Workers' Compensation Market Overview

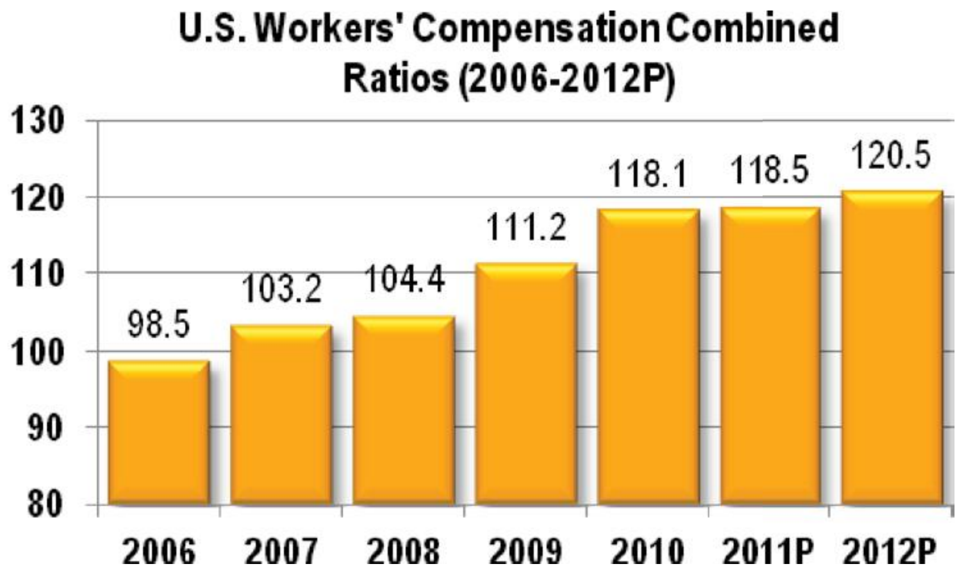
Accident Fund®
INSURANCE COMPANY OF AMERICA

Work Comp Industry Overview

Quick Fact: The workers' compensation industry has averaged a combined ratio of 109 over the last 10 years — with only one year below 100 during that 10-year period.

Combined Ratio

The 2010 industry combined ratio ended at 118.1%, the highest level since 2000 — and up 6.9 points from 2009. According to A.M. Best, the final 2011 combined ratio is expected to be around 118.5% and 2012 is projected to be even higher at 120.5%.



Source Data: A. M. Best

Rates

Workers' comp rates have increased in each of the last three quarters of 2011 (2.6% in second quarter, 4.1% in third, and 7.5% in fourth) after 30 consecutive quarters of declining commercial rates. Pricing adequacy is necessary to address the increasing gap between medical costs and workers' comp rates.

Quick Fact: Return on Equity (ROE) continues to fall. A combined ratio of 100 generated a ROE of roughly 21% in 1985, 15% in 1995, 10% in 2005 and 5% in 2010.

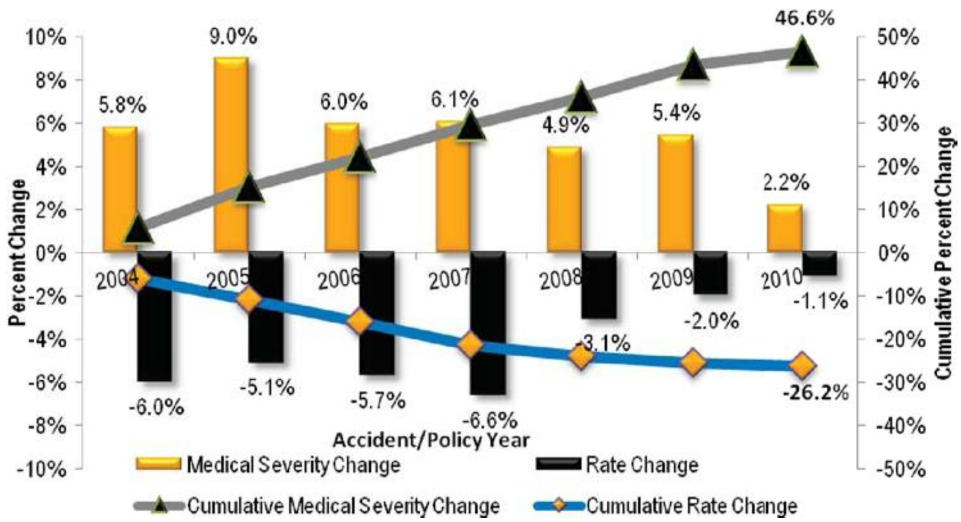
"One area that's going to be very critical for the industry is maintained discipline on underwriting results and reserve adequacy. Companies that are more disciplined are charging the appropriate rate, generating underwriting profit and are less dependent on investment income — they're going to have more stable results."

— A.M. Best

Medical Costs

Medical-only claim cost averages increased from $19,953 to $27,573 between 2004 and 2010. During that same period, medical severity increased a cumulative 46.6%, while rates decreased by 26.2%.

