Draft
BWC BOARD OF DIRECTORS

ACTUARIAL COMMITTEE

THURSDAY, October 30, 2008, 2:00 P.M.
WILLIAM GREEN BUILDING
THE NEIL SCHULTZ CONFERENCE CENTER
30 WEST SPRING STREET, 2ND FLOOR (MEZZANINE)
COLUMBUS, OHIO 43215

Members Present:	Charles Bryan, Chairman David Caldwell James Hummel Jim Matesich Thomas Pitts
Members Absent:	William Lhota, ex officio
Other Directors Present:	Alison Falls, Larry Price, and Robert Smith
Counsel Present:	John Williams, Assistant Attorney General

CALL TO ORDER

Mr. Bryan called the meeting to order at 2 P. M. and the roll call was taken.

MINUTES OF SEPTEMBER 25, 2008

John Pedrick, Chief Actuarial Officer, reported that all changes requested by Mr. Bryan to the September 25 minutes had been incorporated, except for the liabilities item for unpaid loss of $19.435 million. This figure is correct.

Mr. Hummel moved that the minutes of September 25, 2008, be approved as amended. Mr. Pitts seconded and the amended minutes were approved by a unanimous roll call vote.

NEW BUSINESS/ACTION ITEMS

PUBLIC EMPLOYER TAXING DISTRICT RATE INDICATION—SECOND READING

Mr. Pedrick and Elizabeth Bravender, Actuarial Director, recommended that the Actuarial Committee and Workers' Compensation Board approve an overall rate reduction of 5% for Public Employer Taxing Districts. The rate covers the policy year from January 1, 2009, to December 31, 2009.

Mr. Pedrick reviewed his memorandum and the analysis from Oliver Wyman Consulting Actuaries. He asked Oliver Wyman to calculate rate level indications using discount rates of 5% and 4%. The impact of decreasing the discount rate from 5% to 4% is a 9% increase in the rate indication. Oliver Wyman included an assumption of 9% medical inflation, which reflects their estimate of the long-term growth in medical costs. In the opinion of Mr. Pedrick, a discount rate of 4% is prudent.

Mr. Bryan asked if the answers to his technical questions on the calculation of the rate indication had been distributed to the Actuarial Committee. Mr. Pedrick replied that the consultants addressed his technical questions satisfactorily, that the document they prepared was not included with the meeting materials, but he would distribute it to the Actuarial Committee and public by the next meeting.

Mr. Pedrick summarized various items of the Oliver Wyman analysis.

Mr. Bryan emphasized that BWC had adopted a rate indication for private employers using a 5% discount rate. Mr. Pedrick replied the different discount rates are appropriate because BWC is looking at funds to be earned in 2009. He added that the discount rate also encompasses what is a reasonable investment return for the future. Ms. Bravender reported that these premiums would be collected in April and September 2009.

Mr. Bryan asked what is the average duration for a claim for a public employer taxing district? Mr. Pedrick replied he did not have a separate calculation this time; however, the average duration for private employers is approximately ten years.

Bruce Dunn, Chief Investment Officer, reported that recent yields from the bond portfolio—comprising 60% of BWC investments—average 6¾%. There has been a material increase in recent years in corporate bonds of 9%, and 4¾% for government bonds. The forthcoming sales of United States bonds will render high yields.

Mr. Pedrick reported on the range of rate indications recommended by Oliver Wyman, from optimistic (-11.4%) to conservative (+1.4%).

Mr. Hummel asked Mr. Pedrick if he still stands as firmly behind his rate recommendation of September. Mr. Pedrick replied that in September he was highly confident of the rate change. After the unsettling events of October, he is still very comfortable with his original recommendation.

Ms. Falls asked what would happen if BWC used a 5% discount rate. Mr. Pedrick replied a 5% rate would decrease the indication to -14%.

In summary, Mr. Bryan commented that the Actuarial Committee could rely on the expertise of the actuarial staff for its calculation of the rate indication. The Committee has been well briefed by the staff on their assumptions. It is appropriate for the members of the Actuarial Committee to question assumptions used and view the rate indication from a business perspective. Staff and the Committee will develop more information as the Board begins the analysis of the funding ratio.

Mr. Pitts asked if the 4% discount rate created inequity in respect to private employers, for which a 5% rate is used. Mr. Pedrick replied that BWC and the Actuarial Committee had the same discussion prior to July 1 for adoption of the private employer indication, at which time analyses were considered using discount rates of 5% and 4%, just as today for PEC's. The same level of deliberation occurred and a decision was made based on the best information at that time. In this respect the treatment is identical.

Mr. Matesich moved that the Actuarial Committee recommend that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation concerning the Public Employer Taxing District employer premium rates effective January 1, 2009. The resolution consents to the Administrator fixing Public Employer Taxing District employer rates to achieve an overall decrease of five percent in the total collectible premium from the previous year, and consents to the Administrator preparing rate rules consistent with this policy. Mr. Hummel seconded and the motion was approved by a unanimous roll call vote of five ayes and no nays.

