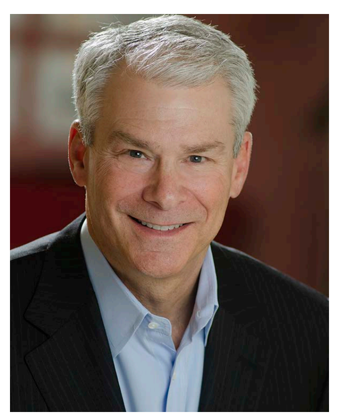
AASCIFNEWS

SUMMER ISSUE | 2020

WHAT'S INSIDE

1 PRESIDENT'S MESSAGE
2 FEATURES FROM AASCIF
2 Workers' Compensation Insurance Companies, 2020 Edition: Strategy Considerations for Growth
12 Performance Matters
16 Considerations for a Telecommuting Workforce
18 Sustaining Healthy Internal Controls During the COVID-19 Crisis
19 Emerging Challenges: Employee Mental Health and Well-Being Through COVID-19 and Beyond
21 How CompSource Mutual Has Integrated the Cybersecurity and Enterprise Risk Management Processes Together
23 AROUND AASCIF
23 Colorado
24 Hawaii
25 Kentucky
25 Maryland
26 Minnesota
27 Montana
28 Oregon

PRESIDENT'S MESSAGE



Greetings,

Hello again from my home office in Denver, where I'm continually amazed at both the rate of change we've all experienced in the last several months and the way our teams have stepped up and adapted and innovated. I'm impressed by how businesses across Colorado have persevered, prioritizing their employees' safety while making creative operational changes that allow them to continue to do business. Whether it's drive-through veterinary care or cocktail carts selling to-go margaritas outside local restaurants, it's inspiring to see them making it work.

Another thing that's changed since I last wrote you that necessitates our attention is our national focus on increasing diversity and inclusion in workplaces. Like many of you, I observed the death of George Floyd with horror and felt the personal responsibility as CEO of a major employer in Colorado to make the lives of all of our employees and our citizens feel safer and more equitable. I heard from many of our employees of color about negative experiences they've had with racism in our communities, and it breaks my heart. Here at Pinnacol, we've committed to making real, lasting change and I hope you do too.

While we made the difficult decision to cancel our annual conference this year, AASCIF is working hard to create virtual experiences to keep our networking, learning, and connection going. We've launched an education series called the AASCIF Connection Series that uses our new digital platform to connect members with great content, ideas, and each other. For the next several months, we are very excited to present this lineup of education.

I hope you and yours stay safe and healthy. Please reach out if there is anything I can do to help you.

Sincerely,

Phil Kalin

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FEATURES From AASCIF

WORKERS' COMPENSATION INSURANCE COMPANIES
2020 EDITION: STRATEGY CONSIDERATIONS FOR GROWTH

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Please note certain information in this presentation constitutes forward-looking statements. Due to various risks, uncertainties and assumptions made in our analysis, actual events or results or the actual performance of the markets covered by this presentation report may differ materially from those described. There is no certainty that events will turn out as we have opined herein.

Table of Contents

1	Executive Summary	2
2	Claims – Frequency/Severity	3
3	Basis of ERM Analysis	4
4	Risk-Based Capital	4
5	In a Quest for Yield	10
6	An Industry Liquidity Option – Federal Home Loan Bank Borrowing Programs	10
7	DWS's Insurance Asset Management Platform	22

1 / Executive Summary

We are in unique times for Workers' Compensation (WC) insurance companies. Not only do you have to deal with the uncertainty of COVID-19 and how it may impact claims (one area may be the increase in claims from nurses and doctors that may be much higher than expected), but you also have a loss of premiums as the unemployment rate increases resulting in a decline in the number of insured. Moreover, you still have the usual risks of increasing competition, low interest rates, and medical inflation to deal with. For WC insurers, the combined ratio tends to be over 100%, with some seeing ratios above 110%. Investment income can play an important role in keeping the operating ratio below 100% and keeping a company solvent. In today's low interest-rate environment, the investment income needed to achieve a viable ratio has often pressed companies to add incremental exposure to their investment risk, which may lead to additional risks if they need liquidity to pay claims. There are a lot of unknowns with the COVID -19 virus but early results show an increase in claims and a decrease in premiums as the unemployment rate increases. One unique finding is an increase in claims that may not have been expected, especially from certain hard-hit sectors (i.e. medical professionals).

The majority of WC claims are paid out in the first two years and the overall average liability duration tends to be in the three- to five-year range and follows a log-normal distribution (Figure 1). With the high percentage paid out in the early years, WC insurers need adequate cash to pay claims. Even though investment income can provide a substantial contribution to income and help pay claims, the liquidity-needs add an additional constraint that WC insurers must consider prior to setting an investment portfolio strategy. Also, generating the same amount of investment income that portfolios may have produced in the past will be harder if rates continue to stay or go lower from where they are today.

In our opinion, the goal of Enterprise Risk Management (ERM) analysis is to help WC insurers expand the effectiveness of their investment strategy by taking a thorough analysis of risks on both sides of the balance sheet. Based on our analysis, we believe there is room to add potential income by selectively adding risk to their portfolios.

As WC companies grows in size, they tend to increase their allocation to riskier asset classes (primarily equities), while decreasing allocation to cash and highly rated bonds. With the increase in the number of companies becoming members of the FHLB program, we have seen this lead to a decrease in the amount of cash they are holding. These moves increase portfolio risks, which larger companies seem to be comfortable with.

As bond yields continue their 40-year decline and are currently well below the historical average, opportunities to invest for yield will continue to diminish. If this trend persists, risk tolerance levels will need to be continually adjusted upward to maintain current investment income levels. As a result, the credit quality of the investment portfolio will need to be adjusted accordingly. High-yield corporate and municipal bonds, real estate (both equity and debt), private credit, bank loans, structured finance, CLOs, and select opportunities within equity strategies (REITs, infrastructure) may represent an attractive option to potentially improve current income while remaining within a targeted risk spectrum.

As investment income continues to be a main driver of profitability for the WC industry, we suggest that the need for proper evaluation of the composition and risk level of investment portfolios is becoming more critical. We suggest companies in the WC insurance industry to consider the potential benefits of ERM as they seek to enhance margins and meet the financial and regulatory challenges that may lie ahead.

FIGURE 1: ESTIMATED LIABILITY CASH FLOWS OVER TIME OF CLAIM

Source: SNL database 2020.

2 / Claims – Frequency/Severity

One area we see impacting profitability is the change in claim frequency and severity. The past few years have seen a continual drop in frequency while severity continues to increase. Medical inflation continues its trend of outpacing the medical inflation reported in the Consumer Price Index. We have seen a change in claim payment patterns because some companies have the ability to settle claims early. Understanding the risks impacting the liabilities, in a continually changing claim environment, can be tricky. The challenge lies in controling claim trends and seeking ways to decrease costs while also maintaining appropriate capital ratios.

ERM analysis can provide valuable insight and a viable path toward implementation by employing a holistic view of the risks impacting both sides of the balance sheet. Our ERM analysis of WC insurance companies leads us to believe they have the potential to increase investment income by selectively raising risk tolerance levels. Our methodology and results are set out in this paper.

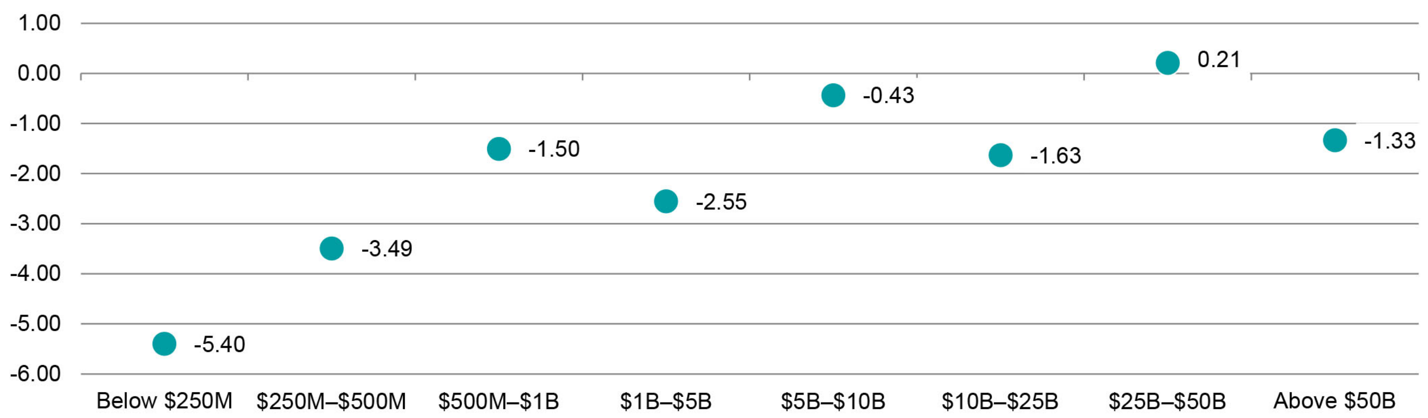
3 / Basis of ERM Analysis

Provision for Adverse Deviations (PADs)

One interesting finding in our research is the amount of redundancy built into claim reserves. As you can see in Figure 2, as a company grows, there was a drop in the amount of reserves released in 2019 (we see similar results when we include prior year results). This makes sense if you think about the law of large numbers: As a company grows, it has more data and tends to be more comfortable with holding a lower amount of excess reserves.

Prior to analyzing a company's capital position, understanding whether the company has redundant/deficient reserves helps to enhance the analysis around its current capital position. As an example, a company with excess reserves and a 900% RBC ratio may in reality be similar to another company with no excess reserves but a Risk Based Capital (RBC) ratio over 1,000%. The goal is to get a better understanding of the true picture of a company's overall capital position. Then an ERM analysis can be conducted and create a holistic approach to design an investment portfolio.

FIGURE 2: REPORTED LOSS DEVELOPMENT REDUNDANCY/DEFICIENCY AS A % OF NET PREMIUM WRITTEN BY WC INSURER SIZE (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

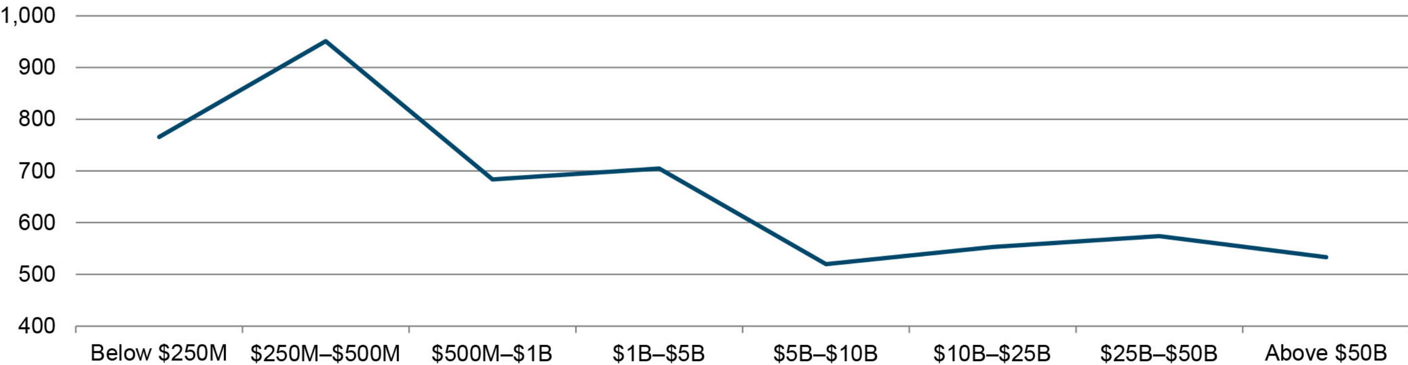
4 / Risk-Based Capital

DWS's analysis is based on an initial review of RBC. Below are a few "givens" regarding RBC ratios:

- Insurance companies must maintain a minimum amount of capital on the balance sheet to remain in business and avoid regulatory scrutiny.
- RBC ratios tend to drop as a company grows, partly resulting from bigger companies writing more lines of business and receiving the benefits of the co-variance calculation of RBC.
- RBC calculation on reserves does not take into consideration excess reserves. The more excess reserves you hold will result in a higher denominator resulting in a lower RBC ratio.

