there will be less of a driving impact from office returns**.

We believe the answer is that you can gain some insights by looking at where people are currently working from home and the characteristics of who is working at home. We do this by comparing data from the Household Pulse Survey referred to above with state personal income data. *We'll explain.*

First, the Household Pulse Survey measures the number of people in households that are working from home. We have utilized the data by state although the analysis can be expanded as the survey includes data for 15 major metropolitan areas.

Next, again using Pulse information, the sidebar on the right shows the percentage of people working from home by income level. As you would expect the percentage increases as you go up the income scale.

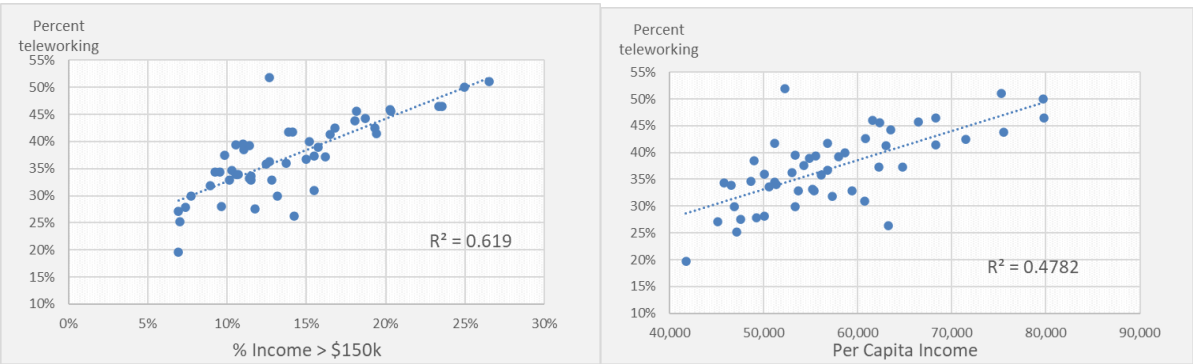
Finally, as you would further expect, **there are reasonable correlations between the percentage of people working from home and various income levels**. We show this in Figure 6 using two statistics. In these charts we have compared the percentage of people in a state to those 1) who reported incomes greater than $150,000 (left chart) and 2) the per capita income by state (right chart). **Note that the trends clearly show that higher income levels lead to more working from home.**

% Teleworking by Income

Income Level	Perent Teleworking
Less than $25,000	16%
$25,000 - $34,999	21%
$35,000 - $49,999	28%
$50,000 - $74,999	36%
$75,000 - $99,999	46%
$100,000 - $149,999	57%
$150,000 - $199,999	67%
$200,000 and above	75%

Source: U.S. Census Bureau,

Figure 6: Percent teleworking vs. Percent of people with Income > $150k (left) and vs. Per Capita Income (right)



Source: U.S. Census Bureau Household Pulse Survey, Bureau of Economic Analysis, Assured Research

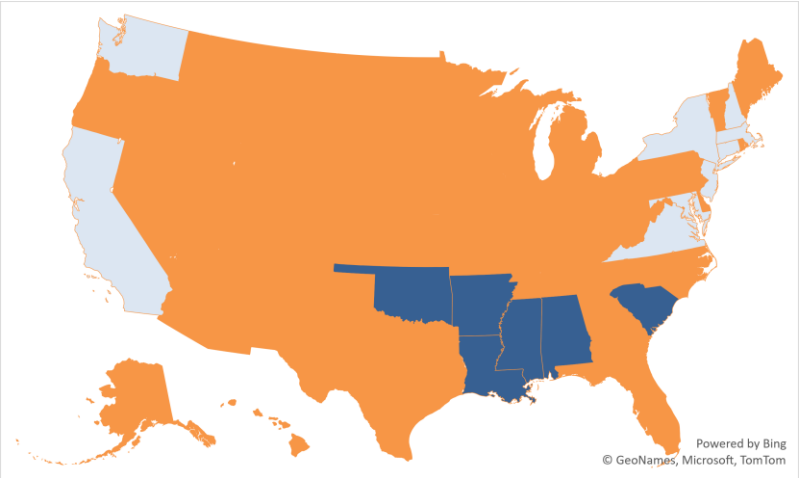
While interpretations can vary, we believe that **those states with the highest percentage of people working from home**, which **are also those with the higher income levels are the most likely to see greater number of employees returning to offices**. The opposite is true for those states with a lower teleworkers and lower incomes.

Auto product managers might want to consider this information when considering rate filings – particularly those to be filed before Labor Day!

If you would like to see the spreadsheet with the individual state data, please ask.

In Figure 7 we have used this data to project what states will see the highest and lowest levels of change. If there is a generalization it is that the coastal states will see the greatest number of returns, while the Southeastern states will see the lowest change level. Our caution: Look for more driving in the higher return states (and particularly if we can assume that use of public transportation into their major cities will be lighter than pre pandemic norms).

