Accurate rates

Implementing a new rating system for premiums
Transitioning to a new claims reserving system (MIRA II)
Stabilizing group rating, strengthening Ohio's economy
Conducting a comprehensive study of all rating programs

Ensuring accurate rates

We will achieve fairness and equity in rates when we charge employers rates that accurately reflect the anticipated costs each of them brings to the system. That is, we must charge the right rate for the right risk.

Employers with safe workplaces and low incidences of workplace injuries should expect to pay less than their competitors with less safety efforts and more workplace incidents. This is what we mean by the risk an employer presents to the system. Rates should reflect the anticipated costs of each employer's risk.

Over time, inequity, inaccuracy and volatility have crept into the rates many Ohio employers pay. This has led to an unstable system and an unpredictable rating situation for many employers, including wild fluctuations in premium costs from one year to the next. We have begun to fix the problem by implementing thoughtful solutions. The top four priorities for bringing accuracy back to our rate making and fairness to Ohio's employers include:

- Implementing a new rating system for premiums (split-plan experience rating);
- Transitioning to a new claims reserving system (MIRA II);
- Stabilizing Ohio's group-rating program;
- Conducting a comprehensive study of all rating programs.

These initiatives are not quick fixes. They are fundamental changes that will ultimately bring fairness, as well as the equity and accuracy that a healthy workers' compensation system requires.

Implementing a new rating system for premiums

Split-plan experience rating

One of the keys to setting accurate premium rates is a reliable experience rating system. We are committed to achieving better rate accuracy and stability for Ohio's employers by transitioning to a new, more accurate experience rating system in the coming years.

The system used today — which emphasizes claims severity more than claims frequency — brings too much volatility to premium rates. For example, the current system can view an employer with one major claim as having the same risk level as another employer with 10 lower-cost claims. This creates an inaccurate reflection of future accident exposure, and it can lead to distorted premiums for certain employers. Additionally, one claim can cause major rate fluctuations from one year to the next.

To address these issues, we are analyzing the possibility of transitioning to an experience-rating plan that emphasizes the frequency of claims more than their cost. Known as a split experience-rating plan, it is modeled after a nationally utilized plan. Transitioning to an entirely new rating system is a monumental undertaking, which will take several years to complete. We expect to bring a transition plan before the BWC Board of Directors in June 2008.

Moving to a split experience-rating plan will allow those employers who are truly safer than their peers to achieve lower rates. Under the new plan, a company with an occasional accident would not face such excessive changes in premium, including elimination from group rating.

Transitioning to a new claims reserving system (MIRA II)

A claim reserve is the total estimated future cost of an individual claim. This estimate is factored into the overall premium rate for an employer. Accurate claim reserves are used to estimate the full cost of workplace injuries and are essential for setting accurate premium rates.

This year, we will be implementing a new, more accurate claims reserving system known as MIRA II. This system will not only provide more accurate individual claim reserves, it will also allow employers to see and understand the cost drivers that impact the overall reserve amount.

The previous system caused frustration for employers because it provided little information about how an individual claim reserve was set. The previous system prioritized accuracy of the total for all claims reserves over individual claim reserves. It was also developed using older data that did not keep pace with the ongoing changes of Ohio's system over the last decade. The new MIRA II system currently being implemented includes several significant improvements that address these deficiencies. Here are a few key highlights.

Data accuracy — MIRA II will use recent Ohio-specific workers' compensation claims data that will be updated weekly to reflect the changing nature of injuries. The new system also will use significantly more data than the current system, and it will focus on the accuracy of individual claim reserves rather than the overall accuracy of all reserves.

System-specific logic — MIRA II also uses common-sense, Ohio-specific logic to estimate the future cost of individual claims. For example, the new system has set conditions to stop reserving some claims more quickly. So, it uses BWC claims, rules and statutory limitations to stop and start the reserves as appropriate.

Customer access — The new system will be easily accessible to customers so they can better understand the cost drivers associated with an individual claim reserve. Our Web site, ohiobwc.com, will have six new service offerings directly related to claims reserves.

Without accurate claims reserves, employers are exposed to unexpected costs and fluctuating premium rates. Implementing MIRA II will significantly improve our ability to set an accurate claim reserve and it will allow employers to see and understand the underlying costs drivers. Improved accuracy of claims reserves will also allow employers to plan and budget for future costs, and it will ensure that the right premium is set for every employer.