Medical Costs vs. Average Workers' Comp Bureau Rate/Loss Cost Changes



Source: NCCI

Inflation

Workers' comp claim cost drivers grew at a rate more than double the consumer price index (CPI). The overall CPI was 1.6% in 2010, while medical CPI was 3.4%. Inpatient and outpatient hospital services far outpace this at 8.8% and 6.1%, following close behind by prescription drugs at 4.3%. Inflation has gone up 18.9% from 2004 to 2010 and workers' comp rates have declined by 26.2% during that same time. If you add inflation into the equation, rates are approximately 45% lower today than they were in 2004.

Net Written Premiums

Premiums plummeted more than 30% since their high of $47.8 billion in 2005 to end 2010 at $34.1 billion. They are projected to grow 6% in 2012.

Frequency

Workers' comp claims frequency increased 3% in 2010 — the first time since 1997. Prior to that, claim frequency had been declining at an average rate of 4.3% per year since 1990, with the only other increases occurring in 1994 and 1997. It remains to be seen if this trend will continue.

Investment Yields

Yields on 10-year treasury notes have been below 4% since January 2008. For each 1% decline in investment yield, there needs to be a 5.7% reduction in the combined ratio to make up for it.

Reserves

Spiraling claims costs have put increased pressure on reserves. The workers' comp industry is under-reserved by $8.2 billion and accounts for more than half of the total P/C industry's reserve deficiency. Solid reserve practices are more important than ever.

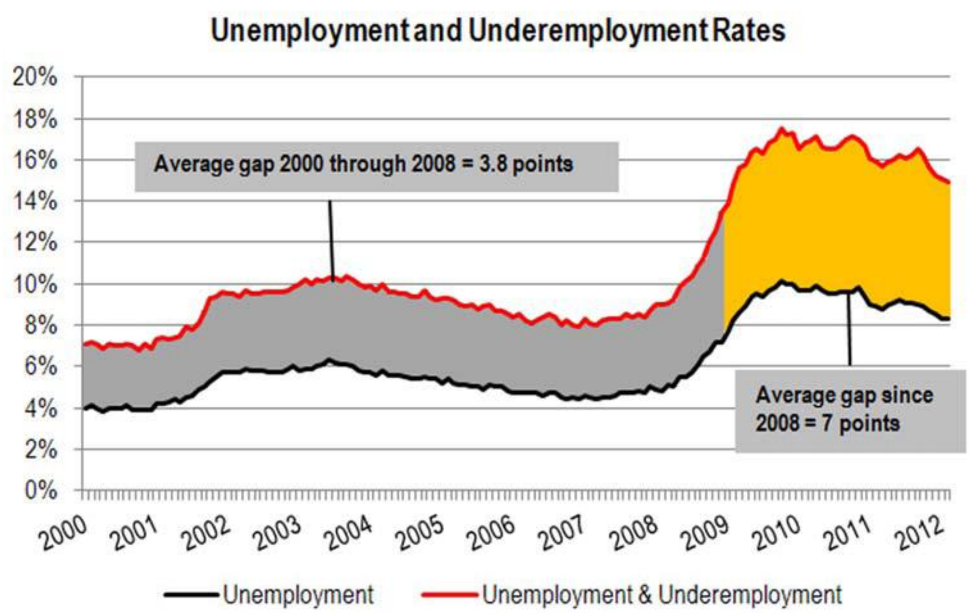
Trends and Forecasts

Medical Cost Containment

More dollars are going to pay medical expenses rather than indemnity wages — in fact, medical is almost 60% of costs today, with projections around 70% by the end of the decade if no major changes are made.

Employment

While jobs have been added for the last 25 consecutive months, national unemployment continues to remain high at 8.3% (as of February 2012) and is projected to remain this way throughout the year. Meanwhile, underemployment also remains high at 14.9%. The larger issue at hand is the difference between unemployment and underemployment. This discrepancy averaged 3.8 points from 2000 to 2008, while from 2009 to present it has increased significantly — at an average of 7 points. This increased gap means that there are significantly fewer quality jobs for claimants to go back to — thus claims durations are longer and overall claim costs are higher.



Data: BLS.gov

Quick Fact: From 1947 to 2011, the United States' average quarterly GDP growth was 3.28%, reaching a historical high of 17.20% in March 1950 and a record low of -10.40% in March 1958.