Figure 7: States Most and Least Likely to Have increase in People Returning to Work



Light blue states are more likely to see greater number of people returning to offices. Dark blue states are least likely to see increases.

Source: U.S. Census Bureau Household Pulse Survey, Bureau of Economic Analysis, Assured Research

Summary

The main reason driving is up, of late, is that people are reconstituting their daily lives and particularly driving again for shopping trips and to other social events. But an important point is that driving of that type does not result in the greatest number of accidents; for that we have to watch for the resumption of people returning to their offices and the impact that has on commuting trips. While the exact calculus for how this will happen is unknown, we believe some idea can be developed by coordinating data from various surveys, as shown in this note.

Liability Insurance: Media Advertising Precedes Bankruptcies

Advertising data from X Ante shows legal advertising is brutally efficient; worth monitoring

We have for several years been researching and writing about the sweeping national trend to amend childhood sexual abuse victims acts; typically resulting in both an increase in the statute of limitations and opening a limited "lookback" window where victims of past and time-barred sexual abuse claims can bring a civil claim against their alleged accuser (or, more likely, the institution for which they once worked). A quick recap of *some* of the titles to our notes reveals both our focus and general sentiments toward the impact on P/C insurers:

Time to Reevaluate Exposure to Catholic Dioceses (January, 2019)

Insured Abuse Claims into Low $Billions…at Least (September, 2019)

Boy Scouts File for Bankruptcy Protection and *Another Dioceses Filing and Coverage Dispute* (February, 2020)

Media Coverage of Boy Scout Settlement Proposal is Misleading (March, 2021).

Our view that the involvement of P/C insurers was inevitable was recently confirmed by the Hartford's proposed $650 million settlement with the Boy Scouts of America announced in mid-April. The Hartford's exposures stem mostly from policies issued during the 1970s (based on management commentary and court documents); yet based on our review of the bankruptcy filing **we count some 650 liability insurance policies issued for the Boy Scouts of America between 1935 and 2019 and over 6,000 policies covering individual councils**. The list of P/C insurers, as you might imagine, includes many recognizable names.

In all filings we have viewed, ***the dioceses expect that their liability insurance policies will pay for a meaningful part of the final settlements.***

But insurers have mostly denied coverage asserting that the dioceses knew or reasonably should have known about the abuses, thus negating the requirement that the occurrence be one that is neither expected nor intended.

These denials have spawned a parallel set of lawsuits as dioceses seek declaratory judgments to require insurers to both defend and indemnify.

Negotiations between the abused claimants and the dioceses as well as between the dioceses and their insurers will go on for many years, though ***the proposed settlement between the Hartford and the Boy Scouts may show other P/C insurers a path forward and thus hasten other settlements for sexual abuse claims.***

And as the nearby sidebar describes, **we expect insurers will fund a material part of the final sexual abuse settlements** (emanating from churches, youth organizations, or schools (etc.)).

According to a table found in the comprehensive report *Catholic Dioceses in Bankruptcy* (Marie Reilly, Penn State Law) last updated in the summer of 2019, 16 settled bankruptcy cases resulted in just under $1 billion of settled assets of which 57% were contributed by insurers. The average settlement per victim was $288,000, though we'll note that most of these settled cases date back many years – today's average award would surely be higher.

What can insurers do? We're not legal experts and have relatively little to add in that area. But **as to monitoring the landscape to understand where victims might reside and where the plaintiff's bar is likely to recruit and pursue claims – we recommend monitoring legal advertisements**.

Legal Advertising is both Efficient and Likely a Leading Indicator of Claims/Bankruptcies

Most readers will by now have heard that the initial February, 2020 bankruptcy filing by the Boy Scouts of America anticipated several thousand abuse claims would be filed by the November, 2020 deadline. Based on media reports that final figure was closer to 95,000. It will surprise few that a media advertising blitz has been viewed as a main driver of that gross misestimation – we regularly heard radio advertisements in the NY/NJ metro area during the fall of last year.

The Latin phrase ex ante means 'before the event'. That's an apt description for the question guiding this work: Is legal advertising a reliable leading indicator of abuse claims against churches and, ultimately, their filing for bankruptcy?

While we have included trends in legal advertising in our social inflation slide deck for years**, for this research note with huddled with our friends at X Ante – the mass tort litigation specialists – to focus on the recruitment of sexual abuse claimants through television advertising specifically against religious institutions**. And in today's legal environment – that means primarily against Catholic dioceses.