Mr. Pedrick further reported that a preliminary estimate of premium rates for government industry group was set forth in his report. It does not include the new group rating structures currently being formed, but gives an estimate of the impacts at the industry level.

Mr. Bryan asked why the rate indication for Public Works Relief Employee was 32% over 2008. Mr. Pedrick replied that this class has a very low volume, so significant claims in the short experience rating period could change the rate quickly.

Mr. Bryan asked if an increase in the rate of an employer could lead to budget cuts that reduce payroll and, subsequently, reported premiums. Mr. Pedrick confirmed that a reduction would reduce premiums, but not affect the rate indication. At the November meeting, BWC will ask approval by the Actuarial Committee of the final rates and two rule changes.

REFORM PLAN—EXPERIENCE MODIFICATION CAPS, OHIO ADMINISTRATIVE CODE RULES 4123-17-03 & 4123-17-71

Mr. Pedrick, Ms. Bravender, and Terry Potts, Supervisor, reported on the proposal to cap premium increases for employers. The caps are components of the employer rating reform approved by the Workers' Compensation Board in June 2008 and are necessitated by the changes in the credibility table effective 7/1/2009 and the need to moderate premium increases for employers moving in and out of group rating.

Mr. Bryan asked if the premium not collected due to the caps would impact other employers' rates. Mr. Pedrick replied that the caps would be used to calculate overall rates. Mr. Bryan asked if that would create legal problems. Mr. Pedrick replied that the Legal Division has advised him it will defer to the Actuarial Department on matters of rate setting, including caps for employers. Eventually, caps will not be needed to soften the impact of large rate increases. Ms. Bravender reported that caps have been used in the past for premium increases and the change to NCCI manuals.

Mr. Potts reviewed two types of caps. BWC originally considered a cap of 20% on premium changes due to the change in credibility, but was concerned that this would require employers to pay a full premium for a year, and then receive a refund after the cap is applied. This delayed the effect of the cap. So BWC is recommending a cap of 30% on increases to the experience modifier as a result of the changes in the credibility table. This approach provides immediate relief to employers and achieves similar financial results as a 20% premium cap. For example, when the credibility table reaches a 77% maximum, a 20% premium cap results in loss ratios for group employers that are 1.33 times the loss ratio for non-group employers. An experience modifier cap of 30% yields a group to non-group loss ratio relativity of 1.34, showing that these two approaches are financially equivalent. This experience modifier cap will affect 74,000 employers out of a total of 235,000, whereas a 20% premium cap only affects 61,000 employers.

Mr. Pitts asked if the caps affect just members of groups. Mr. Potts replied a majority of employers that are helped would be in group rating.

Mr. Smith asked if caps would be unnecessary after a passage of time. Mr. Potts replied they would probably not be used after two or three years.

Mr. Potts further reported that there will be two calculations for experience modification using an 85% maximum credibility table, increased by 30%, and a 77% maximum table. The experience modifier for an employer will be the lower of the two experience modifiers.

Mr. Potts then described the between year experience modifier cap of 100%. This cap limits the impact of a change in claim experience used for an employer's experience modifier. This capping program excludes those experience modifiers in which more than one policy experience is used to create the changes. This excludes combined policies. As a result, it targets those employers who have been rejected from a group.

Mr. Bryan asked if employers would attempt to game the cap limits. Mr. Potts replied all employers can attempt to manipulate whatever rules are in place to benefit themselves, however the restrictions on the between year 100% cap limit opportunities for manipulation. For example, this cap is not available to professional employer organizations since more than one employer's experience is used. Mr. Pedrick stated that he believes that the capping programs reduce the opportunities for gaming.

Mr. Pitts asked about the numerical impact of employers leaving group each year. Mr. Potts replied that 10,000 employers leave group each year, of whom 4,000 to 5,000 join a new group and the balance are excluded from groups.

Mr. Price asked if there is any data on the experience modifier cap affect on non-group members. Mr. Potts replied he did not have that now, but can research it. Mr. Smith also asked for a breakdown between employers who leave groups because of a loss and those who leave a group for other reasons.

Mr. Bryan asked about the response of stakeholders to the proposal. Mr. Potts replied BWC had many conversations with TPAs and sponsors. Most all agree it is easy to implement and has an immediate impact. BWC has promised to consider their suggestions, but made no commitments on the final recommendation.

Mr. Pitts asked if there is a cap on premium reductions of any employer. Mr. Potts replied that there would be none; however, premium relief will be spread over all employers, who will experience reductions because of credibility table changes. There will also be an overall reduction in premium volatility.

Mr. Bryan reported that this was the first reading of the proposal and the proposal would come to the Actuarial Committee in November for a vote on two rules, Ohio Administrative Code Rule 4123-17-03 and 4123-17-71

ACTUARIAL COMMITTEE CHARTER REVIEW

Ms. Falls reported that the Governance Committee was asking the Actuarial Committee to examine its charter and recommend changes to the Governance Committee, to be acted on in November. The only suggested change is to add a provision that the Workers' Compensation Board must ratify all actions of the committee.

