Product Definition –
Group Retro Program

Implementing Operational Reform Program
New Products Project
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Objective

The Ohio Bureau of Workers' Compensation (BWC) is engaged in an intensive reform effort to increase the stability, consistency, and competitiveness of workers' compensation insurance for Ohio's injured workers and employers. One aspect of this reform is to improve BWC's overall experience-rating methodology, create new performance-based incentive programs and strengthen Ohio's group-rating program.

Making meaningful improvements to Ohio's workers' compensation system requires the application of actuarially sound insurance-rating principles, industry best practices and appropriate performance incentives and measures. This includes better aligning premiums with the claims costs of individual employers. It also involves ensuring these discounts correspond with a measurable reduction in risk.

Group retrospective rating is a proven program that promotes safety and equitably reduces premiums. Sponsors would create groups of employers who actively involve themselves with safety and claims management to achieve lower premiums than they could individually.

Employers would continue to pay their own individual premium, with potential a small upfront discount based on group known performance. However, they would have the opportunity to receive retrospective premium adjustments based on the combined performance of the group. This performance-based incentive would promote safety among group retro members. Conversely, if the group performs worse, it would receive an assessment for additional premium.

This document details the preliminary definition of a Group Retro program that would meet the goals as defined by BWC. The content is a result of researching effective workers' compensation in both competitive and exclusive markets. The proposed program will be reviewed by interested stakeholders and built out further per the feedback. Implementation of the Group Retro program and the schedule will be dependent upon the approval of the Board of Directors.

Overview of Best Practices Research

Entities Researched and High Level Structure

Private Workers' Compensation Insurers
Retrospective plans are common in the private sector. The plans are typically individual plans instead of group retro plans. These are usually targeted towards larger employers as a means to capitalize on their own safety efforts. State rules may restrict the structure of insurers' retrospective plans. The state rules are typically based upon NCCI's "Retrospective Rating Plan Manual".

There are 35 NCCI states and 5 independent bureau states that have adopted some variation of NCCI's Retrospective Rating Plan Manual. The NCCI Retrospective Rating Plan Manual defines a plan with the major components as follows:

- Overview
    - The Retro Plan adjusts the premium for the insurance to which it applies on the basis of losses incurred during the period covered by that insurance. The intent is to charge a premium which reflects those losses. Within the principle of insurance, retrospective rating establishes the reasonable cost of insurance by using losses incurred during the term of that insurance and adding the insurance carrier's expenses and the taxes on premiums.
- Loss Control Incentive in Use of the Plan
    - The Plan provides an incentive to the insured to control and reduce losses because the retrospective premium will be the result of losses during the rating period. To the extent that the insured controls losses, there is a reward through lower premiums.
- Qualification Criteria
    - One Year Plan - A risk is eligible for a one year plan if the estimated Standard Premium is at least $25,000.
    - Three Year Plan - A risk is eligible for a three year plan if the estimated Standard Premium for three years is at least $75,000.
- Execution of the Plan
    - The employer pays the Standard Premium at the end of the policy period. Standard Premium is defined as the premium for the risk determined on the basis of authorized rates, any experience rating

modification, loss constants where applicable, and minimum premiums.
    - Premium is recalculated at defined points over the coming years (1 time for the One Year Plan, 3 times for the Three Year Plan) using the following formula:
        - (Basic Premium + Converted Losses) x Tax Multiplier
        - This formula produces a retrospective premium which shall be subject to the Minimum Retrospective Premium and the Maximum Retrospective Premium.
        - If the risk to which the Plan is applied includes more than one legal entity, a single retrospective premium is computed on the basis of the combined entities, not individually for each legal entity.
    - If the newly calculated premium is lower than the original Standard Premium, the difference is refunded to the employer; if it is higher then it is billed back to the employer

Some examples of private retrospective plans are as follows

- The Hartford
    - The employer pays the standard premium in full during the policy year. Six months after the policy period and annually thereafter, a "retro" premium is calculated based on their actual losses. The retro premium is then compared to the standard premium paid to either give a refund or request an additional premium.
- Pinnacol Assurance
    - This is a type of cost-plus payment plan, which allows for a return of premium if losses are low. However, if losses exceed expectations, additional premium will be charged. The retrospective rating plan is appropriate for larger policyholders that can finance a potential obligation for additional premium without adverse impact on their business.
- New York (NYSIF)
    - The employer pays an estimated premium at the beginning of the period. Approximately six to 10 months after the completion of the policy period, the employer's accident record is reviewed and the premium adjusted accordingly. Low administrative costs and the simplicity of the retrospective formula are important advantages of NYSIF plans as compared with others.
- PMA