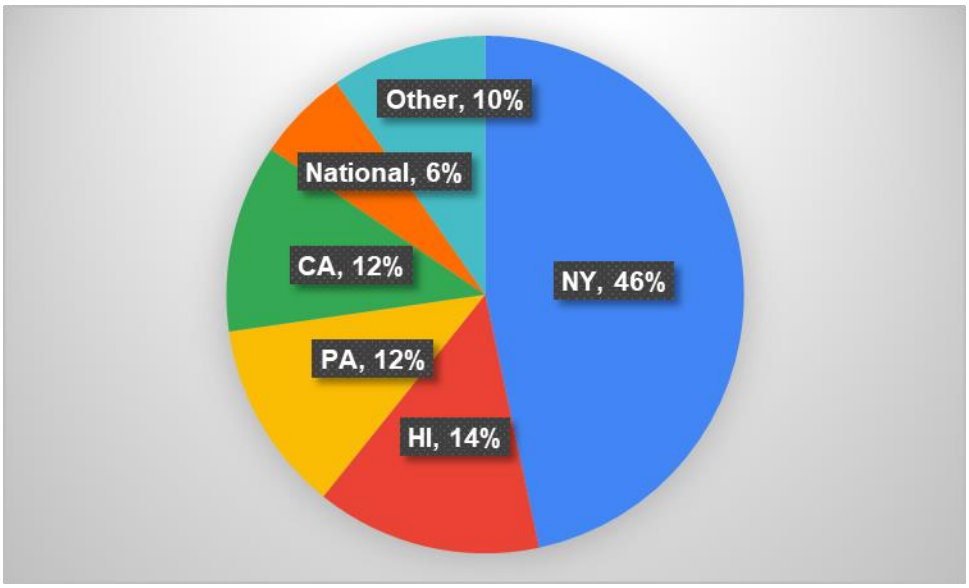
X-Ante searched television ads nationally over the past few years with a focus on those soliciting abuse cases against churches. They captured both the media market and the year in which the ads appeared – both the number of ads and dollars spent on advertising.

Pairing this data with a list of Catholic (arch)dioceses that have filed for bankruptcies (with a focus on the years 2018-2020), we offer two observations.

Legal Advertising is Brutally Efficient

In Figure 1 we show the spread of legal advertising by state (again, focused specifically on 'church' and sexual abuse cases) during 2019 and 2020. As described in the paragraph following the graph, **the states where advertising money was spent were not selected randomly.**

Figure 1: Legal Advertising $ Focused on States with Active Lookback Windows



The vast majority of these advertising $ were spent in 2019; all in states with open lookback windows.

Source: X Ante analysis utilizing data provided by Kantar Media CMAG, Assured Research

A brief examination of each state's childhood victim statutes (or childhood victim's act, "CVA", to use a fittingly generic term) reveals why the advertising dollars were spent as they were:

New York: Not only does New York have a higher than national average population of Catholics (31% vs. 22% nationally, according to Pew Research), but during the heart of the pandemic Governor Cuomo extended the lookback window in its 2019 CVA to August, 2021. We count four NY dioceses filing for bankruptcy protection during 2019 (1) and 2020 (3).

Hawaii: While we don't see any dioceses having filed for bankruptcy (interestingly, one in Guam filed in 2019), the Hawaii legislature did extend their CVA lookback window from its initial deadline in 2019 to the spring of 2020.

When bankruptcies of dioceses have occurred, experience shows ~50% of the estate assets are contributed by liability insurance policies.

Pennsylvania: The Harrisburg dioceses filed for bankruptcy protection in 2020, but that is probably only part of reason for advertising in the Keystone State. After release of a damning 2018 report by the Pennsylvania grand jury which documented over 1,000 abusive actions by 300 clergy members, the Pennsylvania state legislature made substantial progress moving on a CVA bill that would establish a 2-year lookback window. However, based on accounts we read, a change to the state constitution was deemed necessary to enact the legislation and technical failures to follow constitutional protocols has kept legislation on the 10-yard line (or so). The legislation may still move forward

and suffice it to say that law firms probably consider their advertising dollars spent here as a potentially valuable investment in future enabling legislation and claims.

California: California enacted a CVA statute with a 3-year lookback window in 2019.

In short, **we'd surmise that states passing CVA statutes with lookback windows are likely to see a rise in legal advertising specifically for sexual abuse claims**.

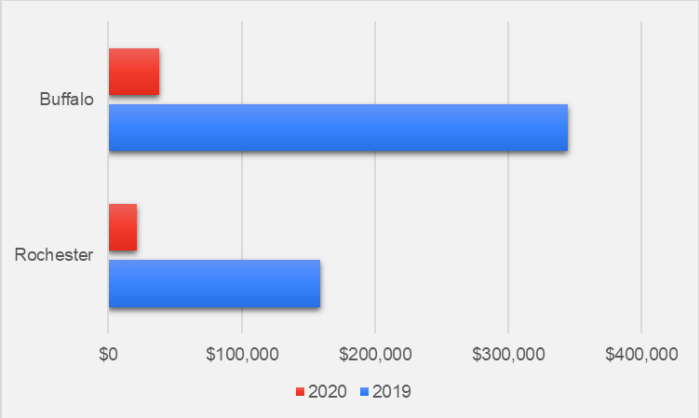
Legal Advertising Precedes Bankruptcies; Monitoring In-State Media Markets

Our data here is a bit less conclusive, but as we examine the timing of recent bankruptcy filings by Catholic dioceses and the timing of legal advertising in their specific media market; well, intuition holds and **it looks to us like legal advertising plays a role in catalyzing bankruptcies**.