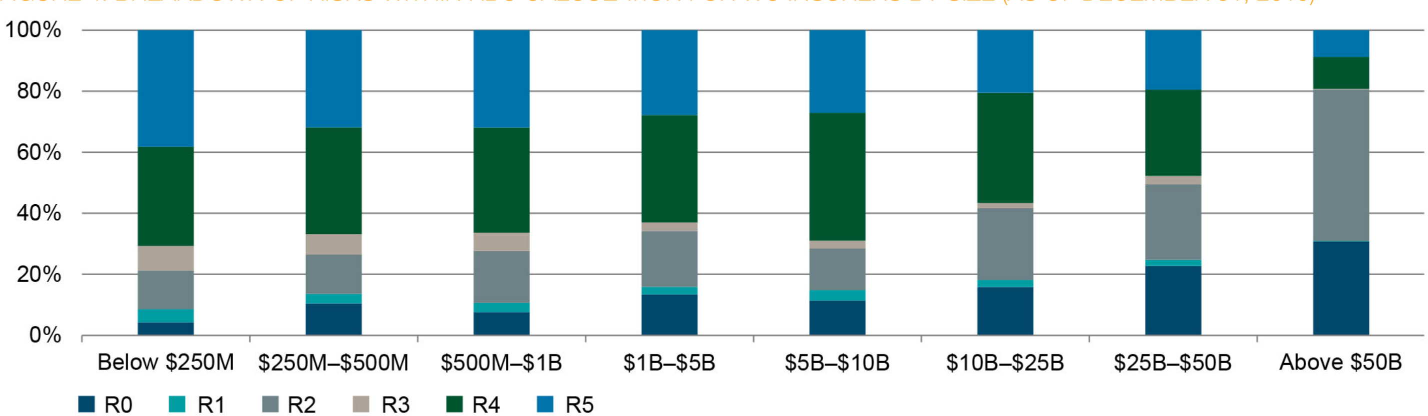
As shown in Figure 3, RBC ratios as defined by invested asset base vary by company size and tend to drop as a company grows.

FIGURE 3: RBC RATIOS ACCORDING TO COMPANY SIZE (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

FIGURE 4: BREAKDOWN OF RISKS WITHIN RBC CALCULATION FOR WC INSURERS BY SIZE (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

Taking a deeper dive into the breakout of risks within the RBC calculation (Figure 4), we see underwriting risk (R4 and R5), not surprisingly, listed as the largest component. One interesting tidbit was investment risk, which accounts for a significant portion of total income, comprises a much smaller component of total RBC. Another interesting finding was the breakdown from asset risks. Fixed income, in which the majority of invested assets are held, contributes less than 5%, on average, of RBC as opposed to 20% for equities.

DWS next considered the liability side of the balance sheet and possible implications for the invested assets base.

Liability Risk Analysis: Combined Ratio

As stated earlier, WC insurance companies tend to have combined ratios greater than 100%, resulting in a heavy reliance on investment income to bring the operating ratio below

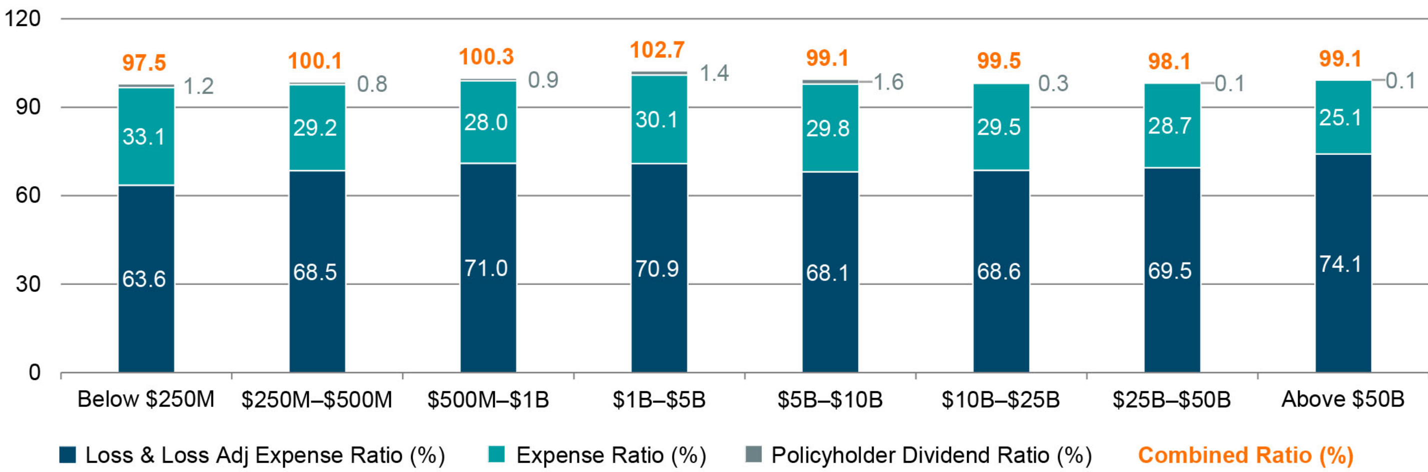
100%. From the perspective of ERM, a higher combined ratio indicates lower underwriting margins, suggesting to us:

- Greater pressure to lower administrative expenses
- Greater reliance on investment income for profitability
- A higher probability of writing business at a loss, which can heighten liquidity and operational risks

We do need to point out a couple observations. Prior to COVID-19, the overall trend in the combined ratio was a continual decrease for the industry. However, with the recent upheaval resulting from COVID-19, the impact on future claims and collected premiums remains to be seen. We will update our paper next year to include the full impact of COVID-19.

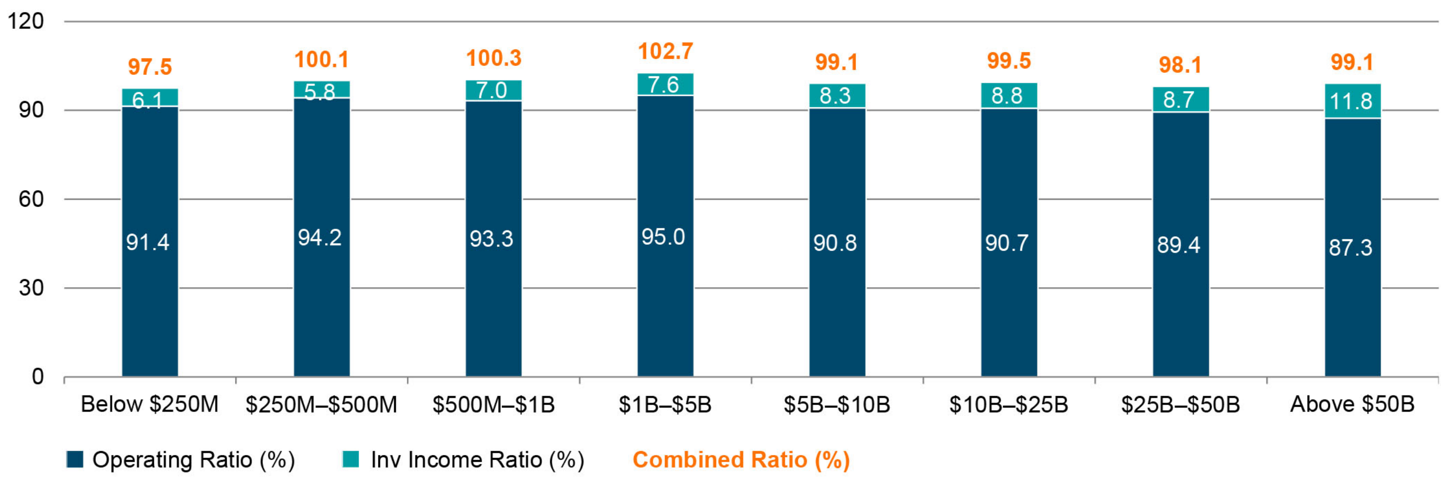
Figure 5 compares combined ratios for WC businesses of different sizes.

FIGURE 5: COMBINED RATIOS OF WC INSURERS BY SIZE (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

FIGURE 6: OPERATING RATIO OF WC INSURERS BY SIZE, WITH INVESTMENT INCOME AND COMBINED RATIOS (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

Figure 6 shows the importance of investment income in helping companies lower their operating ratio below 100%. One intriguing finding was the increase in investment income ratio as a company grows. As we will see later in this paper, larger companies invest differently than smaller ones and, as a result, are able to increase their investment income ratio. Having additional investment income may lead them to set more competitive insurance premiums if they know they can make up for the lost premiums with additional income from the investment portfolio. This inherently makes it harder for smaller companies to compete against larger competitors.

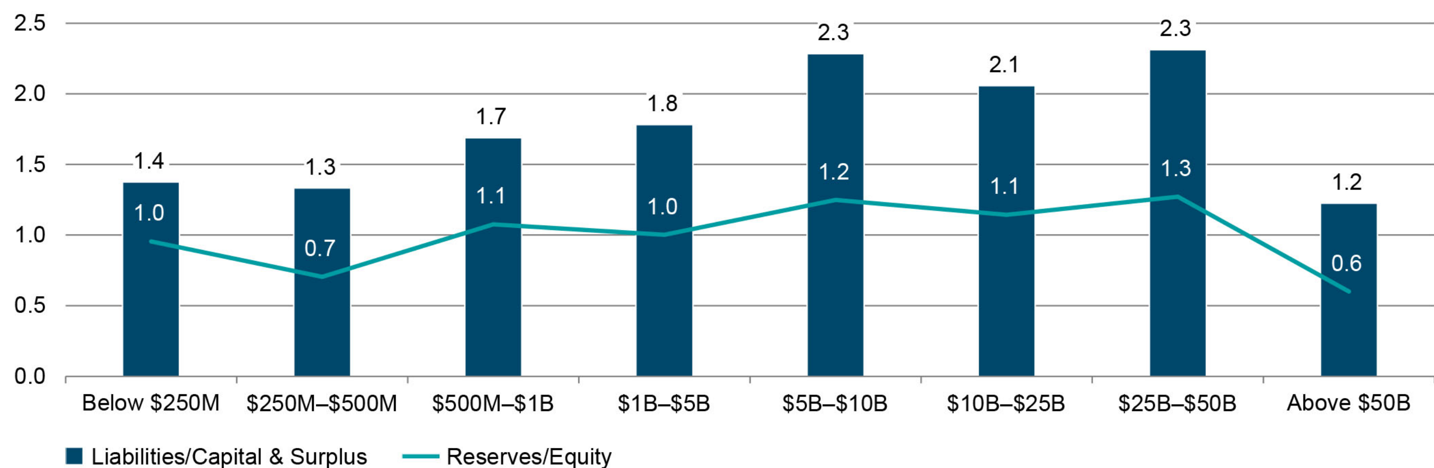
Liability Risk Analysis: Capital & Surplus Ratios

We have mentioned a few times how companies tend to change their strategy as they grow. Here is another example. There is a meaningful difference in the level of business that companies are willing to underwrite or generate for a given level of capital and surplus (Figure 7) as they grow. Liabilities – consisting primarily of claim reserves related to the amount of business written by a company – range mostly between 150% and 250% of capital & surplus. Larger companies tend to write even greater amounts, which is interesting since, as stated earlier, they have lower R4 and R5 factors in their RBC calculations. The covariance in the RBC calculation must help offset the additional risk from writing more business for the same level of capital. To

put this in perspective, a company with an estimated $1 billion in assets may have about $667 million in liabilities and $333 million remaining for capital & surplus, equating to a 200% ratio. A 230% ratio would result in $697 million in liabilities for every $303 million in claims.

In general, liability to capital & surplus ratios increase as a company grows, to a point. Ratios for smaller companies tend to hover around 160% while those for larger companies are around 210%. Larger companies assume additional risk and appear comfortable with writing relatively more business and holding relatively less capital for protection against adverse deviations in claim experience.

FIGURE 7: LIABILITIES COMPARED TO CAPITAL & SURPLUS FOR WC INSURERS BY SIZE (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

Now let's turn our focus to the asset side of the balance sheet. ERM analysis of assets focuses on the risks inherent in investment portfolios, including liquidity and credit characteristics as well as the composition of the invested asset base.

Asset Risk Analysis: Liquidity Risk

Managing liquidity risk is a huge concern for WC and justifiably so given approximately 50% of claims are paid out within the first two years. Overall liability durations tend to follow a log normal distribution with some tail risk and the medical inflation in the tail can be a particular source of concern.