What is a claim reserve?

It is an estimate of the future costs of a claim at a specific point in time. During the life of the claim, the reserve may change based on the activity within the claim.

Why is a reserve needed?

Reserves are needed to ensure that the future costs of a claim are accurate. Claim reserves factor into premium rates for individual employers.

How is a claim reserve determined?

MIRA II uses specific claim data elements to set the initial reserve. Then the system constantly looks for any changes in the data elements to revise the reserve for more accuracy.

MIRA II will predict the total incurred claim cost, which is the estimated value of all claim payments through the life of the claim. The reserve for rate making is the total incurred claim cost minus the total claim payments (to date).

Stabilizing group rating, strengthening Ohio's economy

Current challenges

Ohio's group-rating program began in 1991 to provide smaller employers savings on their workers' compensation costs. The program allows businesses to group their claims history and receive premium discounts similar to large employers. Typically, larger companies have a more consistent claims history, which allows for a better prediction of future costs and often results in lower pricing.

From the outset, the program had two unsound features as noted by multiple actuaries since 1991. The program allowed group-rated employers to receive overly generous discounts that are unique to Ohio's workers' compensation system. Today, participating employers receive up to a 90-percent discount while similar employers who are not group rated must pay full price.

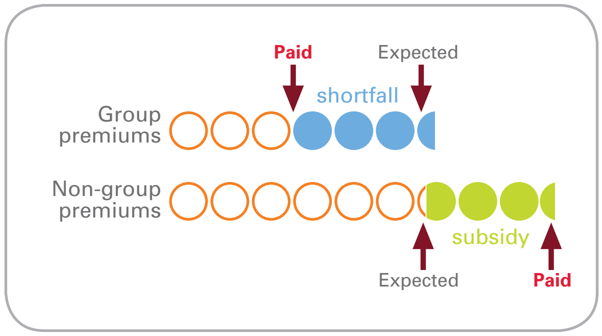
In addition to large discounts, groups are permitted to change their member employers each year. This undermines the notion that a group of smaller employers joining together to look like larger employers should be afforded discounts. Groups, unlike large employers, are permitted to kick out employers with claims to avoid higher pricing for the whole group.

As participation in groups increased over time, the generous discounts and changing composition of employers in groups exposed several critical problems.

First, group rating causes **pricing inequity** between group employers and non-group employers.

- Group employers overall do not pay enough premiums to cover their total claims costs, forcing non-group employers to pay the difference because BWC is revenue neutral.
- Non-group employers, as a result, subsidize group employers by approximately $200 million annually.

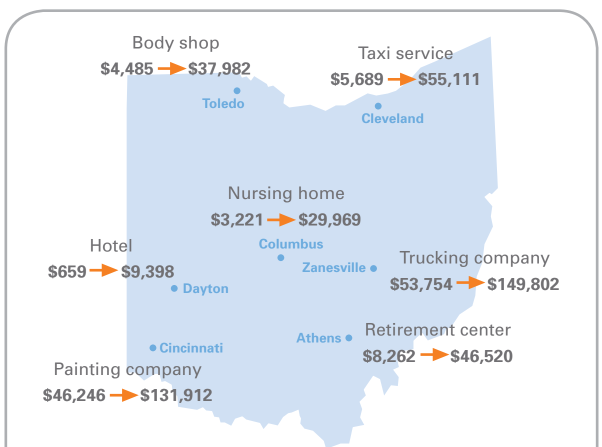
Pricing inequity



Second, deep discounts cause **premium instability** for Ohio employers.

- Group sponsors and administrators can remove an employer from a group as a result of one expensive claim. Losing a group discount can result in sudden and expensive premium increases from one year to the next.
- One in three employers that lost their group discount in 2006 either canceled coverage or filed for bankruptcy.

Premium instability



Actual premium increases for Ohio companies from 2005 to 2006

Third, Ohio's base rate is artificially higher making **Ohio uncompetitive and unattractive**.

- The $200 million subsidy paid by non-group employers inflates Ohio's workers' compensation base rate.
- Ohio's base rates appear to be the 12th highest in the country ($3 per $100 of payroll) and one of the highest in the Midwest.