An Upstate New York State Case Study

Buffalo and Rochester are only 75 miles apart. And while they constitute separate media markets, the patterns for recent legal advertisements for victims of abuse (by clergy/churches) are similar. The diocese in Rochester filed for Chapter 11 bankruptcy protection in September, 2019 followed by Buffalo five months later in the winter of 2020. As noted, New York passed its CVA in February, 2019 with the lookback window extended to August, 2021. Notably, there was no such legal advertising in these markets during 2018.

Figure 2: Legal Advertising $ Focused on Buffalo and Rochester New York



First, a state needs to pass CVA legislation (likely with a lookback window). At that point, we recommend tracking local media market to spot the vulnerable institutions.

Source: X Ante analysis utilizing data provided by Kantar Media CMAG, Assured Research

Summary

To the surprise of very few, we suspect, this work shows that legal advertising is efficient – it flows to where CVA laws have recently been changed. From there, we suspect insurers can gain an edge by examining where legal advertising dollars are flowing. New York is a large and diverse state; it seems unlikely a coincidence that advertising dollars flowed into the two upstate NY state dioceses which shortly thereafter declared bankruptcy.

Financial Analysis: Reported Liability Loss Ratios Improved 1Q21

Private passenger auto loss ratios worsened Y/Y as rate decreases earned in

This is our fourth construction of quarterly reported loss ratios (i.e., paid + case reserves, no IBNR) using statutory filings. **We think this in-the-weeds financial analysis can be valuable to underwriters, actuaries, and claims professionals because it lends insight into the level of disruption (or, lack thereof!) the pandemic has had on the normal flow of claims through insurance companies**. Next quarter will be particularly interesting – more in the sidebar.

Our key takeaways:

1) **The private passenger auto line deteriorated by about 300bp relative to 1Q20**. Gasoline consumption for the quarters (as a proxy for driving) was virtually the same, so we'd attribute the deterioration to slightly lower premium rates and loss trend. Rising commodity inflation probably didn't impact results too much in the 1Q21, but we believe it soon will!

2) The adverse impact of weather is evident in the CMP line, but **the 1Q21 loss ratios of most liability lines improved compared to 1Q20**. The comparison isn't yet apples-apples since the first two months of 2020 were relatively normal, but **in addition to the more favorable loss impact during 1Q21 there would be, of course, the favorable impact of steady rate increases**.

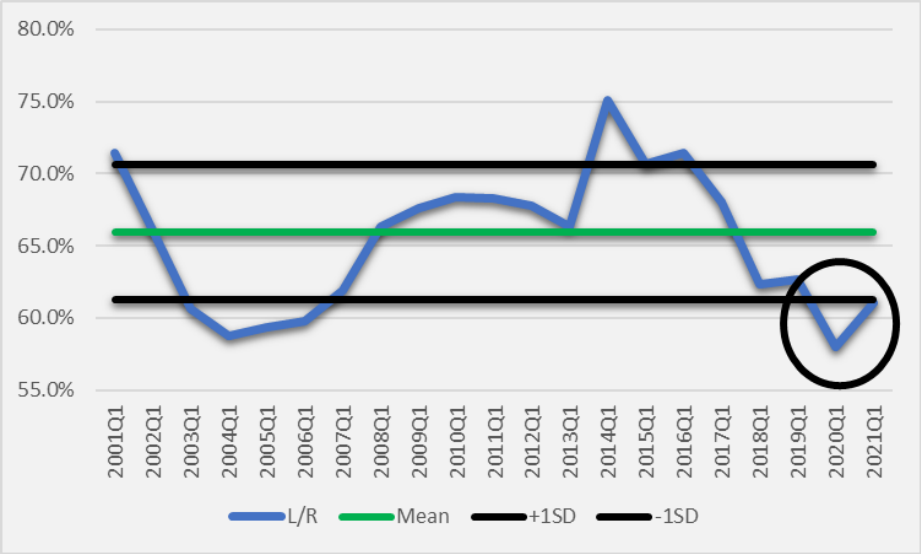
3) It'd be a stretch to make too much of this data as to its ramifications for the pricing cycle. Suffice it to say, **we see nothing here to lessen our conviction that the peak of the pricing cycle has passed. Next quarter will be more interesting** with possibly **more claims impact from the economic rebound and the ability to track IBNR changes on AY2020**. The pricing cycle will deflate quickly, we think, if IBNR from AY20 begins to decline.