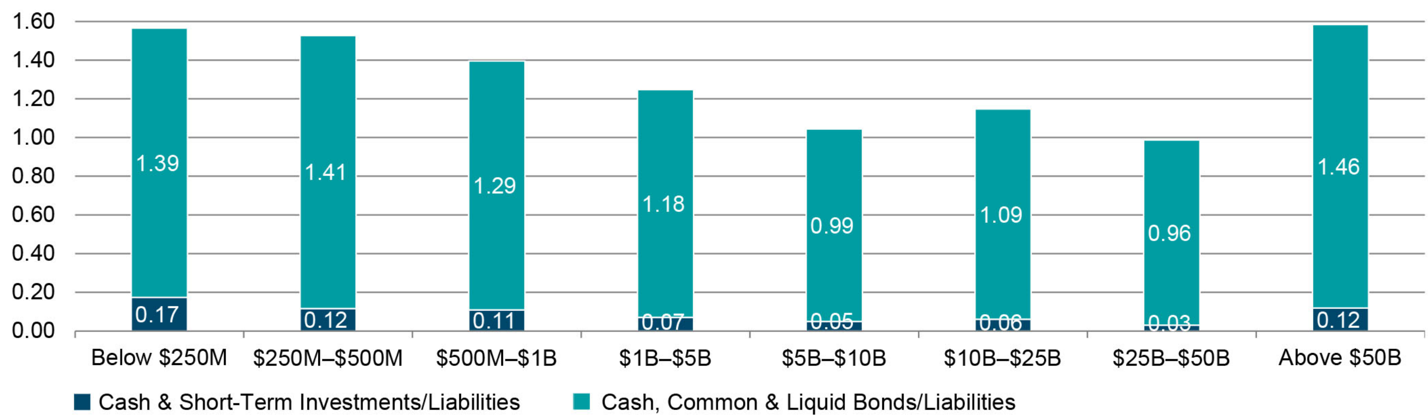
Net cash flows – premiums and investment income less claims and expense – can vary depending on the state of the company. For a company growing premiums year over year, this could be increasing. If the company is seeing a drop in premiums then it could be close to zero or at times even negative, something that may happen for a few companies during the COVID-19 pandemic. This potentially increases liquidity risk for a given WC company. To manage this risk, companies often maintain two portfolios, one for operations and the other for investments. Asset duration for the operations portfolio, used for day-to-day cash needs and liquidity management, is typically kept short (ie money market funds). The duration in the investment portfolio tends to be in the four- to five-year range.

Let's consider a few of the factors for measuring liquidity risk, for WC insurance providers:

- **Net written premium growth:** Changes in premium growth will impact liquidity needs.
- **Growth in claim reserves:** Claim reserves generally grow on an annual basis, due in part to premium growth and inflation. Also, annual medical inflation may impact the growth in reserves as the medical component of reserves may be growing faster than the indemnity component.
- **FHLB membership:** As we have seen from the impact of COVID-19, companies are looking to their membership to borrow money for additional liquidity.

As we can see in Figure 8, as a company grows, it tends to increase its amount of liquidity risk.

FIGURE 8: LIQUIDITY RATIOS FOR WC INSURERS BY SIZE (AS OF DECEMBER 31, 2019)

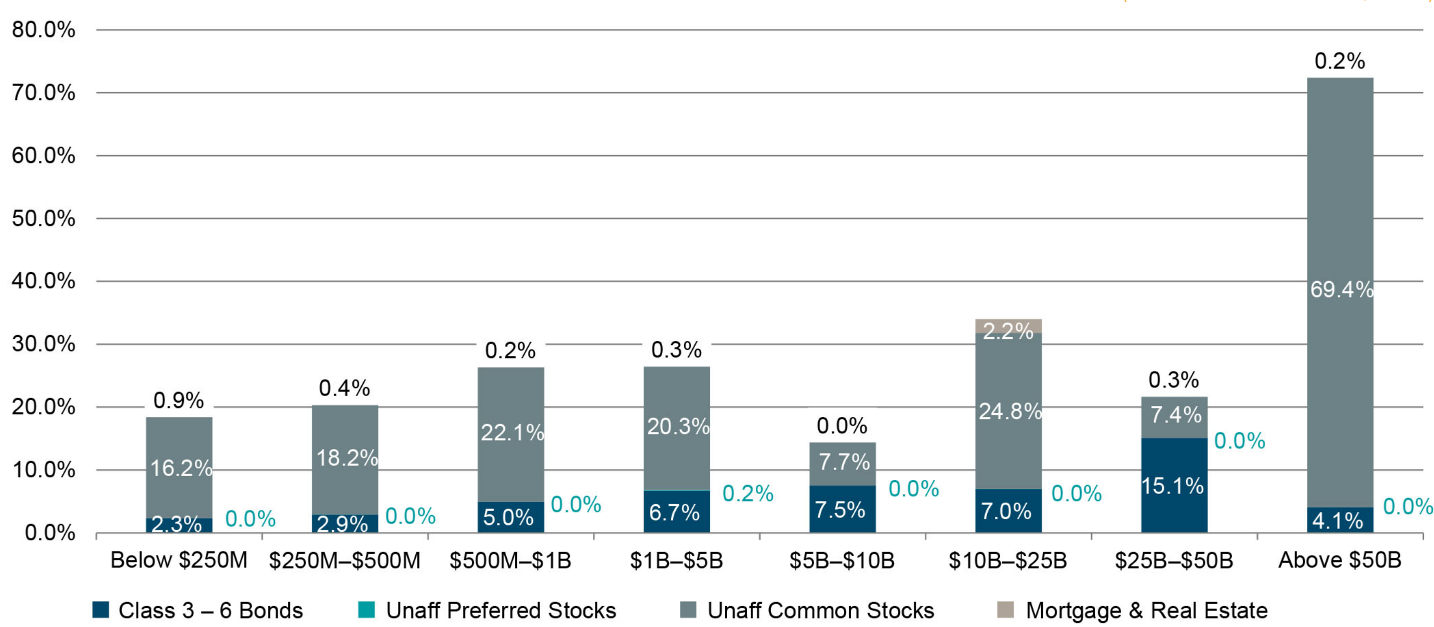


Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

Asset Risk Analysis: Credit Risk

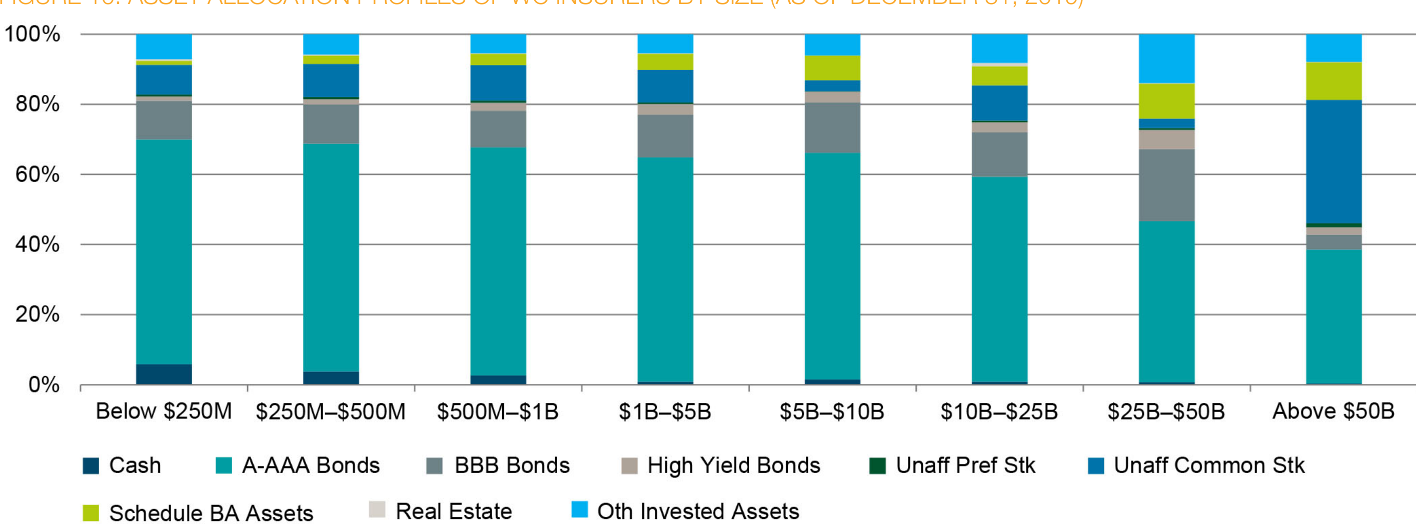
Credit risk can have a major impact on total investment returns for WC insurers, as was demonstrated in 2008 at the height of the global financial crisis, and again with what we are seeing today with COVID-19. For the purposes of this paper, we looked at a few of the riskier asset classes. As the investment world changes, we may see others become riskier than expected. We have categorized high yield, common stock, preferred stock, schedule BA and "other invested" assets as risky. Figure 9 compares the percentage of surplus that WC companies invest in these riskier asset classes.

FIGURE 9: PROPORTION OF RISK ASSETS AS A % OF CAPITAL & SURPLUS OF WC INSURERS BY SIZE (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

FIGURE 10: ASSET ALLOCATION PROFILES OF WC INSURERS BY SIZE (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

Asset Risk Analysis: Investment Risk Comparison

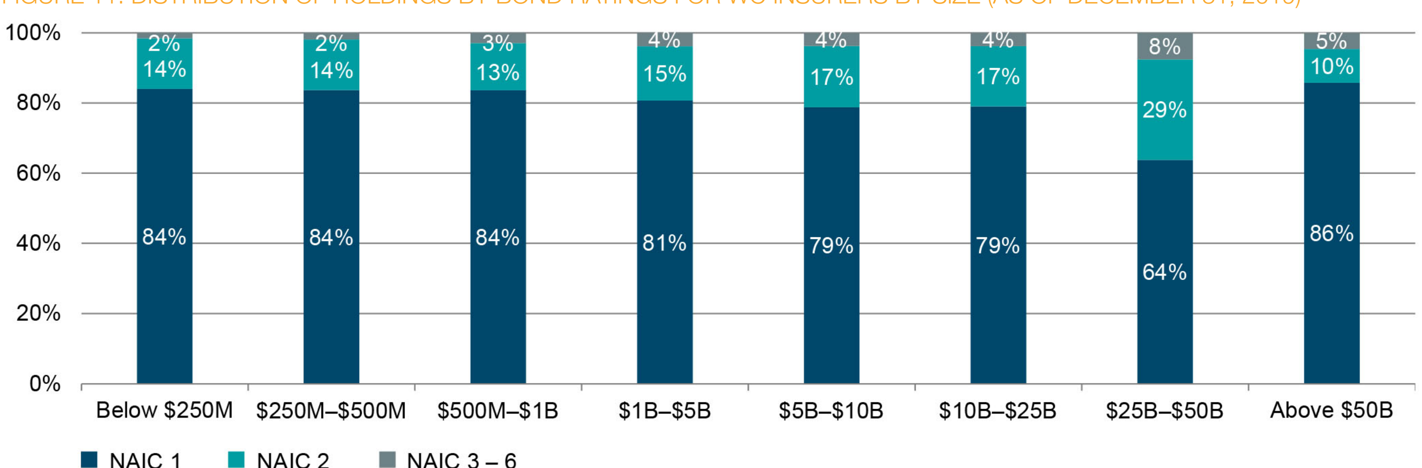
WC companies tend to hold less cash and maintain larger allocations to "other invested" assets compared to other P&C insurers. The main reason for this is that over half of the premiums written in the P&C universe comes from auto coverage with a liability duration around 1 year. We did our best to eliminate companies not writing WC business to help minimize the noise in our results. As the invested assets base increases, there tends to be a corresponding increase in allocations to riskier asset classes and a decreased investment in cash and bonds.

In addition to evaluating liquidity and credit risk, a review of investment portfolio composition also reveals several interesting themes. Figure 10 compares the asset allocation decisions of worker compensation insurance companies by size.

Asset Risk Analysis: Potential Bond Allocation Considerations

Examination of bond portfolios in isolation provides further evidence of the relationship between risk tolerance and invested asset base increases. The allocation to National Association of Insurance Commissioners (NAIC) 1-rated securities (AAA-A) declines, while the allocation to NAIC 2 (BBB) and NAIC 3 – 6 (high yield) securities rises.

FIGURE 11: DISTRIBUTION OF HOLDINGS BY BOND RATINGS FOR WC INSURERS BY SIZE (AS OF DECEMBER 31, 2019)



Source: SNL 2019 Q4 STAT data. The data contained in this analysis was obtained from a third party. While we believe the data is accurate, we have not independently verified it and do not attest to its accuracy.

5 / In a Quest for Yield

Recent market volatility may drive additional changes in asset allocation decisions and risk tolerance levels. Are we in a 2008 period again for bond yields? Rates have been coming down over the past decade and reinvesting maturing securities at similar yields has been a daunting task (excluding the current market volatility). If the current market volatility subsides (March and April 2020 period), we could be back in a similar position as we have been in the past few years. Also, what about taxes? To pay for all this stimulus, one might assume taxes will be going up and municipal bonds may make sense again.

Workers' Compensation insurers seeking to boost investment income in an environment of potentially diminishing yields may benefit from a shift in asset allocation to potentially higher-yielding opportunities such as high-yield corporate and municipal bonds, real estate (both equity and debt), private credit, bank loans, structured finance, CLOs, and select opportunities within equity strategies (REITs, infrastructure). Such assets may produce yields from 3% to over 7%*, though they bring with them a higher risk profile. We believe the higher-yielding asset classes discussed here may represent an attractive option for improving current income while remaining within a targeted risk spectrum, along with potential for additional diversification.