- Incurred Loss Retro - The ultimate cost of insurance is determined by the actual incurred loss experience for a specific policy year. The indicated retrospective premium is adjusted annually until all claims are paid and closed. The ultimate cost can be limited on a specific and maximum basis.
- Paid Loss Retro - The ultimate cost of insurance is determined using the same retrospective formula as an incurred loss retro. However, premiums are determined utilizing paid loss amounts rather than incurred (reserved) amounts. The program is adjusted annually until all claims are paid and closed. Premium deferral is introduced into the installment plan to provide the opportunity to reduce initial cash outlay to company expenses and an initial loss fund. The deferred premium amount is generally collateralized with a letter of credit. The ultimate cost can be limited on a specific or maximum basis.

State Workers' Compensation Insurance Funds

A number of State Funds around the country utilize Retrospective Programs. States vary in their target audience for the Retro plans; some limit it to groups, some to individuals and others open it up to both.

Some examples of state fund retrospective plans are as follows

- Washington
  - Washington hosts group and individual employer retro programs that are particularly well accepted by their products. Premium from employers utilizing retro programs accounts for 47% of their total premium.
  - Bill Vasek, Senior Actuary for the Washington State Fund, stated that it was successful in a letter to BWC.
  - Employers pay the standard premium at the end of the policy period. A retrospective premium is then recalculated 12, 22, and 36 months from the last day of the policy period. If losses are lower than expected, a portion of premium is refund; if they are higher, an additional assessment is charged. The amount of assessment is capped depending on the level of risk chosen by a group.
  - Maximum Premium Ratio choices vary from 1.05 times standard premium up to 2.00 times standard premium. The amount that a group or individual is eligible to receive as a refund varies according to the Maximum Premium Ratio chosen.

    - Various restrictions are put in place for who can participate including a minimum standard premium for the individual retrospective plan (no minimum for group employers but the group as a whole must have annual expected premium of over $1.5 million), groups must have non-insurance purpose and be homogeneous, and possibly the provisioning of a surety bond to cover associated credit risk.
    - Refunds and Assessments are distributed to the group sponsors for distribution to their constituents.
- North Dakota
    - The retro rating plan is a cost-plus rating plan, resulting in a premium that is highly reflective of an insured's own loss experience. The ultimate premium is subject to minimum and maximum premium amounts.
    - Retrospectively rated policies are offered to qualified employers. The premiums under these policies are rated, subject to a certain minimum and maximum, to reflect the current loss experience of the insured. Retrospective rating combines actual losses with graded expenses to produce a premium which more accurately reflects the current experience

Conclusions of Research

From the research gathered, our team determined that retrospective rating programs are common throughout the private workers' comp insurance industry and utilized at some exclusive state funds. Individual as opposed to Group retrospective programs are the most common structure. Group retro has been proven successful in Washington though, and the NCCI Retrospective Rating Plan Manual includes rules to account for the administration of a Group Retro plan.

Retrospective plans are typically setup so that the insured pays a Standard Premium at the end of their policy period. The Standard Premium is equivalent to the premium they would typically pay based on their experience. 10 to 12 months after the end of the policy period, a Retrospective Premium Formula will be used to recalculate the premium based on actual losses and open reserves. If the recalculated premium is lower than the Standard Premium, then a refund will be sent to the insured or group. If the recalculated premium is higher, then an assessment will be billed to the insured or group. This recalculation and billing/refund cycle will appear 2 or 3 more times at 12 month intervals. After

the final recalculations, the original policy year will be closed and no more refunds or assessment will be charged.

Maximum and minimum premium limits are typically set to limit the exposure to the insured and the insurer. Examples would be that an employer or group would never pay over 1.75 of their standard premium or less than .25 of their Standard Premium. Assessments and refunds would be limited as to not exceed these limitations.

There are limited examples of Group plans in the market, but those that do exist vary in their method of distributing refunds and assessments. Washington, considered a benchmark, distributes the full amount of assessments and refunds to the sponsoring organization. This method adds some complication like regulation of the distribution of the refunds and assessing the credit worthiness of an organization. The advantage of such an approach is that the sponsoring organization can create their own safety incentive plans using the assessment and refund distribution.

Proposed Group Retro Structure

Overview
BWC would offer a Group Retrospective plan to be utilized by Sponsoring organizations. The program will be structured to closely match the market proven NCCI Individual Retrospective plan and Washington Group Retrospective plan.