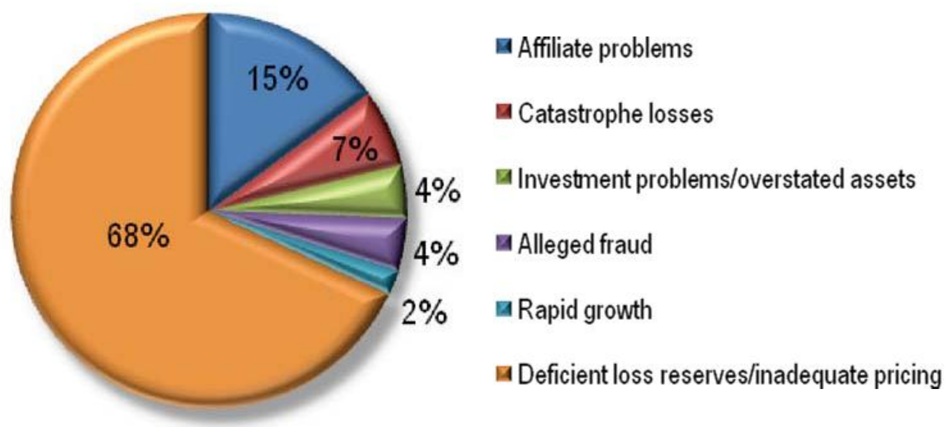
U.S. Gross Domestic Product

The GDP has been consecutively positive (albeit slow) since the third quarter of 2009. In 2011, real GDP growth came in at 1.7% for the year. The future of the U.S. economy continues to remain uncertain.

Impairments

A.M. Best designates an insurer as a Financially Impaired Company (FIC) as of the first official regulatory action taken by an insurance department. P/C impairments are on the rise and increased to 28 in 2011 (up from 21 in 2010) — workers' compensation was the largest category of P/C impairments, with 11 failures during a two-year period. Workers' compensation accounted for 26.2% of the premium volume of impaired insurers for the last 10 years, while only accounting for 8% of the total P/C premiums. The primary causes for impairments are deficient loss reserves and inadequate pricing.

Property/Casualty FICs: Primary



Source: A. M. Best

Quick Fact: The fatality rate for workers 65 and older is five times that of workers age 25 to 34.

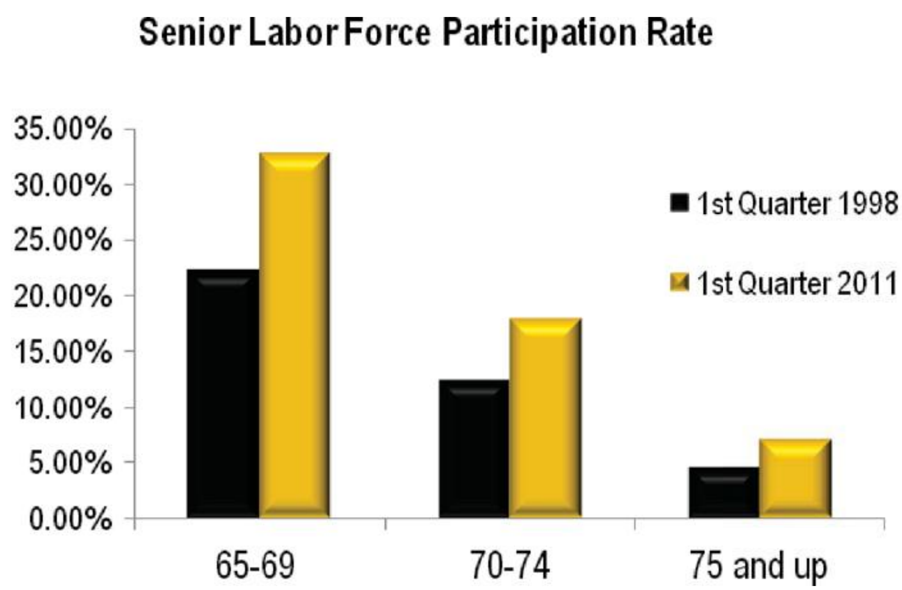
Quick Fact: In 1994, there were no states where the percent of obese adults was more than 20%. By 2010, all 50 states had obesity rates of 20% or more. There are now 12 states where the rate is 30% or higher.

Politics and Washington

NCCI states "With the enactment of the financial reform bill and the establishment of the new Federal Insurance Office, the influence of the federal government over property/casualty insurance issues is likely to increase significantly. In addition, the large federal deficit and potential for an increase in inflation are definitely a challenge."

Aging Workforce

The workforce is changing, due in part to the need for many to remain on the job longer to build more personal savings and afford retirement. Older workers tend to make higher wages and have more medical treatments per claim; however, it remains to be seen if this will adversely impact comp results.



Obesity Rates

Obesity rates continue to increase nationwide at an alarming pace. The epidemic is creating increased complications for workers' comp, as returning employees to work and full health is more challenging when comorbidity factors are involved. Workers' compensation medical claims and indemnity costs are five to 10 times higher for the most obese workers (Body Mass Index of 40+).

Quick Facts: The average annual growth in workers' comp medical severity from 2002 through 2009 was more than 6%.

Historical Perspective

Comparing Costs Over Time

Averages	2000	2005	2010	Change Since 2000	Change Since 2005
Med-Only Claim Cost	$14,240	$21,640	$27,573	Up 94%	Up 27%
Health Insurance for Family of Four	$6,438	$10,880	$13,770	Up 114%	Up 27%
Annual Treasury Bill Return	5.76%	3.01%	0.13%	Down 98%	Down 96%

Additional Information

The information in this report came from a variety of sources including: A.M. Best, The Insurance Information Institute, NCCI, The Bureau of Labor and Statistics and Standard and Poor's.

Please contact your Business Development Consultant if you have any questions.