Finding Opportunities With ERM

With growing competition, regulatory changes, and market turmoil leading to increasing pressure on margins, workers comp insurance companies face the challenging task of searching for ways to improve margins while maintaining appropriate liability coverage and capital ratios.

As companies grow and rely on more income coming from investments, we expect the need for proper evaluation of the composition and risk level of investment portfolios to become more urgent. ERM analysis leads us to believe that there is an opportunity to increase profitability by selectively adding risk to an insurer's investment portfolio – just one demonstration of how ERM's holistic approach can provide a possible solution.

The process of balancing the drivers of both asset and liabilities can be challenging. In skilled hands and learning from how bigger companies are managing the balance, ERM has the potential to support the evolving needs of growing companies, particularly in the dynamic financial and regulatory environment. We believe companies in the WC insurance industry should consider the potential benefits of ERM as they seek to enhance margins and meet the financial and regulatory challenges that may lie ahead.

**Source: As of year-end 2019 yield levels reflected in respective indices Bloomberg Barclays High Yield, Bloomberg Barclays Municipal Bond, NCREID-ODCE, Giliberto-Levy, Cambridge Associates, S&P/LSTA, Bloomberg Barclays U.S. Aggregate, JP Morgan Loan, FTSE NAREIT, and Dow Jones Brookfield Global Infrastructure.*

6 / An Industry Liquidity Option – Federal Home Loan Bank Borrowing Programs

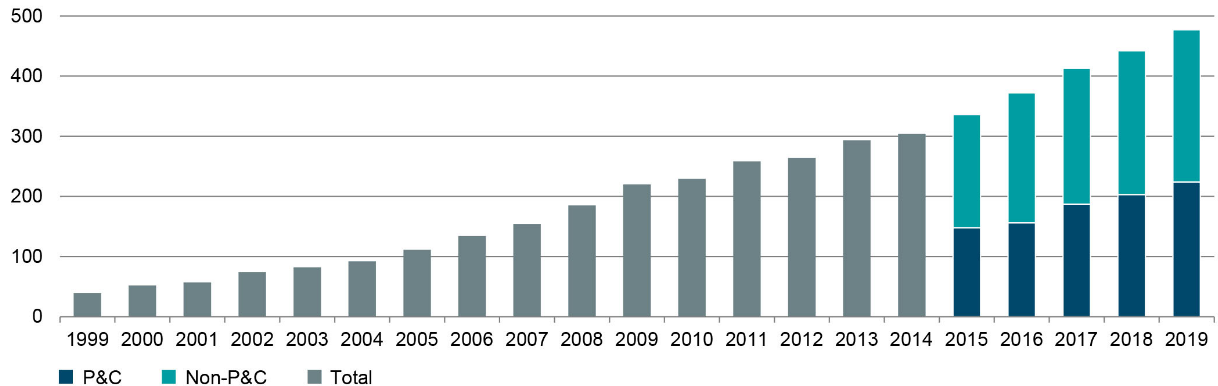
To reduce allocation to low-return cash-equivalent investments and/or add liquidity by borrowing to increase cash on the balance sheet during volatile times; many P&C insurers manage their liquidity requirements through the Federal Home Loan Bank (FHLB) funding. See Figure 12 for growth in companies becoming members (pre-2015 they did not break out by line of business).

Also, membership is looked at favorably by the rating agencies. Below are a few comments:

- AM Best – FHLB programs provide financial flexibility for insurance company members and are an attractive source of capital because of the low rate offered on advances.
- Moody's – Access to an alternative, low-cost funding source is credit positive. The FHLBs offer eligible insurers access to low-cost, collateralized borrowing capacity for both their ordinary operating needs and emergency liquidity.
- Fitch Ratings – Fitch Ratings believes that membership in the Federal Home Loan Bank (FHLB) system can enhance liquidity and financial flexibility for insurance companies, particularly those insurers with limited access to capital markets. The FHLB is able to source funds at very low rates due to its position as a government sponsored entity (GSE).
- S&P – Although not immune to major market dislocations, the FHLB System has proven to be a stable source of funding through good times and bad.
- A material dislocation in financial markets will not likely affect the FHLB in providing insurers this alternative access to funding.

Formed in 1932, the government-sponsored enterprise, FHLB, provides readily available low-cost source of funds with a wide range of maturities. Currently, more than 470 insurance companies are members of the FHLB, with aggregate borrowing in excess of $1 trillion overall as of year-end 2019.

FIGURE 12: GROWTH IN COMPANIES BECOMING MEMBERS



Source: Data provided by FHLB bank of Boston

7 / DWS's Insurance Asset Management Platform

We are insurance asset management.

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Our global platform delivers multi-asset investment programs in an insurance context across active and passive fixed-income, equity, alternative, cash, and ESG strategies. It is supported by an understanding of the dynamics and complexities of insurance investing in a constrained environment that is subject to state regulations, solvency requirements, rating agency considerations, reporting and accounting standards.

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PERFORMANCE MATTERS

Scott Skowronski, CFA, AAM–Insurance Investment Management

In the investment industry, there is a widely held view that a Core Fixed Income strategy is a commodity. The belief is that there are variations among managers and styles of course, but over time, those distinctions will offset, and there will ultimately be an immaterial difference in returns.

Removing the Noise

The question necessarily becomes, is there evidence to support this belief? If there are, the costs of assuming homogeneity could be more significant than investors realize. We wanted to explore this concept further, but to do so objectively, it was essential to level the playing field by eliminating as much noise in the data as possible. Return differences between core managers can most often be explained by two factors: managing to either different benchmarks or duration targets, and/or a measurable allocation to "non-core" or below investment grade securities.

With these factors in mind, we evaluated a universe of institutional core managers with the most comparable objectives and characteristics we could find. The core managers in this peer group all list the Bloomberg Barclays Aggregate Index as their primary benchmark, share a common duration range, and have an inconsequential allocation to "non-core" bond sectors such as high yield, emerging markets, or non-US dollar assets. Finally, all return statistics for these managers were viewed gross of fees to further eliminate any nuances caused by variations in expenses. In other words, we constructed the most "commoditized" group of U.S. institutional core managers as possible. In Exhibit 1 we show the distribution of historical returns for the U.S. core peer group over the last 10 years. Even over the longest time interval (10 years), the average annualized return difference between the 5th and 95th percentile manager is substantial at 2.42%. In economic terms, that return differential has an impact on investors of **$24.2 million** a year for every **$1 billion** in assets. Even the difference between the median core manager and one that performs in the top quartile is significant at 0.65% on average, or **$6.5 million** each year by the same measure (Exhibit 2).

Comparatively, every 1 basis point (0.01%) in savings for the same $1 billion in assets costs **$100,000** less a year. That's a prudent input for an investor to analyze but can pale in comparison to the costs of a manager who doesn't produce competitive returns.

EXHIBIT 1: U.S. CORE FIXED INCOME DISTRIBUTION OF RETURNS

Source: Investment Metrics, LLC IM US Broad Market Core Fixed Income (SA+CF) which includes 122 firms and 161 products. Data as of 12/31/2018 and returns greater than 1 year are annualized.

EXHIBIT 2: U.S. CORE FIXED INCOME DISTRIBUTION OF RETURNS – INVESTOR IMPACT

Name	1 Year	3 Years	5 Years	7 Years	10 Years
Bloomberg Barclays US Agg	**0.01**	**2.06**	**2.52**	**2.10**	**3.48**
US Core Median	**0.07**	**2.48**	**2.87**	**2.62**	**4.37**
5th Percentile	1.28	3.46	3.74	3.72	5.82
25th Percentile	0.39	2.80	3.17	2.95	5.02
50th Percentile	0.07	2.48	2.87	2.62	4.37
75th Percentile	-0.10	2.15	2.63	2.29	3.91
95th Percentile	-0.50	1.87	2.39	2.07	3.40
Returns Difference (Median-25th Percentile)	0.32	0.32	0.30	0.33	0.65
Investor Impact ($1B assets)	$3,200,000	$3,200,000	$3,000,000	$3,300,000	$6,500,000
Returns Difference (5th-95th Percentile)	1.78	1.59	1.35	1.65	2.42
Investor Impact ($1B assets)	$17,800,000	$15,900,000	$13,500,000	$16,500,000	$24,200,000
Fees (1 basis point)					0.01
Investor Impact ($1B assets)					$100,000

*Source: Investment Metrics, LLC IM US Broad Market Core Fixed Income (SA+CF) which includes 122 firms and 161 products. Data as of 12/31/2018 and returns greater than 1 year are annualized. *Investor Impact – Returns is the difference in annualized returns between Core managers in the 5th and 95t percentile for $1B in assets Fees are the cost of every 1 basis point for $1B.*

Exploring the Differences

So if performance does in fact affect returns for investors, what is driving the differences in a low interest environment? When you dissect the core universe by asset size, there is a consistent pattern of excess returns relative the benchmark as measured by Alpha. Exhibit 3 shows a heat map of the average Alpha generated by core managers within each asset category. The colors move gradually from dark green representing the highest (therefore best) Alpha to dark red representing the lowest. Noticeably, the mid-size managers with core assets ranging from $1 billion to $50 billion exhibited consistently superior performance over all periods longer than one year, while both the largest and smallest managers were consistently the worst performers over longer periods of time.

One way to analyze this underperformance is to explore the average sector allocation along the same size segments we examined above. In Exhibit 4, the table highlights that larger managers had hefty allocations to liquidity sectors such as U.S. Treasury and Agencies and the lowest allocation to credit-related sectors that traditionally offer more yield. Green indicates the highest average allocation in the peer group while red indicates the lowest. We can see that the $50 billion and over category had the lowest allocation to credit sectors and the most benchmark-like sector allocations overall. This helps explain why the largest managers appear to have the most difficulty delivering excess returns, as their positioning closely aligns them with the benchmark itself. For smaller managers who underperformed, sector allocation alone does not offer a clear explanation. A likely consideration is that they lack the resources or scale to allow full access to bond dealer offerings.

EXHIBIT 3: ALPHA

Core Assets	1 Year	3 Years	5 Years	7 Years	10 Years
Under $1B	0.28	0.53	0.34	0.39	0.62
$1-5B	0.28	0.68	0.61	0.79	1.19
$5-10B	0.43	0.65	0.52	0.77	1.17
$10-25B	0.19	0.30	0.32	0.50	1.12
$25-50B	-0.09	0.43	0.37	0.55	0.93
Over $50B	0.67	0.34	0.28	0.34	0.73

Source: Investment Metrics U.S. Broad Market Core Fixed Income Separate Accounts and Common Funds Universe. Average Annual Data as of 12/31/2018. U.S. Core Managers benchmarked to the Bloomberg Barclays Aggregate Index. Excludes those with 2% or more in Emerging Markets, High Yield, or Bank Loans, Non-Dollar. Alpha is the measure of the difference between the portfolio's actual return versus its expected performance given its level of risk as measured by beta. It is a measure of the portfolio's performance not explained by the movements of the market.

EXHIBIT 4: INVESTMENT GRADE SECTOR ALLOCATION

Core Assets	Liquidity Sectors		Credit Sectors		
	Treasury / Agency	MBS	US Corporates	ABS	CMBS
Under $1B	25.96	21.46	27.04	3.38	1.68
$1-5B	23.10	23.73	34.73	5.03	3.83
$5-10B	35.57	22.29	37.00	2.86	4.14
$10-25B	27.00	29.67	28.33	5.00	4.00
$25-50B	25.50	31.90	29.00	4.80	7.10
Over $50B	36.67	28.67	24.00	3.33	2.00
Bloomberg Barclays US Aggregate	**44.97**	**28.21**	**24.31**	**0.52**	**1.95**

Source: Average Sector Allocation per Core Strategy Assets. Investment Metrics U.S. Broad Market Core Fixed Income (SA+CF) Universe, Bloomberg Barclays data as of 12/31/2018. Core Managers benchmarked to the Bloomberg Barclays Aggregate Index. Excludes those with 2% or more in Emerging Markets, High Yield, Bank Loans, Non-Dollar.