Regional cost comparison
__Before__ group-rating improvements

Indiana	$1.24
Michigan	$2.05
West Virginia	$2.20
Pennsylvania	$2.80
Ohio	**$3.00**
Kentucky	$3.78

__After__ group-rating improvements

Indiana	$1.24
Michigan	$2.05
Ohio	**$2.19**
West Virginia	$2.20
Pennsylvania	$2.80
Kentucky	$3.78

Source: Ohio's rate per $100 of payroll per the Oregon workers' compensation premium rate-ranking study of 2006, applied to actuarial analysis recommending a 53-percent maximum credibility resulting in a reduced base rate of 27 percent (Base rate impacts, BWC actuarial June 27, 2007)

Long-term plan to stabilize group rating

In 2007, we began addressing the challenges of group rating by reducing the maximum allowable discount from 90 percent to 85 percent. This reduction, effective July 1, 2008, will help to reduce the $200 million subsidy paid by non-group employers. It will also ultimately help to lower Ohio's base rates.

This improvement is an incremental step in a long-term process to improve the program. The BWC Board of Directors, which approved this reduction in November 2007, also mandated that a plan for stabilizing group-rating be provided by June 2008.

Strengthening group-rating rules to protect Ohio businesses

We are also identifying opportunities to protect Ohio businesses by ensuring greater accountability from those organizations that sponsor and administer groups. More information about sponsors and third-party administrators will allow BWC customers to make informed decisions before enrolling in a group.

Enhancing pricing equity for employers

The long-term plan for pricing equity must include sound practices based on nationally recognized actuarial standards to reduce the subsidy between group employers and non-group employers. It must also make sure that premium pricing is an accurate reflection of the risk for each employer. We can accomplish this by transitioning to a split experience-rating plan and reducing the maximum allowable discount to an actuarially sound level, which multiple independent reports indicate to be approximately 50 to 60 percent.

Improving Ohio's workers' compensation system

If successful, we will strengthen the group-rating program, stabilize our experience-rating system and fundamentally improve Ohio's workers' compensation system overall. These improvements will: 1) ensure that **every Ohio employer pays its fair share**; 2) provide **stability and predictability** by limiting volatility, particularly when an employer loses a group discount; and 3) **reduce base rates** to make **Ohio more attractive for new business and new jobs**.

Conducting a comprehensive study of all rating programs

In addition to addressing immediate concerns such as claims reserving and group rating, we are also comprehensively studying all of our rating programs. This includes the components used to calculate rates and our multiple discount and safety incentive programs.

The importance of this study and its findings cannot be overstated. For far too long, our rate-setting process lacked the rigor associated with any sound, private-sector insurance operation. This analysis will build the foundation to improve our services and the stability of the entire system for Ohio's employers and injured workers.

This study was made possible by HB 100 passed in June 2007. By February 2008, we had completed a thorough search process, worked with the new BWC Board of Directors, and selected the actuarial firm of Deloitte Consulting, LLP to conduct this study. The study will provide analysis on the following aspects of our current rating system.

- The appropriateness of our current experience rating system and potential improvements to it, such as the use of credibility, the experience period, and the method used to calculate credits and debits based on an employer's experience
- The impact of the group-rating program and methods of improving it

Deloitte Consulting, LLP

Dating back to 1845, Deloitte Consulting, LLP is an international firm known for its financial advisory, tax, consulting and auditing services. Its private-sector insurance clients include companies such as Allstate, MetLife and Norwich Union. It also provides services to other public-sector entities such as the State of Texas and the U.S. Departments of Defense, Justice, Homeland Security and Intelligence.

- A comparison of Ohio methods and those used in other states, both private insurance systems and state compensation funds
- The cost effectiveness of BWC discount programs

Other areas for review include:

- The appropriate use of dividends;
- Subrogation standards;
- Policies, procedures and selection criteria governing self-insurance;
- The level of surplus/net assets BWC needs to be financially strong;
- Effectiveness of MCOs in the workers' compensation system;
- Evaluation of the use of reinsurance and other methods of mitigating the costs of a catastrophic event.

We look forward to working with Deloitte to determine the areas of strengths and weaknesses in our rating programs. This independent study will help us target areas for improvement in determining employer premium rates and future public policy decisions.

The time line for this project is aggressive. HB 100 set a deadline for completion of this study by September 2009. However, we are ahead of schedule and expect Deloitte to present its **final report to our board of directors by December 2008**. In the meantime, portions of the **findings will be presented to the board as they are completed — most likely in June, August and October 2008**.