Disrupted diagonals will matter…*as we said throughout the pandemic.* ***But the level of disruption was less than we initially envisioned*** *based on our YE20 Industry Study of Loss Reserves. Claims adjusters used the ~30% decrease in reported AY20 liability claims to winnow their claims inventory. And that statistical evidence is backed by more and more anecdotal evidence from law firms reflecting on their success settling liability cases during the pandemic year.* ***There will be particular value next quarter because we'll be able to examine the change in IBNR (during 1H21) specifically for accident year 2020.***

A word on the data*: The quarterly loss experience exhibit from which our data is drawn is net of reinsurance and includes all lines of insurance flowing through the individual filing entities we're using (in other words, there is no way to track direct loss experience for a particular line of business). To home in on the experience of each statutory line, we use individual filing entities where the net premiums in any one line represent a high percentage of total premiums.* ***Our graphs shows the progression of accident year 1Q reported loss ratios (i.e., paid + case reserves, excluding IBNR) since 2001****.*

The Pandemic Impact on Reported Loss Ratios in Pictures

Figure 1: Private Passenger Auto (Liability + Physical Damage) Reported Loss Ratio



Our cohort includes 5 companies representing nearly 1/3 of industry PPA premiums with PPA accounting for 86% of their total premiums. The 1Q21 loss ratio jumped!

Source: S&P Global, Assured Research. Incurred L/R = Paid + Case Reserves (including L&LAE) net of reinsurance

One key datapoint will help to interpret the 1Q20 vs. 1Q21 loss ratio comparison – gasoline consumption (a proxy for driving) was virtually the same during both quarters. We expect the loss ratio increase comes primarily from 1) lower rates in 1Q21; 2) more adverse weather adding to comprehensive losses; and 3) commodity inflation.

We have particular concerns for rising accident frequency in the summer and fall of 2021 as we convey in our 'mobility' note in this *Assured Briefing*.

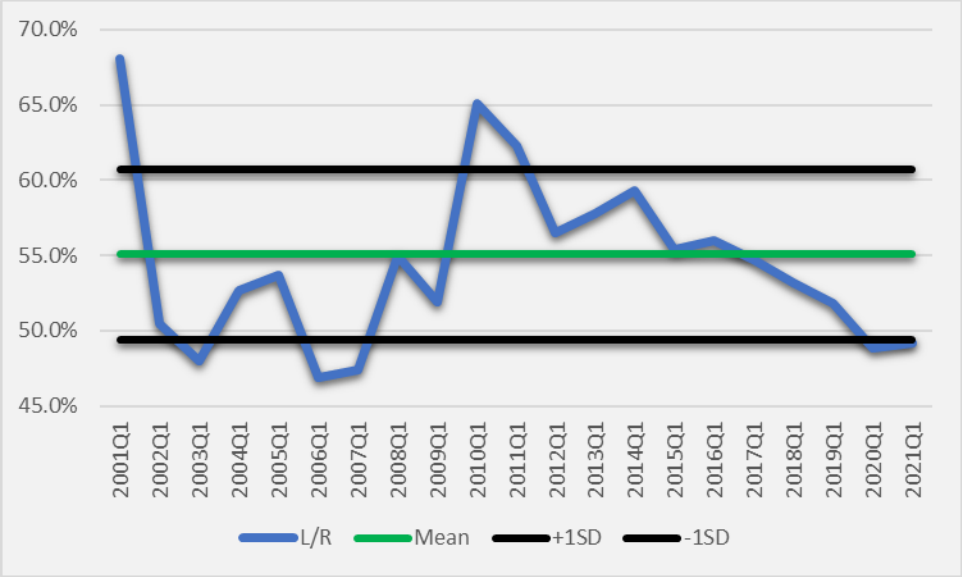
How does this data differ from GAAP? *Quarterly GAAP figures do not require disclosure of reported (paid + case) loss ratios. GAAP loss ratios are inclusive of IBNR which masks underlying loss activity.*

Commercial Auto Liability

Figure 2 on the next page shows the commercial auto loss ratio didn't decline as much as personal auto - consistent with the observation that commercial trucking has been 'essential' during the pandemic and, of course, commercial auto insurance rates have continued to rise by more than even conservative estimates of loss cost trends.

We'll remind readers that **the results of commercial auto can't be viewed in isolation** – they share the roads with private passenger autos! **If the roadways become meaningfully more crowded, as we expect they will, and consumer demand continues to accelerate** (which is predicted by every economist on the planet) **more commercial autos will bump into more private passenger autos**…rising frequency (impacted by inflation) and possibly **rising loss ratios**!