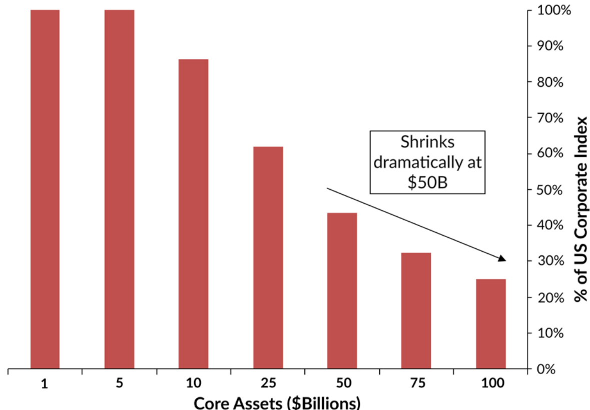
Identification vs. Execution

It stands to reason that the largest managers have more difficulty allocating to credit sectors simply because these sectors make up a much smaller portion of the investment grade universe. Even if you successfully allocate to these sectors, it is even more challenging to accumulate an overweight position in a particular bond that offers good value. To illustrate this point, Exhibit 5 shows the percentage of the U.S. Investment Grade issuers that are large enough for a manager to accumulate a 0.5% position. We highlight 0.5% because it represents the largest corporate holding in the Index. So, by default, a 0.5% represents an overweight position relative to the benchmark for any other holding. In other words, if a manager buys a 0.5% position in a bond and it performs well, your portfolio outperforms the benchmark because you own a larger position.

As you can see in the chart below, the corporate issuers that a manager can overweight shrinks dramatically for managers with assets above $50 billion. Less than half the index is eligible at $50 billion, and only 25% of issuers are large enough at $100 billion. This indicates that implementing trade ideas

becomes increasingly difficult for strategies above $50 billion given the limited supply of corporate issuers that are large enough to buy a meaningful position. These managers have the ability to purchase the issues of course, but it is much more difficult to accumulate more than the benchmark's position size, making it challenging to outperform.

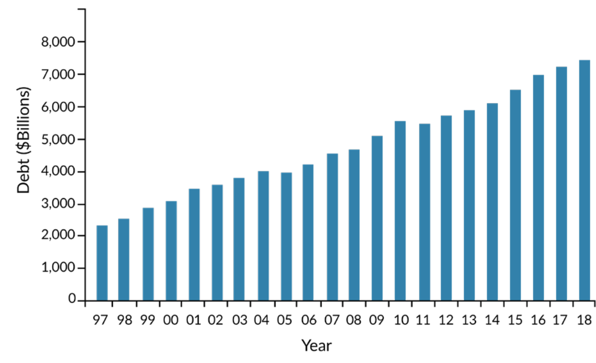
EXHIBIT 5: PERCENT OF CORPORATE MARKET THAT MANAGERS CAN OVERWEIGHT (0.5% POSITION)



*Source: U.S. Corporate Market is Bloomberg Barclays U.S. Corporate Index U.S. Issuers as of 2/28/2019. *As of 2/28/2019, JPM is the largest U.S. Corporate issuer, representing 0.5% of the Bloomberg Barclays U.S, Aggregate Index. Assumes the manager is capped at owning 10% of all of the issuers index eligible debt.*

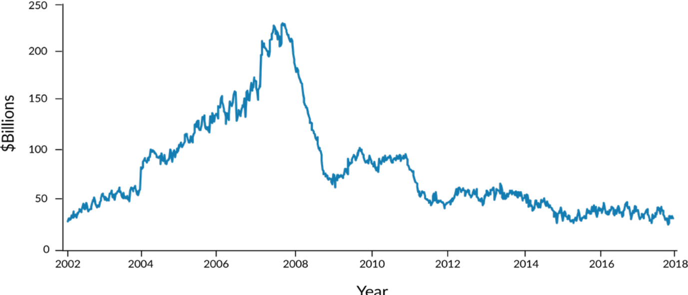
While this example addresses issues related to purchasing bonds, it also pertains to the potential difficulties these same firms encounter when trying to sell large positions whenever credit or valuation concerns arise. The ability to trade large bond positions has declined significantly as bond dealer corporate inventories continue to fall as a regulatory consequence of the financial crisis. At the same time, investment grade debt outstanding has ballooned to all time highs. Put together, because dealers have less capital to make markets buying and selling bonds from their customers, trading volumes in larger sizes have contracted. For example, only 13% of the trades that occurred for the 10 largest bonds in the index were $5 million or greater over recent periods. To put that in perspective, $5 million represents a 0.50% position for a $1 billion portfolio.

EXHIBIT 6: INVESTMENT GRADE DEBT OUTSTANDING



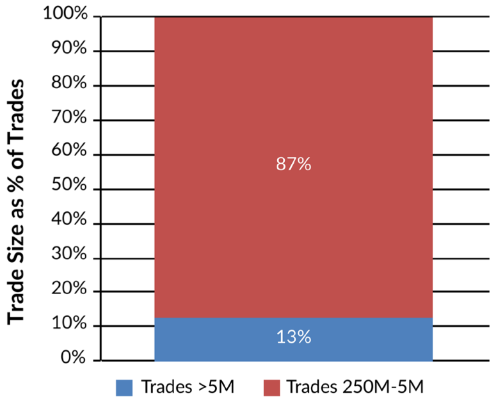
Source: Morgan Stanley, SIFMA, S&P LCD. Data as of 4/1/2019.

EXHIBIT 7: CORPORATE DEALER INVENTORIES



Source: Morgan Stanley Research, Bloomberg, Federal Reserve Bank of New York. Data as of 4/1/2019.

EXHIBIT 8: PERCENT OF CORPORATE TRADES BASED ON SIZE



Source: Bloomberg TRACE data as of 3/14/19. Fixed Coupon IG trades previous 50 days trades as a % of all trades sized 250,000 par and above.

Conclusion

This analysis has focused on the corporate universe because it is the largest credit related sector. A similar evaluation of the ABS and CMBS sectors would show even less flexibility given the smaller size of these markets. The industry can sometimes assume that larger managers provide superior returns given their size and market influence. However, this analysis demonstrates that size can actually limit the ability to implement relative value views across investment grade sectors or individual credits. Scale and trading limitations can result in portfolios with heavy allocations to Treasury and Agency related securities that are not desirable for income-oriented insurance investors.

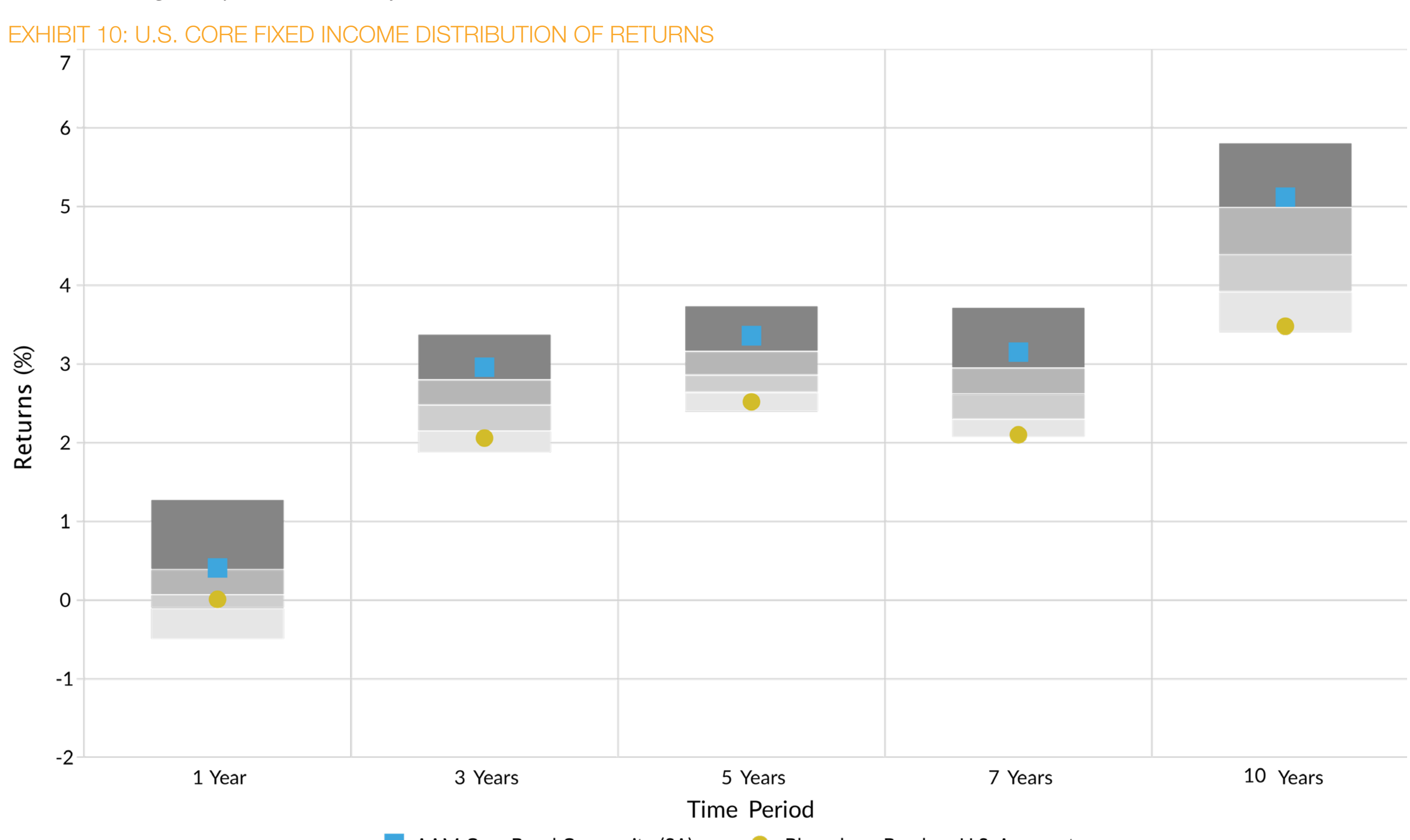
With this analysis, we have shown the connection between the size of a manager's assets and their portfolio characteristics, which ultimately is reflected in their investment performance. Managers need scale and resources to successfully navigate the market, but being too large can limit execution of investment ideas.

EXHIBIT 9: ANNUALIZED RETURNS

Name	1 Year	3 Years	5 Years	7 Years	10 Years
AAM Core	**0.41**	**2.96**	**3.36**	**3.15**	**5.12**
Bloomberg Barclays US Agg	0.01	2.06	2.52	2.10	3.48
+/- Bloomberg Barclays US Agg	**0.40**	**0.90**	**0.84**	**1.05**	**1.64**
US Core Median	0.07	2.48	2.87	2.62	4.37
AAM Core - Percentile Rank	**22**	**13**	**11**	**14**	**22**
Bloomberg Barclays US Agg Percentile Rank	63	85	85	95	92

Source: Bloomberg Barclays, AAM. Data as of 12/31/2018.

EXHIBIT 10: U.S. CORE FIXED INCOME DISTRIBUTION OF RETURNS



Source: Investment Metrics, LLC. All rights reserved. Data as of 12/31/2018. AAM Core Bond Composite includes nine portfolios and $2,377 million in AUM. Peer group based on IM U.S Broad Market Core Fixed Income (SA + CF), which includes 124 firms and 160 products.

CONSIDERATIONS FOR A TELECOMMUTING WORKFORCE

Timothy B. Wilson, Safety and Risk Service Regional Manager, Missouri Employers Mutual

Telecommuting (aka working from home, working remotely e-commuting) is not a new concept and has always presented challenges as well as benefits. This option has largely been reserved for jobs that obviously benefited from the telecommuting model, such as field-oriented positions and/or employees with no access to local offices. Classic examples in the workers' compensation industry include loss control, sales, and premium audit. In recent years, there has been a growing trend to allow additional departments to offer employees the opportunity to split their time between traditional offices and a home office. Despite this, most non-field-oriented work still takes place in an office building. That last statement was true until a few months ago, when COVID-19 forced many insurers to transition office employees to home offices overnight and, in doing so, reevaluate how work is accomplished. The result has been a grand experiment, forcing some questions to be answered:

How do you manage telecommuting employees?

Those departments that have been working under this model for years have an advantage in this regard and should be considered Subject Matter Experts. Common management tactics and strategies used to facilitate remote worker success include, but are not limited to:

- Requiring shared calendars to be used for time management, planning work, and reminders as well as maintaining transparency for others to understand the employee's day, week, or month. The primary disadvantage in managing a remote worker is not being able to "manage by walking around." Maintaining an accurate Outlook calendar allows the manager to virtually view the employee's cubical/office behaviors.
- A sophisticated productivity model that strikes a balance between quantity and quality of work products. Without the pressure of a productivity goal, the pace at which work is completed tends to decrease with time.
    - During a lockdown, augmenting productivity goals may be warranted to reflect the limitations and expectations.
- Developing and clearly communicating performance goals that drive employees to focus on value-added activities.
- Continued, frequent performance discussions that focus on employee performance.
- Use of virtual meeting platforms for regular group and one-on-one meetings. Virtual platforms such as Webex, Skype, and Zoom also provide excellent methods for training (planned and impromptu).
- Building a collection of how-to instructional videos focusing on common tasks that employees can access on an as-needed basis. This strategy can be a valuable time saver for the manager that finds themselves providing the same training repeatedly. Example topics: submitting mileage and expense reports, generating loss runs, and experience rating analysis reports.