Mr. Pitts moved that the Actuarial Committee of the Workers' Compensation Board of Directors refer the Actuarial Committee Charter to the Governance Committee to consider the recommended changes as discussed here today. Mr. Caldwell seconded and the motion was approved by unanimous roll call vote of five ayes and no nays.

DISCUSSION ITEMS

PROJECTED RESERVES AS OF JUNE 30, 2009

Jeffery Scott and Jeffery Scholl, Oliver Wyman Consulting Actuaries, provided a report on the projected reserves as of June 30, 2009. Their presentation is incorporated by reference into these minutes. Mr. Scott reported that Oliver Wyman began estimation immediately after conclusion of the calculation of the June 30, 2008, reserve. Oliver Wyman has used the same methodology, adding a new year of expenses and a new year of claims. Mr. Scott reported that the original reserve estimate for June 30, 2009 was $16.2 billion for the State Insurance Fund, and the reserve estimate was $20.1 billion for all funds. After one quarter of the fiscal year a change in assumptions results in lower estimated reserves for June 30, 2009: $15.6 billion for the State Insurance Fund and $19.4 billion for all funds. The two main reasons for the decline are lower than expected medical payments and better than expected payments for lump sum settlements. Oliver Wyman also reduced the medical inflation factor from 9% to 6% for the next twelve months, to reflect the previous five years average growth. However, future years' estimates increase to 9% by 1% increments per year.

Mr. Smith asked how often Oliver Wyman revisits the medical inflation factor. Mr. Scott reported that it is done annually, as illustrated in the report.

Mr. Bryan commented that these factors also impact on excess reserves and the funding ratio. Mr. Pedrick added that Deloitte's analysis showed lower reserves estimates, while also recommending an offsetting reduction in the discount rate.

Mr. Matesich asked if the chart labels for 2009 on page 5 are correct. Mr. Scott replied they 6/30/2009 column labels were off by one year and should start with 2009 and end with 2015.

Mr. Scott further reported that the average claim cost per ultimate lost time claim count had declined from 9.6% to 6%. The reduction began in 2004.

Mr. Bryan stated that the lump sum settlement reflected payment of future expenses and asked what the impact would be on future reserves. Mr. Scott added that as the discount rate is reduced by 0.5%, reserves would increase by $750 million.

QUARTERLY RESERVE AS OF SEPTEMBER 30, 2008

Mr. Bryan asked if Oliver Wyman had a report for the end of the third quarter of 2008. Mr. Scott reported that it is included in the Actuarial Committee packet.

Mr. Bryan requested that Oliver Wyman work with BWC staff to construct a ten-year run-off. The Securities and Exchange Commission uses a ten-year period in its reserve run-off.

CHIEF ACTUARIAL OFFICER REPORT

Mr. Pedrick delivered the Chief Actuarial Officer (CAO) report. He first reported that BWC has experienced a few glitches in MIRA 2 and has gone to Fair Isaac for assistance. User feedback has been favorable. All issues identified are quickly addressed.

The Oliver Wyman consultant contract will expire in 2009. The Request for Proposal (RFP) is being formulated and the timeline is contained in the CAO report. BWC will need to enter the black-out period soon, including any discussion in public forums. The RFP will need input from the Actuarial Committee. Accordingly, Mr. Bryan appointed Mr. Hummel as the Actuarial Committee representative on the consultant RFP and Mr. Hummell agreed to accept the appointment. Ann Shannon, Legal Counsel, advised that the Actuarial Committee must make a recommendation to the Workers' Compensation Board, so the Actuarial Committee must participate. Mr. Pedrick added that BWC will also include Mr. Bryan for his views. Ms. Falls stated that the process will be similar to the RFP for selection of the investment advisor and urged that the Actuarial Committee learn from the experience of the Investment Committee. Mr. Bryan commented that because of the reserve audit schedule, the new consultant should have a start date of July 1, 2009, in order to provide a seamless transition if a firm other than Oliver Wyman is selected.

Mr. Hummel asked what the impact of HB 562 on the RFP is. Mr. Pedrick replied that BWC is still assessing the impact. The intent is to consolidate state contracting functions in the Department of Administrative Services (DAS) in order to take advantages of economies of scale. However, DAS may delegate this RFP to BWC because of the specialized knowledge and skill for this particular contract.

Finally, Mr. Pedrick reported that BWC has posted job postings for three staff actuaries. BWC has received four applications so far.

COMMITTEE CALENDAR

Mr. Bryan requested that an agenda item be added to the November meeting on obtaining a traditional actuarial reserve opinion from Oliver Wyman. He also asked for time for a discussion on the reserves and a staff report detailing the procedure for the reserve audit consultant RFP.

ADJOURNMENT

There was a motion by Mr. Matesich, second by Mr. Hummel, and adjournment by Mr. Bryan.

Prepared by: Larry Rhodebeck, Staff Counsel
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November 4, 2008