Figure 2: Commercial Auto Liability (CAL) Reported Loss Ratio



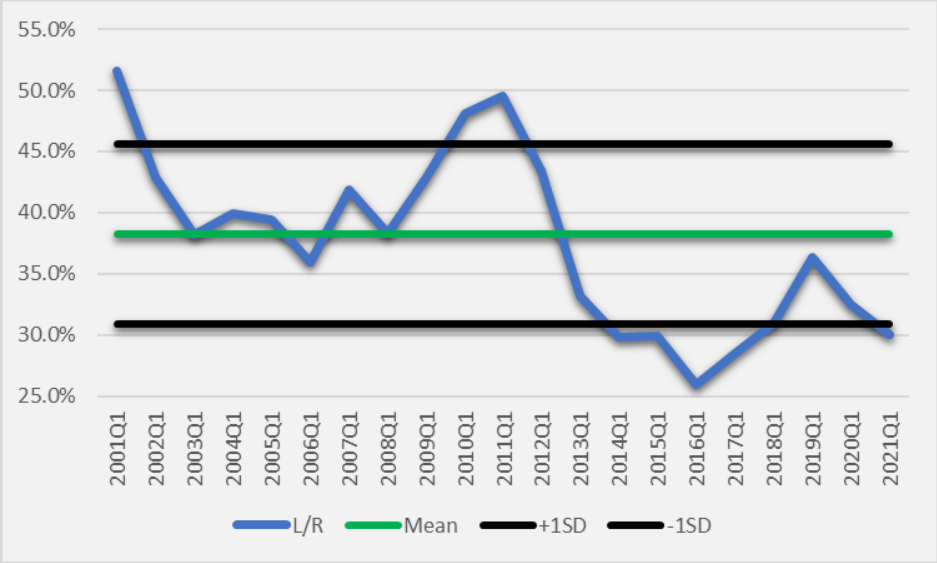
The commercial auto loss ratio remained largely unchanged from one year ago. As the roadways become more crowded, that'll adversely impact results.

Source: S&P Global, Assured Research. Truck Tonnage (TT) index from St. Louis Fed (FRED)

Workers' Compensation

Laws granting a rebuttable presumption of coverage to essential workers stricken with Covid-19 did not overwhelm the WC reported loss ratio as some had predicted. WC insurers have experienced Covid claims but they were offset by the decline in frequency of normal, attritional claims due to the slower economy and work-from-home orders. The favorable experience continued into 1Q21.

Figure 3: Workers' Compensation Incurred Reported Ratio



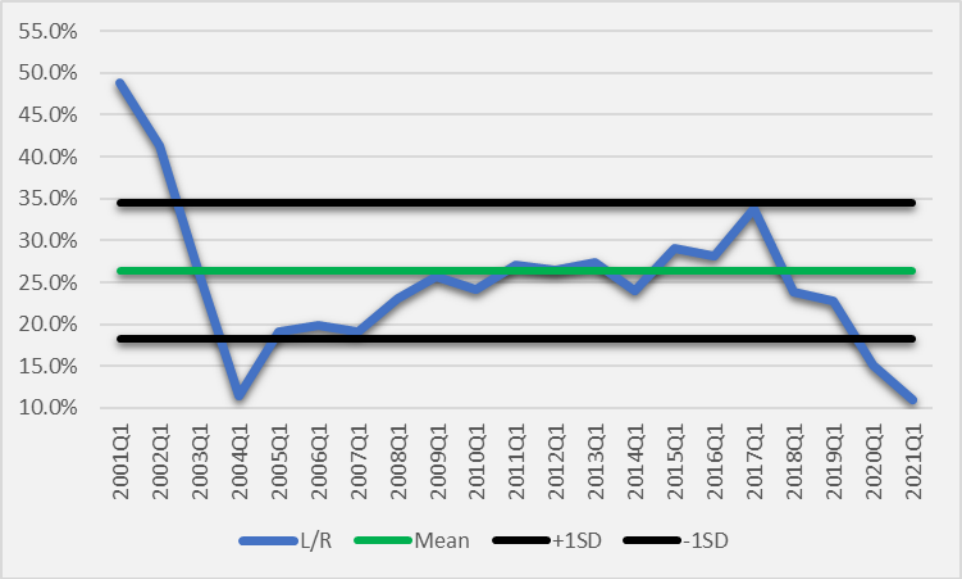
Our cohort includes 5 WC companies with WC premiums accounting for 94% of their total. Concern that Covid claims would swamp insurers proved to be overblown.

Source: S&P Global, Assured Research. Incurred L/R = Paid + Case Reserves (including L&LAE) net of reinsurance

Medical Professional Liability

Two words – holy smokes! If the 2021 accident year loss ratio decreases again when we measure next quarter; that'll be difficult to explain. Our best guess would be that the (anticipated) far greater number of elective procedures (1H21 vs. 1H20) and the reopening of lawyer's offices (and courts) will pressure the 1H21 accident year loss ratio. Stay tuned!