How do we keep a telecommuting workforce connected?

The most common objection to maintaining a telecommuting workforce is the anticipated lack of connectivity and bonding between staff members. Never has the workplace been better equipped to minimize the significance of this barrier. With the proliferation and quality of virtual platforms, a blossoming paradigm shift of management acceptance of telecommuting, and the growing social familiarity of digital relationships, this objection is increasingly marginalized. Companies across the country are using various tactics and strategies to facilitate connectedness and maintain cultural stability that are tailored for the telecommuting workforce. Examples include:

- Provide training for and access to virtual meeting platforms that allow video. Being able to see your co-worker provides a deeper connection that is difficult to achieve via phone, email, or chat.
- Conduct regular virtual "happy hour" meetups. Most virtual meeting platforms have phone apps that allow the user to move around, thus allowing the user to share a view into their homelife beyond the computer desk. Keeping happy hours lighthearted with games and activities helps to spur conversation and create happy memories.
- Facilitate interdepartmental activities, such as inviting others to meetings and happy hours as well as inviting Subject Matter Experts to participate in special projects.
- Encourage participation in wellness program group activities, competitions, and campaigns.
- Encouraging former "walking buddies" to check in and motivate each other virtually.

- Take time in virtual meetings to connect on a personal level prior to getting down to the business at hand.

How do we keep a telecommuting workforce safe?

When the workforce transitions to telecommuting, the hazards at hand may seem superfluous but are far from it. Ignoring them can result in employee injuries and diminished morale. Ensuring ergonomically correct office setups, minimizing exposure to slips/trips/falls, and managing material handling hazards are expected. New to the equation are the ever-evolving best practices associated with minimizing COVID-19 risk. Tactics, strategies, and hazards to consider include but are not limited to:

COVID-19

- Restrict access to buildings
  - Social distancing
  - Staggered scheduling
  - Sanitation (personal and facility)
  - Shut down common areas (e.g., drink dispensers, kitchen)
  - Restrict physical interactions and leverage virtual opportunities
  - Implement contact tracing protocols to document employee and visitor activities in offices
- Develop, communicate, and enforce reporting requirements regarding travel, attending gatherings, possible exposures to COVID-19. This is not limited to work-related exposures.
- Establish self-quarantine guidelines.
- Provide Personal Protective Equipment (PPE).
- Regular communication regarding company policies.

Slips/trips/falls and material handling

Training on the following topics can help to minimize the frequency of slip/trip/fall-related injuries.

- Housekeeping
- Home office cord management
- Distractions while walking (i.e., cell phones)
- Stair safety
  - Proper lifting and negotiating stairs while carrying boxes and equipment

Home office ergonomics

In general, when a workforce transitions to a telecommuting model, much planning, preparation and setup is involved. This is not the case in 2020, where thousands of office workers made the move seemingly overnight. In this process, many staff went from finely tuned and ergonomically correct offices to the kitchen table or worse. To address ergonomic hazards, many companies have employed the following:

- Virtual ergonomic assessments – Unlike the cloned cubical, every home is different and offers a unique puzzle to be solved to minimize ergonomic stresses.
- Offering ergonomic equipment – This strategy helps to not only minimize the probability of ergonomic injuries but also bolsters the employee's morale.
- Training on topics such as:
  - Basics of office ergonomics
  - Unique issues found in home office ergonomics
  - Early warning signs of ergonomic injuries
  - Encouraging staff to seek assistance sooner rather than later
  - Work/Rest Rule of Thumb – the greater the ergonomic stresses, the more frequent the breaks needed

How do we resume office and field work safely?

The question on the minds of employers across the country is how to safely transition back to some semblance of normalcy. For most AASCIF members, this includes both the return to office and field work. It is incumbent on each fund to develop, train, implement, and enforce policies to manage the COVID-19 risk relative to populations, including employees and their families, policyholders, agencies, and vendors.

The need to resume office work is ubiquitous. Consequently, guidance and best practices already published are abundant and do not need to be restated here. Conversely, there are fewer field staff relative to office staff, the result of which is far less solidified best practices for the safe return to field work. Field employees are unique in their COVID-19 exposure and the risk they present not only to themselves but the policyholders and their families. In the attempt to resume field work while minimizing risk, the following strategies are being utilized to varying degrees by AASCIF members:

- Developing corporate and department specific policies and procedures that reflect the unique nature of work.
- Continuing virtual service activities for work that can be accomplished virtually.
- Defining business-critical activities. This should clearly define the nature of activities that cannot be accomplished virtually and are integral for the management of risk, maintaining of relationships, acquisition of new business, and/or retention of existing business.
- Restricting onsite visits for industries with high risk of COVID-19, such as healthcare providers and emergency responders.
- Requiring daily self-health inspections of field staff prior to leaving the house.
- Monitoring of regional infection and/or hospitalization rates and setting thresholds that trigger a loosening or restricting of protocols.
- Providing and requiring usage of applicable PPE as well as sanitary supplies.
- Implementing vehicle sanitation equipment and requirements.
- Emphasizing the importance of social distancing, not only onsite but at all stops in between.
- Consulting with policyholders on developing infection control protocols prior to onsite visits.
- Developing data collection procedures needed for after-the-fact contact tracing.
- Implementing a rotating schedule for field staff—one week of field work followed by two weeks of quarantine and virtual only work.
- Limiting joint visits.
- Limiting overnight work/hotel stays.

The pandemic of 2020 has forced our industry to adapt in short order. In so doing, it has demonstrated the resilience of our organizations and the character of our people. Through this process, challenges have been presented and not only overcome, but they have been used to drive continued improvement. While normalcy will return, it will not be the same as before. We are forever changed. Whether this change is for the better or not is largely up to us. Will we learn and be better prepared for the next pandemic? Will we evolve our business models and be more efficient with time and resources? Time will tell.

SUSTAINING HEALTHY INTERNAL CONTROLS DURING THE COVID-19 CRISIS

Danielle Kopf, Beacon Mutual

COVID-19 triggered the activation of business continuity, disaster recovery, and crisis management plans all around the world. For years, many businesses have identified business continuity, disaster recovery, and crisis management as significant business risks. These risks can be described as a variety of disruptive events, including those related to weather, power loss, illness, or cyber threat, potentially rendering a business's building, systems, or people partially or fully unavailable for a period of time. Such events could require a full or partial implementation of these plans in order to maintain core business operations.

As with all known business risks, risk mitigation actions need to be identified and implemented. For the risks of business continuity, disaster recovery, and crisis management, risk mitigation actions include regular plan updates and testing, among others. It takes strong diligence to ensure consistent updating and live testing of these plans on a regularly scheduled basis. Oftentimes, plan testing succumbs to competing business priorities and limited resources; however, the entities that perform these regular updates and tests of their plans were likely in a better position once their plans were activated due to the pandemic.

Once businesses activated their response plans and sent their employees home to work remotely, it quickly became apparent which processes would and would not work remotely. During this time of rapid change, it could have been easy to forego the internal controls in place; however, there can be severe consequences in doing this. These internal controls are in place to protect the assets of the company and the integrity of the business's reputation, and to support the continued operations of the organization. Simply foregoing controls will have dire consequences. Let me repeat that, simply foregoing controls will have dire consequences. Instead, businesses need to make adjustments to their internal controls to reflect and react to changing business processes and availability of personnel.

Additionally, by rapidly changing operations from in house to all or most employees working remotely, the threat actors (the bad people) are waiting to exploit vulnerabilities. Maintaining healthy and strong information system controls while working remotely, including controls around the protection of sensitive or private information, is imperative. Because the protection of sensitive data is a significant risk to any business, internal controls built around the process cannot be relaxed during the crisis response period. Threat actors are hungry and working hard to exploit any shortcuts. Don't feed them. Maintain your controls, and add additional controls to changed processes where appropriate.

This pandemic has created new automation everywhere. Operational procedures have been changed, automated, and made more efficient. Processes that used to include paper routing and wet signatures are no longer viable. At Beacon, as with most companies, we have been forced to develop new automated processes for items such as contract approvals, processing of accounts payable invoices, and employee reimbursements. As these processes have been automated, it has been vitally important to ensure that the controls around the process (audit trail of approvals) have been maintained or updated to reflect the new environment. This is something that we have discussed doing in the past but are now compelled to make these changes. And, guess what? We are better, stronger, and more efficient for it now. This new process will stay in place once "normal" operations resume—whatever the new normal looks like.

As we embark on restarting the economy, it is unlikely that we will resume operations exactly as we previously knew them, and the return to office operations will be different for everyone. Companies will benefit from maintaining their streamlined, automated means of transacting business, and management should be mindful of additional changes to processes, or even reverting to the pre-pandemic processes, once office operations resume, and ensure the internal controls remain appropriate.

Also, just as it was important to have a business continuity, disaster recovery, and a crisis management plan in place before the pandemic, it is just as important to have a plan to resume operations for the health and safety of employees, customers, and anyone else that visits your workplace. For us at Beacon, the diligence and focus on updating and testing of our plans before the pandemic provided for successful plan activation and positive remote work operations, allowing us to be in a position to be conservative and methodical in our approach to returning to office operations.

EMERGING CHALLENGES: EMPLOYEE MENTAL HEALTH AND WELL-BEING THROUGH COVID-19 AND BEYOND

Cindy Mohler, New Mexico Mutual and Lindsey Deason, Louisiana Worker's Compensation Corporation

> *"Without mental health, there can be no true physical health."*
>
> *—Dr. Brock Chisholm, the first director-general of the World Health Organization*

Uncertainty, social isolation, and fear of the virus itself have combined to cause a significant blow to the health and well-being of employees around the globe. The rapid onset of the pandemic provided little, if any, time to prepare for or process all that has and will continue to occur in terms of disrupting everyday life and relationships, both in the workplace and at home. While leaders are appropriately focused on the business continuity effects of COVID-19 and reforecasting efforts, it is also important to keep an eye on another increasingly important emerging challenge: employees' mental health and well-being.

The Shock to Mental Health

Based a survey conducted by Qualtrics, mental health is suffering across all levels of the organization, with 44.4 percent of respondents who are now working from home saying their mental health has declined. Of those:

- 44.0 percent of *individual contributors* report decreased mental health
- 40.5 percent of *C-level employees* report decreased mental health
- 40.1 percent of *managers* report decreased mental health

Additionally, a new study conducted by Prudential reports that 55% of those currently working from home reported feeling less connected to their company.

While much attention has been paid to the immediate physical response to the pandemic through our focus on social distancing, mask wearing, and the large-scale move to remote work, psychologists warn that the long-term impacts to mental health are an equally important issue. If addressed proactively, both employers and employees stand to gain in terms of monetary costs through savings in healthcare spending and the

talent outcomes that come along with having an engaged and productive workforce.

Wellness Disrupted

As patrons of the insurance industry, disruption is not a new concept to us. Applying some of the same frameworks and innovative approaches we are using to respond to disruption in insurance can help to ensure our employee wellness programs don't also fall victim to the "doing it the way we have always done it" mentality in the face of changing demands. Historically, many wellness programs have offered monetary incentives for reaching certain health benchmarks or provided discounted and/or onsite gym memberships to help break down barriers and motivate employees to focus on their physical health. Additionally, employee assistance programs have heavily relied on in-person meetings. In an era of social distancing, with an increased focus on mental health, are these offerings relevant to the needs of a distributed workforce in a way that provides value and maximizes the dollars spent on employee wellness? Organizations can take a "keep, stop, start" approach to innovating their wellness programs to determine what they should keep doing, what they should stop doing, and what they should start doing in order to deliver wellness services in a way that can have a meaningful and relevant impact.

Innovating Delivery of Services

Telehealth. Healthcare systems and group health insurers have ramped up their telehealth offerings—including behavioral telehealth offerings—in an effort to break down barriers to healthcare access. Reach out to your group health insurer, local healthcare systems, or Employee Assistance Program provider to explore what opportunities exist to provide telehealth services to your employees.

Create awareness through internal communication. According to this Qualtrics survey, "those who say their company has proactively shared mental health resources are 61% more likely to feel their company is communicating to them the information they need to look out for their own wellbeing." Use internal communication channels to educate and bring awareness to wellness resources available to employees through employer-supported and community health initiatives that may be available to them at little to no cost.

Virtual fitness. Several Netflix-style, app-based businesses exist to connect people to a library of trainer-led fitness and wellness sessions that can be done at home or in a gym, usually with minimal equipment. If opportunity exists in the wellness budget after completing the "keep, stop, start" exercise, consider investing in an enterprise solution for one of these app-based platforms.