Target Customer
Any private employer or public employing taxing district that insures their workers' compensation insurance obligations with BWC may participate in the Group Retrospective programs. The Group Retro program will not be compatible with select other BWC Programs (such as Existing prospective group if offered and Individual Retro.) The retro groups will be formed by sponsoring associations based on homogeneity and other factors. The advantages of a Retrospective Plan to an employer would be:

- Employers who believe that their experience rating (or base rate) does not properly reflect their current level of safety could profit by receiving a rate directly reflective of actual losses.
- Successful safety practices could be shared across the group in an effort to improve overall loss performance, thus leading to retrospective premium refunds.
- Members that would not qualify for the traditional sponsor rating group (if offered) because of loss history could enter a Retro Group where premium levels would be more directly linked to performance.

Per the advantages above, it would be expected that the Group Retro program would be most attractive to debit rated employers who believe they are inaccurately rated. Debit rated employers account for approximately 15,000 PA and PEC employers.

These assumptions lead to the conclusion that Non-Group, debit rated employers would be the most likely target audience for Group Retro at this time. This would account for approximately 10,000 Ohio employers. Non-Group employers with EMs from 0.8 to 1.0 may also find Group Retro attractive. This would add approximately 5,000 additional employers to the target audience.

Qualification Criteria

- Members of a retro group must be made up of employer members who are engaged in substantially similar business operations when the nature of their services or work activities of employees is considered.
- Retro Groups must meet a minimum total premium size requirement (Proposed to be $1 million in projected annual group premium)
- Members of a retrospective group must be submitted by a given deadline and cannot be modified throughout the year except through change of ownership or other such involuntary actions.
- The group must commit to participate in the plan for the entire billing cycle of the retro plan.
- Employers participating in the group retro program must be determined to be an acceptable credit risk by BWC
- A Group Retro employer must be in good financial standing with BWC.
- A group safety and accident prevention plan must be presented to BWC by a to be determined deadline.
- A group retrospective rating agreement must be signed by sponsor officials and participating employers each year
- Direct payment of medical services will be prohibited and salary continuation will be prohibited for injuries that occur within the retro year.

Pricing/Billing Structure

The detailed pricing structure will be determined with the assistance of Oliver Wyman. The high-level format will be similar to what is defined in the NCCI Retrospective Rating Plan Manual.

Individual employers will be billed at the end of the policy period as if they were individually experience rated (or base rated) with a group retro participation discount applied. An employer will pay experience or base rated premium to BWC under the same terms as if they were not in a retro group. The total of the premiums for the entire group is the "Standard Premium" of the group. The Standard Premium will be the benchmark that is adjusted up and down "retroactively" based on all indemnity and medical costs incurred by the group.

The Group Retrospective Premium will be recalculated 12 months after the end of the policy year (based on developed incurred losses including reserves for the whole group during the original policy year). The new premium will be compared to the Standard Premium. If the Retrospective Premium is lower than the Standard Premium, then a refund will be distributed to the employers in the

group. If the Retrospective Premium is higher than the Standard Premium, then an assessment will be billed to the employers in the group.

The Retrospective Premium is devised to reflect a premium based directly on the actual incurred costs, reserves, and an estimate of future unaccounted for losses. The Retrospective Premium Formula will account for claims costs, administrative costs, the cost of covering premium maximums, tax implications, and the possibility of increasing cost of claims after the 3 year recalculation is complete.

An example of a retrospective formula is below:

Formula	Definition
(Base Premium Ratio x Standard Premium) +	A charge for administrative/insurance costs
(Loss Conversion Factor x	Exp. for claims handling and PV of developed losses
Total Incurred Losses Developed)	Paid losses and reserves with loss dev factor applied
= Retrospective Premium	

This recalculation will occur again at 24 months and 36 months with refunds and assessments following shortly afterward. If the employer has refunds and assessments from multiple policy periods, the amount of each will be netted and a single bill or refund for each employer will be sent to them annually. Decision regarding billing sponsors versus employers may alter the previous sentence.

Refunds and assessments will be distributed by BWC on a pro-rata basis dependent on the percent of total group Standard Premium paid by an employer. For example, if an employer's Standard Premium accounted for 10% of the total group Standard Premium for that retro year, it would receive 10% of all refunds and assessments resulting from that retro year.