Figure 4: Medical Professional Liability Reported Loss Ratio



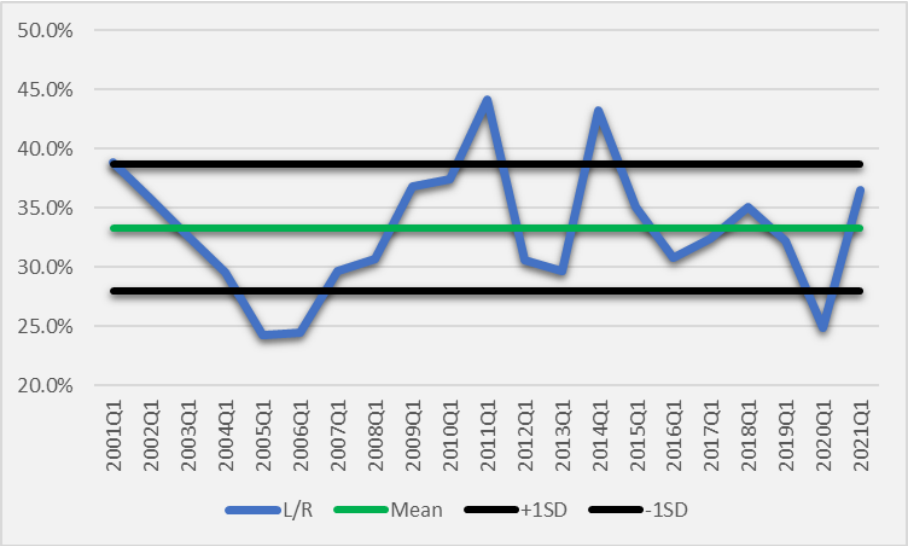
Interestingly, reported MPL claims on accident year 2020 (as measured during 2020) decreased by far less than the general and product liability lines.

Source: S&P Global, Assured Research. Incurred L/R = Paid + Case Reserves (including L&LAE) net of reinsurance

Commercial Multiple Peril

Bad weather during much of 1Q21 (but particularly in February) is probably the dominant issue here.

Figure 5: Commercial Multiple Peril Reported Loss Ratio



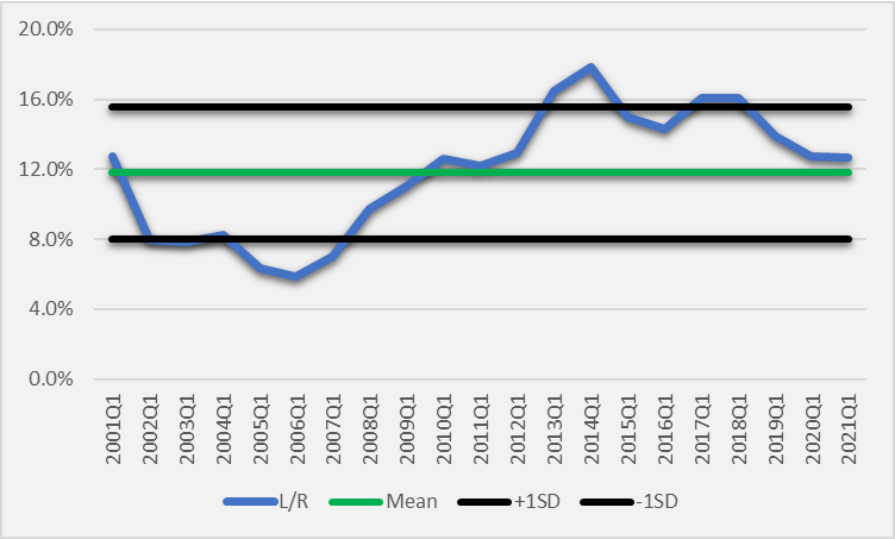
Our cohort: 5 companies for which CMP represents about 60% of premiums.

Source: S&P Global, Assured Research. Incurred L/R = Paid + Case Reserves (including L&LAE) net of reinsurance

Other Liability Occurrence

Nearly all management teams speaking on their 4Q20 and 1Q21 conference calls preached to the necessary conservatism in their accrued loss ratio for liability business. We agree that conservatism is warranted, though it will be fascinating to see how the economic rebound impacts the reported AY21 loss ratio (and to begin tracking the changes in IBNR on AY2020) when we revisit this analysis next quarter with YTD results.