Incorporate wellness into team meetings. Innovating on wellness does not have to mean forging new partnerships or engaging with new technology. Make a point to integrate movement breaks into existing structures, such as regularly scheduled team or departmentwide meetings. Encourage teams to incorporate 5¬–10 minutes of stretching into the beginning of daily or weekly meetings. Dub your next teleconference a "walking meeting." Set up a recurring peer-to-peer led meeting for the sole purpose of having a 10–15 minute mindfulness or movement break. You don't have to be a fitness expert to lead a movement break. YouTube has a plethora of quick stretching and mindfulness videos that employees can follow along with for the purposes of these breaks. The dual benefit of a meeting that is set up strictly for wellness and connection is that it allows employees to interact in a "water cooler" type manner that we miss out on while working in a distributed workforce model.

Connect on purpose. Appreciation is vital during challenging times, not just because it helps people feel like their work matters but because it helps connect people to one another. Encourage your team members to recognize each other for helping someone out. Send a thank you note for extra effort you've witnessed. Share stories of contributions. Celebrate service anniversaries virtually. Social distancing doesn't have to mean disconnected. By intentionally helping your employees feel connected to a purpose, accomplishments, and each other, you can help them thrive during these potentially lonely times.

Opportunity That Lies Ahead

While we cannot predict how long and to what extent social distancing and remote work will have effects on the mental and physical well-being of the workforce, we can surmise that it will be significant and that employer support of these needs will not look the same. There is a window of opportunity for organizations to proactively focus on and innovate wellness offerings to help mitigate the potential impacts of the mental health crisis that lies ahead. Organizational support for the mental and physical well-being of its employees will prove to be a notable factor and strategic advantage in organizations' longer term recovery from this pandemic.

HOW COMPSOURCE MUTUAL HAS INTEGRATED THE CYBERSECURITY AND ENTERPRISE RISK MANAGEMENT PROCESSES TOGETHER

Clarence Washington Jr., CompSource Mutual

CompSource Mutual's (CSM's) ERM Framework provides a holistic view of the risk management system and associated strategies, processes, tools, and risk owners. The ERM Framework encompasses risk identification and reporting, risk appetite and tolerances, stress testing and non-modeled risks, risk management and controls, and governance across four layers: Core-Strategy, Process, Infrastructure, and Culture. Layers and components are depicted in the diagram below.

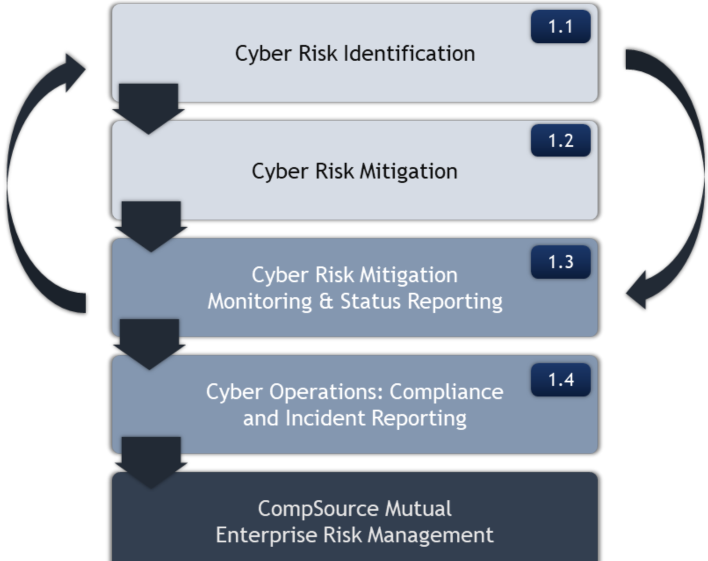
The ERM framework provides the conceptual foundation for aligning risk with strategy at all levels of CompSource Mutual and assists the board of directors and executive management of the company in appropriately leveraging the strategic advantages of risk-taking. The ERM Framework also encompasses the COSO ERM components of internal environment, objective-setting, event identification, risk assessment, risk response, control activities, information and communication, and monitoring.

Digital security/cyber risk is a prominent component of risk management and is appropriately considered within the Enterprise Wide Key Risks document and Risk Limit Summary report, which are updated quarterly by the ERM Committee and provided to the Board of Directors Audit Committee.

Cyber risk is also appropriately considered within the IT internal audit risk assessment and audit plan. In fact, due to the potential impact of lost data or inaccessibility of data and applications to business operations, Information Technology/ Cybersecurity is identified as a top 5 risk in CSM's Enterprise Risk Management matrix.

Cybersecurity Process Alignment and Integration Into the ERM

CSM has implemented a multi-phase approach to the identification, mitigation, and reporting processes of cybersecurity risk as part of the ERM Framework. CSM's Internal IT Department, Internal Audit, and third-party external auditors all play critical roles in the processes that feed into the ERM. Steps one through three of the Cybersecurity Risk Identification & Mitigation processes are iterative, in that every year, the Cyber Risk Identification component of the process begins anew.



Cyber Risk Identification

Cyber risk is identified through a process of annual cybersecurity audits. First, a cybersecurity "Audit Universe" is established and agreed upon by IT Operations, Internal Audit, and the third-party audit firm. Then, cybersecurity audits are conducted by external firms in alignment with the pre-established audit universe and based on a comprehensive risk assessment performed at the beginning of each year.

Both the audit universe and the audit plan for the year are communicated to the ERM Committee for feedback. Each year, audits are then planned, scheduled, and executed. Audits focus on the following cyber risk areas:

- Security General Controls (Assessment Against Cybersecurity Best Practices). These audits are performed by third-party audit firms.
- Assessment of Current Security Posture (Access Control Audits, External and Internal Penetration Testing). Access control audits are performed by Internal Audit, while network penetration testing is performed by an additional third-party firm that is not familiar with the current security control being employed at CSM.
- Security Governance, Security Operations, and Incident Response. These audits are performed by a combination of Internal Audit, third-party auditors, and CSM IT Operations, where appropriate.

The results of every audit and the audit mitigation response plan are communicated to the CSM ERM Committee and to the board of directors. Additionally, audit findings that are disputed, or are found to have other sufficient mitigating controls that would act to lessen the risk articulated in the audit finding, are also communicated to the ERM Committee and the board of directors.

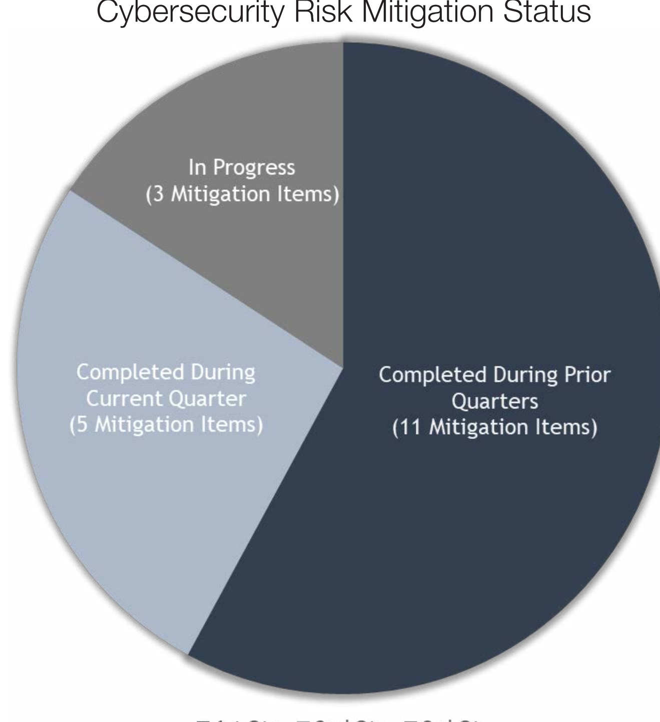
Cyber Risk Mitigation

Based on the risk identified in the Cyber Risk Identification process, risk mitigation plans are formulated and communicated to Internal Audit. Those plans are summarized for presentation to the ERM but are also budgeted for and integrated into the yearly IT Operations execution plan. Within the plan, they are given a special tag identifying the entry as a "Cyber Risk Mitigation/ERM" item, which gives those items higher priority. Cybersecurity items are given a higher priority explicitly due to the conservative "risk appetite" of the company. As previously stated, cybersecurity has been identified as a top 5 business risk on the CSM ERM Risk Matrix.

Cyber Risk Mitigation Monitoring and Status Reporting

On a quarterly basis, CSM's Internal Audit department provides a high-level status report of the cybersecurity risk mitigation efforts to the ERM Committee, the CEO, and the Board of Directors Audit Committee. The high-level communication by Internal Audit and the associated report looks similar to the following:

"Internal Audit has confirmed that corrective action has been completed for 16 recommendations based on additional information that was provided by the director of IT operations."



Cyber Operations: Compliance and Incident Reporting

Cyber Operations Compliance & Incident Reporting is provided to the ERM committee and the board of directors on a quarterly basis. These reports are generated by data collected and correlated by the CSM Security Event and Incident Management platform, the CSM email security platform, and correlated firewall logs. The ERM Committee and board of directors are provided a summarized, high-level review of the security exploits defended against as well as any successful exploits, if any. The allows the ERM to adjust the risk ranking and risk probability as appropriate.

Assessment: The Importance of ERM/Cybersecurity Process Integration

The cybersecurity auditing and reporting provides the ERM Committee and the board of directors with a comprehensive view into the CSM cybersecurity posture and readiness. Additionally, it provides them with the information needed to make appropriate decisions around the acceptance of cyber risks in alignment with the corporate risk appetite. It is important to note that in accordance with company priorities and risk appetite, a higher risk probability ranking for cybersecurity may then trigger risk mitigation activities, including additional spend, whether in the form of capital or operating expense.

For CSM, the integration of the cybersecurity processes into the ERM Framework is critical to unimpeded business operations.

AROUND AASCIF

COLORADO

Best Places to Work

For the fourth consecutive year, Pinnacol has been named a Top Workplaces by the *Denver Post*. The honor is based on employee feedback gathered through a third-party anonymous survey that measures 15 drivers of engaged cultures, including alignment, execution, and connection, that are critical to the success of any organization. Pinnacol also received high marks for seeing where employees fit in Pinnacol's business strategy and for supporting employees' continuous learning and career development.

"Pinnacol has a people-first culture, and caring for people is at the center of what we do and who we are," said Barbara Brannen, Pinnacol's vice president of human resources. "It shows in our customers' interactions with us and in our interactions with each other and in our culture."

Pinnacol's First Apprentice Cohort Completes the Three-Year Program

In May, Pinnacol celebrated the graduation of the first cohort of apprentices in the three-year apprenticeship program, which included 300 hours of classroom training and more than 2,500 hours of on-the-job training in professional skills and workers' compensation. This cohort—recognized for excellence by CareerWise, the state of Colorado, the Colorado Department of Education, and the Colorado governor's office—is the largest in Colorado. While completing high school and earning college credits, they've also earned certifications in Fundamentals of Insurance, Kapow robotics, IBM data science, and US Department of Labor-registered Apprenticeship General Insurance Associate certifications.

So far, Pinnacol has hired six former apprentices as full-time staff members, and three apprentices have been asked to stay beyond their apprenticeships.

Pinnacol has a people-first culture, and caring for people is at the center of what we do and who we are.

Top row: Elijah Peterson, Eric Miller, Riley Becker
Middle row: Monique Lane, Angela Mendoza-Rico, Brielynn Garza
Bottom row: Gabriel Valdivia-Amor, Isela Aguilar, Warren Stokes

PiA Volunteers Assist Following Days of Protests

In June, Pinnacol in Action (PiA), Pinnacol's employee volunteer organization, coordinated 29 volunteers to join thousands of others to support the Downtown Denver Partnership by cleaning up the city after days of protesting and vandalism. While following strict safety protocols, the group helped pick up trash and hand out water bottles to workers and other volunteers around Union Station.

Community Rallies to Support the Pinnacol Foundation During Coronavirus Shutdown

As COVID-19 began to spread throughout Colorado this spring, the Pinnacol Foundation made the decision to cancel the annual golf tournament, its primary fundraiser. Without the event, the foundation faced a shortfall of more than $180,000. Sponsors were asked to consider converting their sponsorships to donations rather than accepting a refund. The response was overwhelmingly positive, with Pinnacol vendors, agents, and other partners contributing $144,500.

"Our supporters believe in the foundation's mission of providing scholarships to the children of workers who were seriously injured or killed on the job," said Pinnacol Foundation Director Mara Wheeler. "Canceling the tournament was a dark moment for all of us who plan this event to support our scholars. Knowing our community had our back was the silver lining in all of this."

The foundation awarded $452,280 in scholarships to 95 students for the 2020¬–2021 academic year.

For more information about the Pinnacol Foundation, visit Pinnacolfoundation.org.

Pinnacol Plans Remote Work Environment Through 2020, Focuses on Culture and Safety

While Colorado enters a phase of cautious reopening and organizations throughout the nation make decisions about reentry, Pinnacol Assurance expects to serve customers remotely through the remainder of 2020.

