Retooling Proposal –
Premium Discount Proposal

Implementing Operational Reform Program
New Products Project
November 4, 2008

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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.

The following document proposes changes to the current Premium Discount Program so that it will more closely match the performance-based program strategy adopted by BWC. The new performance-based version of PDP would reward employers based on positive results. This would emphasize the need to make true organizational change when adopting the program and reward those who do.

Overview of Current Program

Program Overview
PDP+ was designed as an incentive program to assist experience-rated employers (those not in a group rating, retrospective rating or one claim program), having a .90 or greater experience modifier, establish a safer, more cost-effective workplace. Eligible employers receive discounts on their workers' compensation premiums for implementing the program in their businesses.

Employers can save up to 10 percent the first and second year they are in the program and up to 5 percent the third year off their workers' compensation premiums. In addition, PDP Plus participants can earn bonuses of 10 percent for a 15 percent, or greater, claims severity reduction; 5 percent for a 15 percent, or greater, claims frequency reduction; and a 5-percent bonus for meeting both criteria.

As an added bonus to employers who have completed PDP+, we've implemented a two-year extension of the program.

Usage
2007 Average Enrollment: 2,527 active employers (1% of BWC insured employers)

Cost
The following costs are sourced from the 7/1/2008 *Slippage Study Private Employers Report*.

<u>2006 PDP Costs</u>
Cost of discounts/refunds to PA Employers: $31,590,644
Cost of discounts/refunds to PEC Employers: $4,541,916
Total Cost of PDP: **$36,132,560 (2% of total premium collected)**

Deloitte Analysis
Summary from the Ohio Bureau of Worker's Comprehensive Study created by Deloitte in June 2008:

- Our analysis indicates that the current credits for the Premium Discount Program and the Drug Free Work Place are not supported by the loss experience of those participating in these programs.

Detailed evidence for the conclusion is available in the Comprehensive Study.

Conclusion of Current Program Analysis
Based on our own research and that of Deloitte, the PDP program appears to provide value to employers but the high level of up-front discounts are out of line with subsequent loss reduction. This may be a result of the discounts being set too high, organizations not truly embracing the program, or other unidentified reasons.

There are also some instances of PDP not being fully continued once the 5-year discount period is expired. This is presumably a result of the absence of an ongoing direct reward for maintaining the safety program.

Changing the program to a performance-based format without a limitation on the participation period will ensure that employers are rewarded in line with their actual success at improving safety. The participating employers will also be incentivized to continue improving safety indefinitely, thus securing future PDP refunds.

Proposed Program Changes

Overview of Changes
The new PDP program would no longer provide up-front discounts for participation. Instead, the employer will receive direct benefits for participation through the administration of refunds 12 months after the end of the policy period. The refunds will be based upon the employer's or gorup's success in containing loss costs during the policy year. Success will be determined based on the employer or group meeting a defined loss ratio goal.

The program will also no longer have the .90 EM threshold, thus being available to any experience rated employer. It will also be available to groups, even if all members of the group may not be experience rated. The performance-based nature of the new program justifies the opening up of the program to employers with better loss histories. It is believed that all employers and groups of a "significant size" should be rewarded if they effectively adopt the PDP safety plans leading to an exceptional year in reducing loss costs.

If a group chooses to participate, all members of the group must fulfill the PDP requirements including the adoption of the 10-step safety plan. The dividend for groups will be calculated based on the loss ratio of the entire group. If the group qualifies for a divided, BWC will distribute it to the group employers on a pro rata basis.

Another way that the new program continues to emphasize continually improving safety is the escalation of the requirements for an "exceptional loss cost reduction" for an employer or group that is historically successful. This increasing standard results from the structure of the loss ratio. The denominator in the loss ratio calculation is "Total Pure Premium". This premium amount is the experience adjusted premium. If the employer (or group) has been a historically successful employer, their premium will be lower as a result of the experience adjustment. This lower "Total Pure Premium" will require the employer (or group) to significantly minimize losses in a year, as compared to an employer (or group) that paid higher premiums, to accomplish a low loss ratio.

The current 5-year limit in program participation will be removed to recognize the need for continued emphasis on safety.

Qualification Changes

All current qualification criteria will remain as they do currently except those specified below. The same emphasis will be applied on the 10-step program and its importance in improving safety.

There will be no restriction in years of participation or EM level qualification for participating in PDP. Any private employer or public employing taxing district that insures their workers' compensation insurance obligations with BWC may apply for participation if they agree to perform the 10-steps and other requirements of the program. An exception will be employers who are part of a rating group. They may only participate if their entire group chooses to participate in the PDP program.

If upon auditing, it is found that the employer or member of a group is not performing the agreed upon PDP requirements, the employer (or entire group if the employer is a group member) will be removed from the program for the policy period and not allowed to participate again in the future.

Discount Structure

12-months after the close of the policy period (period ending 6/30 for PA employers and 12/31 for PEC employers), the loss ratio will be measured for the original coverage period. All employers or groups that meet the defined loss ratio goals, registered for the PDP Program, and have fulfilled the PDP requirements will be refunded accordingly.

The loss ratio that will be used will be an undeveloped loss ratio. The equation for calculating this premium will be:

For the coverage period:

Undeveloped Loss Ratio =
Total Paid Losses + Total Outstanding Case Reserves
divided by
Total Pure Premium

This loss ratio will be compared to an industry benchmark. The benchmark is broken out per industry because of the different inherent loss development differences between industries. The level of the loss ratio goal will be determined with further assistance from Oliver Wyman.

The refund amount that will be distributed is also dependent upon further review by Oliver Wyman. The goal will be to put the refund % at a level that will create less premium slippage than the current program. This will allow the changed program (with an increased target market) to not adversely affect base rates. Initial thoughts have estimated the maximum refund at 10% of premium.

Projected Cost of Revised Program
TBD – Per research by Oliver Wyman

Areas Requiring Further Definition

- Further study with Oliver Wyman on various issues
    - Usage of developed or undeveloped loss ratios for determining dividend distribution
    - Defining the level of dividends to be distributed
    - Determine the loss ratio goals at the industry level
- Define the communication and transition strategy for changing the structure of PDP
- Determine if the new program should use a new or modified name to reflect the restructured program

TPA/Sponsor Workgroup Feedback

The TPA/Sponsor Workgroup met on 10/28/08 and a portion of the meeting was used for brainstorming the retooled PDP proposal in a small group. The following are the questions asked and related feedback that came from that effort:

1) Should there be limits on who can participate in this program (risks with EMs 0.90 or greater can participate today)?

• Available to all employers

2) How should dividends be structured? Should a larger percentage of participating employers receive refunds (which would result in lower average returns)? Or should a smaller set of employers who outperform their competition receive larger average returns?

• Dividends based on performance

Frequency–

Loss ratio target–

Severity needs changed–

• Cost/claim?

Group sponsor can distribute–

• Eliminating discount will discourage participation

• Employers > $10,000 premium

• Sponsors create industry-specific programs

BWC resources are limited–

• Upfront discount and/or grants

8) What other aspects should BWC consider as development of a PDP program continues?

• Make "11-step" optional to get higher discount

• Bring back grants

• Unlimited years of participation