Figure 6: Other Liability Occurrence Reported Loss Ratio



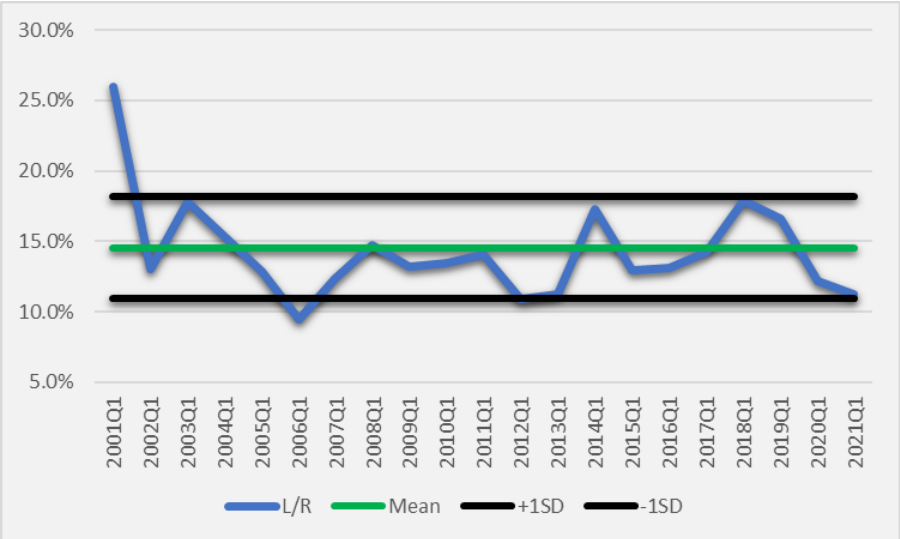
It's difficult to find 'pure' OL Occ writers, so this graph is influenced by other coverages and claims.

Source: S&P Global, Assured Research. Incurred L/R = Paid + Case Reserves (including L&LAE) net of reinsurance

Other Liability Claims Made

The claim volume in this line actually increased by 7% comparing 2020/2019. We suspect: 1) cyber claims, 2) EPLI suits, and 3) D&O claims…SPACs maybe?

Figure 7: Other Liability Claims Made Reported Loss Ratio



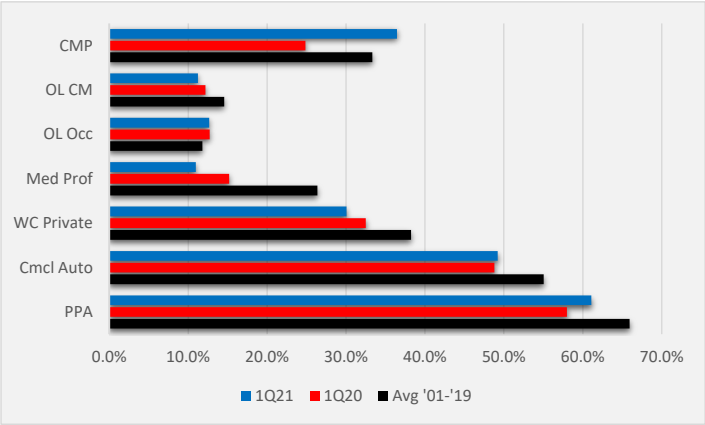
As with OL Occ., it's difficult to find 'pure' OL CM writers, so this graph is influenced by other coverages and claims.

Source: S&P Global, Assured Research. Incurred L/R = Paid + Case Reserves (including L&LAE) net of reinsurance

Putting It All Together

Figure 8 brings all the lines into one exhibit, comparing the 1Q21 loss ratio to the long-term average (1Q2001-1Q2019) and to 1Q20.

Figure 8: 1Q21 L/R vs. Average (2001-2019) & 1Q20



Source: S&P Global, Assured Research

Summary

As noted at the outset, we're hesitant to overstate the importance of the 1Q reported claim data or to overinterpret what it could mean for the overall pricing cycle. Starting with the working hypotheses that the pricing cycle has peaked – we see nothing here to undermine that assertion.

It's certainly interesting to observe (and intuitive) that the liability loss ratios generally improved in the Y/Y comparison. Economic activity, while improving steadily throughout the quarter recently ended, was surely below the year-ago level while accelerating quarterly rate increases during 2020 earned into the denominator of the loss ratio equation.

The private passenger auto line could be headed for trouble. Increasingly congested roadways, distracted driving and accelerating inflation could meet with intransigent regulators if (or, when) requests for substantial rate increases are submitted.

And as for commercial auto, we're all well-served to remember that that line can't be considered in isolation – the economy and private passenger auto trends will have a big impact on accident frequency. The economy is expected to BOOM which will mean more trucks on the road (if they can find drivers) at risk of bumping into a surging number of private passenger autos as people head to the stores and back to the office.

We're sorry to end with a glass-half-empty view here. Compared to our frame of mind when undertaking this analysis exactly one year ago; our spirits are soaring! But a massive economic rebound with everyone out and about consuming goods and services…that's a recipe for a rise in P/C claims. Ending on a positive note, however, that would support rising rates and maybe extend the hard market.