To maintain company culture, Google chat was launched to create a virtual meeting space, and virtual happy hours and team-building games are hosted throughout the organization. Surprise mailings to employees have included Pinnacol-branded face coverings, a sweet treat, and wipes for electronic devices. Leaders were provided with a remote leadership tool kit with dozens of tips and resources, and virtual presentations of "the Link" keep employees informed about critical issues, including recent topics such as COVID-19 impacts and financial forecasts. Pinnacol President and CEO Phil Kalin shares weekly video messages to help connect with colleagues.

To maintain a productive and safe workspace while working remotely, team members can schedule appointments to pick up equipment and retrieve personal belongings.

Some field visits and face-to-face interactions are allowed if deemed essential to business, as long as safety protocols are followed by both team members and those at any location or stakeholder they visit. However, most of the work will be completed remotely.

HAWAI'I

HEMIC Provides $2 Million COVID-19 Premium Relief Program for Policyholders

HEMIC announced a new financial relief program to help Hawai`i businesses as they begin the road to recovery. HEMIC's COVID-19 Workers' Compensation Premium Relief Program will provide $2 million dollars in financial relief to HEMIC policyholders in the form of a premium credit. All HEMIC policyholders automatically qualify for this program: No application is required, and no action is necessary on their part. The premium relief distribution will be credited to policyholders' accounts by the end of July.

"As a mutual insurance company, HEMIC's dedication to our policyholders' success is in our DNA," said Marty Welch, chief executive officer of HEMIC. "From the first days of the COVID-19 impact on our islands, HEMIC has been committed to addressing the evolving needs of our policyholders during this challenging time."

"We hope this $2 million program will help provide immediate relief at a time when it is needed most, will help business owners recover, and in turn, will support Hawai`i's overall economic recovery."

In addition to providing financial relief, HEMIC's underwriting and servicing teams are assisting policyholders as we address issues such as returning employees to the workplace safely, validating employee job descriptions, and adjusting their business models.

HEMIC Updates TV Campaign Honoring Hawai`i's Workers

To keep our advertising campaign relevant to Hawai`i's current situation, HEMIC updated our TV commercial, "Unsung Heroes," which gave tribute to those working to keep Hawai`i safe during the era of COVID-19, to address the larger movement and desire to return to work. Our new spot, "Keep Going" appreciates the strength and resilience of Hawai`i's workers at a time when business and the economy has been severely impacted. We produced the updated commercial quickly and economically by leveraging footage from the original shoot.

HEMIC Offers a "Passport" App to Help Policyholders and Agencies Transition Workers Back Safely

To facilitate our employees' safe return to a healthy workplace, HEMIC has developed a web-based app called "Passport." The Passport app helps confirm that each worker is symptom-free prior to entering the workplace each day or shift. The app is simple, easy, and confidential:

- The employee opens the app before reporting to work and takes a short survey about COVID-19 symptoms.

- Their status is sent confidentially to a dedicated HR contact.
- If the employee is symptomatic, they are instructed not to report to work, to monitor their symptoms, and to follow up with a doctor.
- HR can then maintain regular communication with any symptomatic employee, confirming their next steps and planning for a healthy return.

Since the Passport app has worked well for HEMIC, we made it available to our policyholders and agencies as a useful tool.

HEMIC's Large Deductible Program

HEMIC's Large Deductible Program is now available for large employers who have the capacity to self-insure a portion of their workers' compensation while benefiting from HEMIC's expertise in claims, safety, and risk management. This program provides employers with greater control over their workers' compensation program and greater incentive for risk management and loss prevention, resulting in reduced workers' compensation costs over the long term. HEMIC offers a range of deductible options, from $15,000 up to $1 million per occurrence, in line with NCCI's Rating Values. Optional aggregate limits are also available.

KENTUCKY

Jeremy Terry Appointed to NCCI Underwriting Committee

Jeremy Terry, KEMI vice president of policyholder services, has been appointed to serve a three-year term on the Underwriting Committee for the National Council on Compensation Insurance (NCCI). The committee meets to discuss and provide feedback on key NCCI research topics affecting the workers' compensation industry. The committee includes 10 members, including representatives from companies such as AIG, Texas Mutual, Zurich, and others.

MARYLAND

Chesapeake Employers Insurance Holds First Election for Board of Directors

Chesapeake Employers' Insurance Company announces the election of Suzanne Carter Thompson and John J. Scott Jr. as board members of the organization, effective immediately. The results of the election were announced during the company's first-ever annual meeting on Thursday, June 24, 2020.

This is the first time in the company's 106-year-history that policyholders can elect board members. The change stems from Maryland legislation passed in 2013 that allowed for the conversion of IWIF, a quasi-state agency, to Chesapeake Employers' Insurance Company, a nonprofit, non-stock, private corporation.

Suzanne Carter Thompson was first appointed to Chesapeake Employers' board by Governor Larry Hogan in June 2015 for a five-year term ending in May 2020. Ms. Thompson has served as board chair since June 2019 and previously served as board secretary. She is a member of the board's Finance and Budget Committee as well as its Compensation Committee. Ms. Thompson was previously a member of the Audit Committee and chair of the HR Committee.

Ms. Thompson is currently the vice president/advisor at PSA Insurance & Financial Services and the president of HealthPlan Headquarters. Ms. Thompson has also held executive positions at Advanced Benefit Solutions Insurance and Heritage Financial Consultants, LLC.

John J. Scott Jr. is the president of Westminster American Insurance Company. Prior to his current position, Mr. Scott was vice president and general counsel. Mr. Scott serves on Westminster American's board of directors and is a member of the executive and investment committees. Mr. Scott is also a member of the board of directors for the Maryland Property & Casualty Insurance Guaranty Corporation, a position he has held since 2012, as well as the Calvert County Board of Elections. Mr. Scott received his bachelor's degree from George Washington University in 1993 and his J.D. from Western New England University School of Law in 1997.

Mr. Scott replaces board member V. Rocky Gonzalez. For a complete list of Chesapeake Employers' board of directors, please visit the Leadership page on the company's website.

MINNESOTA

SFM Rolls Out Online Portal for Injured Workers

Injured workers covered by SFM now have 24/7 digital access to their claim information through SFM's website.

Through a new self-service tool called SFM Claim Connection, workers with SFM claims can access claim details, review payments, download forms, and set up text alerts to be notified of payment activity.

"This is the latest development in our ongoing initiative to improve the claim experience for the workers we serve," said Steve Sandilla, SFM's senior vice president of strategic business operations. "We're striving to eliminate barriers for the employees we insure, and this tool gives them a valuable new way to access critical information about their claims."

Optimized for mobile devices

The system was designed with mobile users in mind, as we recognize that a growing percentage of users prefer to access this kind of information on their phones. Smartphone users can access all the same information that's available on the desktop version. The application even includes a mobile-friendly insurance ID card that workers can take with them to medical appointments.

Empowering workers with information

"Equipping injured workers with the right information at the right time makes their lives easier," Sandilla said. "We've always worked hard to empower our customers with reliable answers, and now we have a convenient new tool to help us deliver on that promise."

To learn more about how the SFM Claim Connection can make a difference for you your employees, visit the Injured Workers section of SFM's website.

Star Tribune Names SFM a Top Workplace for 2020

SFM ranked ninth among medium-sized employers in the *Star Tribune's* Top 150 Workplaces in Minnesota for 2020.

The *Star Tribune's* top workplaces were chosen based on anonymous surveys of employees that asked them to rank their employers in areas such as quality of leadership, cooperation between departments, meaningfulness of work, appreciation from co-workers, positivity of workplace, flexibility in scheduling, level of pay, and quality of benefits.

92 percent of SFM's 250+ employees participated in the survey. Key findings include:

- SFM employees describe SFM as a caring, ethical, collaborative, and supportive workplace.
- SFM employees rate their job satisfaction 77 percent higher compared to similar business insurance companies.
- 99 percent of employees feel well informed about important decisions at SFM compared to other business insurance companies.
- 93 percent of employees believe that there is good interdepartmental cooperation at SFM.
- SFM employees are engaged 9 percent higher than the industry benchmark.

"I truly feel that we are the work comp experts because of our wonderful employees," said Terry Miller, president and CEO. "Our employees are the heart and soul of SFM, and I believe they are the reason SFM is such a great place to work."

SFM is known for its caring culture. We do this by helping employers keep safe workplaces, helping injured workers get their lives back, and making sure we take great care of our own employees.

"It's wonderful to see that our employees feel good about working at SFM," said Jody Rogers, senior vice president, human resources. "It's always been our philosophy to take excellent care of our employees, and these survey results confirm that our efforts are being felt."

The *Star Tribune* Top Workplaces designation is awarded based on the results of a survey of employees conducted by Energage, a company that specializes in employee surveys and conducts more than 66,000 annually.

MONTANA

PPE Grants for Frontline Workers

Montana State Fund employees packed and shipped 506 boxes of PPE (personal protection equipment) to 453 frontline policyholders and their employees. This included 30,000 KN95 masks, 156,000 tri-fold masks, and 100 thermometers. The items were distributed through MSF's COVID-19 PPE grant program.

The grants were available to policyholders with the most vulnerable workers, including firefighters, EMTs, police, physician, dental and physical therapy offices, nursing homes, grocery and drug stores, social services organizations, and group homes.

"It's in our mission and vision to partner with Montana businesses and their workers to create a safe environment for them," said MSF president and CEO Laurence Hubbard. "This has never been more important than during this pandemic."

Qualifying policyholders completed an application with the stated number of PPE requested and the necessity of the items. There was no cost for the PPE. The response was overwhelming. Fortunately, MSF fulfilled the majority of the requests.

New Look and Feel: MSF Launches Website

Montana State Fund launched its redesigned public website, montanastatefund.com, on May 16, 2020. The original launch date was slated for March 21, 2020, but the pandemic hit, and plans were put on hold. But after realizing that staff was not returning to the office anytime soon, we created an internal plan to educate and familiarize our remote MSF employees about the new site.

Employees were given access to the development site, and we offered two Zoom Q&A open houses. In addition, we sent eblasts to our customers to inform them about the redesign and new features.

The redesign was a year and a half in the making. The site was designed from the ground up. The communications team collaborated with our ad agency on the look and feel and held several meetings with employees on content and site structure recommendations. We drastically trimmed down the amount of unnecessary information from the old site, allowing us to highlight highly accessed information. In the end, the redesigned site has an updated look and feel, user-friendly icons, and more intuitive navigation for our customers.

Qualifying policyholders completed an application with the stated number of PPE requested and the necessity of the items. There was no cost for the PPE. The response was overwhelming. Fortunately, MSF fulfilled the majority of the requests.

OREGON

SAIF Declares $100 Million Dividend

In June, SAIF declared a $100 million policyholder dividend.

“Oregon’s employers and their employees make dividends possible by working together to prevent workplace injuries and illnesses,” said Kerry Barnett, SAIF president and CEO. “Every business is being impacted by the COVID-19 pandemic, and SAIF is no different. We are seeing declines in our premiums, investment returns, and overall capital. However, after careful consideration, we felt a dividend was the right thing to do to support our policyholders through this challenge.”

The dividend will be based on premium for policies whose annual term ended in 2019 and will be distributed in October. This is the 11th year in a row that SAIF has been able to offer a dividend, and the 23rd dividend in the past 30 years.

SAIF/AGC Members Get $3.4 Million

The Associated General Contractors Oregon¬–Columbia Chapter (AGC) and SAIF announced a payout of more than $6.5 million for the 639 companies who participated in the AGC/SAIF group workers’ compensation program during 2018–2019. This includes a $3,360,142 retrospective return—representing a 9.98% return of paid premiums during the policy year—and adjustments from the Department of Consumer and Business Services (DCBS) assessment and non-disabling claim reimbursements.

Individual results and retro checks will be mailed directly from SAIF to policyholders in mid-August.

Helping Oregon Businesses Reopen

As many Oregon businesses reopened during the pandemic, SAIF knew they had questions about safety and HR practices. SAIF developed an intensive coronavirus safety page that includes a handout with six things employers should consider when reopening.

SAIF also worked with a local legal firm to offer two recorded webinars on reopening.

Don’t Forget Existing Hazards

With the current heightened focus on coronavirus protections, it’s easy to forget that every workplace has many other hazards that also should be identified and controlled.

As a reminder about these hazards, SAIF produced a safety campaign aimed at policyholders and their employees. “Don’t forget existing hazards” provides tips on how to identify, assess, and control potential hazards.

Responding to Racism

In response to the anti-racism protests in Oregon and across the nation, SAIF president and CEO Kerry Barnett submitted an op-ed to the *Oregonian*. The article was based on an email he sent to all employees and called for working together to combat systemic racism.

Offering webinars and virtual chats on a variety of topics important to you every week!