A maximum premium ratio (MPR) will also be applied to all retro groups and will be taken into account when billing. During the Group Retro Application process, the sponsor will choose the maximum premium for the retro group (options of 1.05, 1.25, 1.50, 1.75, and 2.0 of standard premium.) The basic premium ratio is adjusted so that groups choosing a higher MPR would be eligible for higher refunds than those choosing a lower MPR. This higher potential return is offset by the possibility of a greater assessment. These different levels will allow a sponsor to adjust risk/reward levels for their retro groups.

Preliminary Internal and External Impacts

Internal Impacts

Based on preliminary analysis multiple departments of BWC will be effected by the implementation of a group retro plan. A full study of impacts will be performed later in the product definition lifecycle.

Estimated internal impacts include:

- Information Technology
  - Rates and Payments will need to be changed to account for the new retro tables, factors and sponsor summary premium calculation.
  - The WICS system will require changes to track groups and bill at an aggregate level (if decision is to bill and refund to sponsor).
  - The Data Warehouse will be changed to account for the new group retro related fields.
  - Additional software may be required to assist in the additional credit risk analysis processes.
  - Web-site may require updating so sponsors can enter group retro participants and apply.
- Risk Analysis Department
  - Additional processes will be required to determine the credit worthiness of employers.
  - Additional processes will result from the adoption of the deductible program including the application process, underwriting, and billing process.
- Account Receivable
  - New processes will need to be created to account for retrospective scheduled reviews (may happen in Employer Management or Actuarial)
  - Additional workload will result from the adoption of the group retro program; both in billing and collection efforts.
- Customer Service
  - Will require additional education regarding the structure of the program
- Actuarial
  - Will need to build new processes to account for the implications of the new program (e.g. periodic table updates).
- Employer Policy
- Law
  - Will participate in the creation of rules for the program
- Training & Communication to internal staff

External Impacts

Based on the input of our TPA/Sponsor Workgroup and expertise of internal BWC employees, the implementation of a group retro plan would affect the following external entities:

- Ohio Employers
    - Additional options would be available for reducing Workers' Compensation premiums.
    - An employer would be able to or could be required by the sponsor to join a group retro plan if they believe their experience rating does not adequately reflect their safety risk.
    - Education will be required
- TPA
- Sponsors
- Injured Worker attorneys will need to be made aware as it could have settlement implications.
- Business accountants, CPA's
    - Will need to understand this from and accrual and financial statement perspective.

Areas Requiring Further Definition

The following areas will be further explored before the December Board of Directors meeting:

- Decision regarding weather to bill/refund directly to employers or sponsors.
- Size of group and individual employer size (currently none)
- Decision to use existing homogeneity or create new (because of time contraints, recommendation is to use existing).
- Evaluation of the market acceptance for a Group Retro program
- Detailed pricing structure with the actuarial assistance of Oliver Wyman
- Further evaluation of internal and external impacts and the proper timing for implementation if approved by the Board of Directors

Oliver Wyman will also provide us with the following actuarial information:

- Group Size Break Outs
    - An indicator of the size of the group
    - Based on Standard Premium

    - An example would be that total group SP of $1,500,000 to $1,700,000 would have a Size Group Number of 20.
    - This grouping will be used to determine the Basic Premium Ratio to charge to a group
- Base Premium Ratio
    - Per the Group Size and Max Premium Ratio chosen
        - Max Premium Ratios options of 1.05, 1.25, 1.50, 1.75, and 2.00
- Loss Conversion Factor
    - Reflective of the cost of claims adjustments and interest discounted for investment returns on employer premium
    - Will be calculated each adjustment period, but will be constant regardless of the MPR and Group Size
- Developed Losses Formula
    - Should include paid losses, reserves, and a Loss Development Factor to account for future claim development
    - Formula should treat fatality and total permanent disability claims differently from other claims
        - Loss development factors should not be applied
    - The Loss Development Factor can probably be a single figure for all industry groups, though breaking it out by industry would probably make it more accurate
        - A separate LDF will be necessary for each evaluation period of a given retro year (since the LDF should theoretically decrease as the policy year ages)
- A recommendation on the use of Performance Adjusted Factor similar to Washington
    - Need to determine whether something similar should be used in Ohio
    - Washington's is based on retro group's having a lower loss ratio than members outside of retro groups. This data will not be available immediately so may be hard to calculate. The Ohio and Washington markets also vary in that the best performing employers in Washington are involved in Group Retro as opposed to Ohio where they will most likely remain in Group Rating.
    - If a PAF will be used, it should be defined how it will be applied
        - For example, it could be built into the LDFs or applied separately