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# Measuring Performance

**Ohio Bureau of Workers' Compensation**

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2.28.08

# Enterprise Reporting Package

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Judicial Risk

Competitive Risks

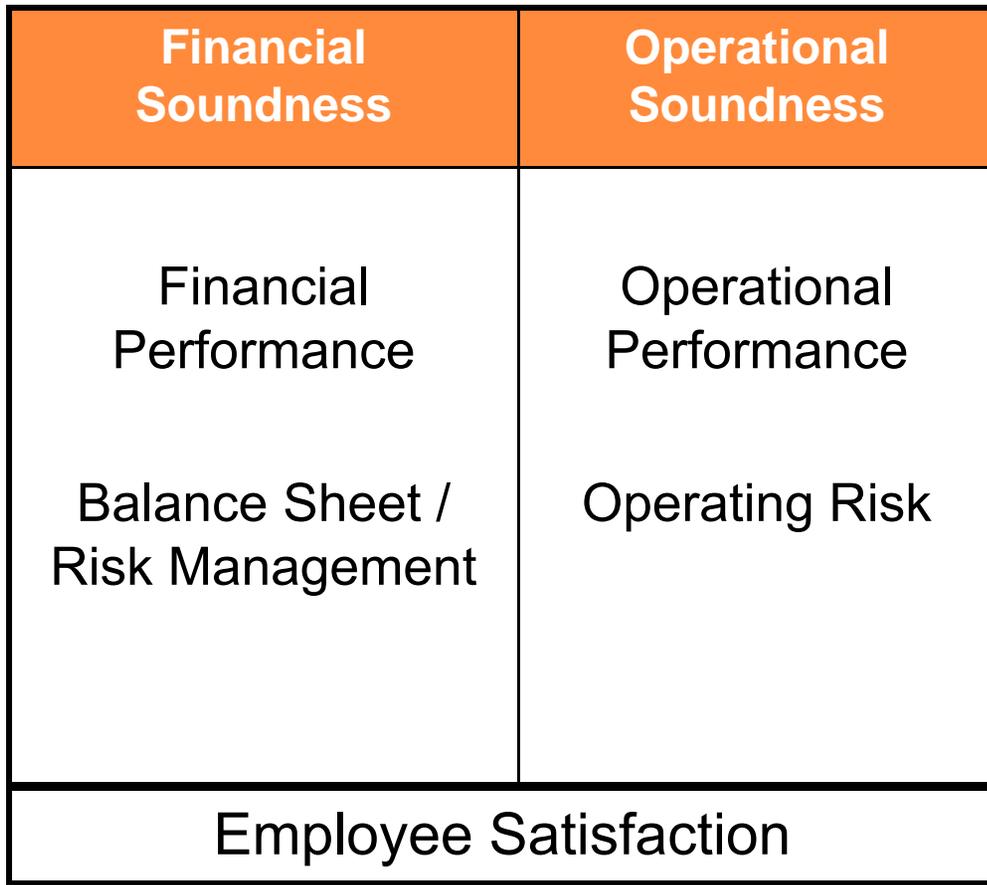
Medical Inflation

Shock Events

Legislative Risk

Latent Injury Risk

Environment / Cultural Risks



## *Financial Soundness*

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### **Financial Performance Measures**

- Loss Ratio
- Expense Ratio
- Combined Ratio
- Operating Ratio
- Return on Revenue (ROR)
- Yield on Invested Assets
- Yield on Bond Portfolio
- Return on Net Prem/NA
- Loss Reserve Development Ratios
- Loss and LAE Reserves to NA
- Operating Cash Flow
- Investments to Loss Reserves
- Investment Type to Total Investment Portfolio
- Equities to NA
- Bonds to NA

### **Balance Sheet Risk**

- Liabilities
- Assets
- ROR

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## *How should we judge BWC's Financial Performance?*

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- Comparison of actual financial results to prior periods
- Comparison of actual financial results to projected amounts
- Calculation of industry recognized financial metrics
  - Comparison to established targets
  - Benchmark to similar entities

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## *Four Primary Types of Financial Metrics*

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- Profitability Ratios
- Leverage Ratios
- Liquidity Ratios
- Loss Reserve Ratios

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## *What entities would we benchmark against?*

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- Washington State's Workers' Compensation Fund
- State Insurance Fund of California
- Workers' Compensation Industry
  - A.M. Best Workers' Compensation Composite

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## *Why Washington State's Workers' Compensation Fund*

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- Exclusive state fund, similar size
- Reserves appx. \$17b discounted basis
- Financials prepared on GAAP basis
- Reserves are discounted:
  - temporary total, permanent partial, survivor benefits at 2.5%
  - medical, vocational rehab services at 2.5 %
  - permanent and total at 6.5%
  - Cost of living adjustments at 6.5%

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## *Why the State Insurance Fund of California*

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- Competitive state fund with 55% of the workers' compensation market in the State of California
- Reserves appx. \$17b undiscounted
- Financial statements are prepared on a STAT basis (no GAAP reporting)
- Reserves are not discounted
- Reforms enacted from 2003 to 2006

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## *Why A.M. Best Workers' Compensation Composite?*

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- Comprised of groups and companies for which more than 50% of their business is workers' compensation
- Comprised of 96 organizations that underwrite 91.4% of the workers' comp insurance industry premium
  - State Insurance Fund New York
  - Texas Mutual Insurance Company
  - Zenith Insurance Company
  - Missouri Employers' Mutual Insurance
  - RTW Group
  - SAIF Corporation

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## *What may cause differences in the comparisons?*

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- BWC discounts all reserves
- BWC investments reported at fair value
- BWC does not pay commission, brokerage, or income tax expenses
- BWC is not required to maintain surplus at levels established by department of Insurance or rating agencies
- BWC has a separate assessment for the Administrative Cost Fund

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## *Assumptions used in compiling info*

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- BWC information is based on the 5 most recent fiscal years
- Comparative info based on the 5 most recent calendar years
- Results exclude impact of accounting change to DWRF in 2005 and statutory change to DWRF in 2007
- Results include impact of all other financial statement adjustments

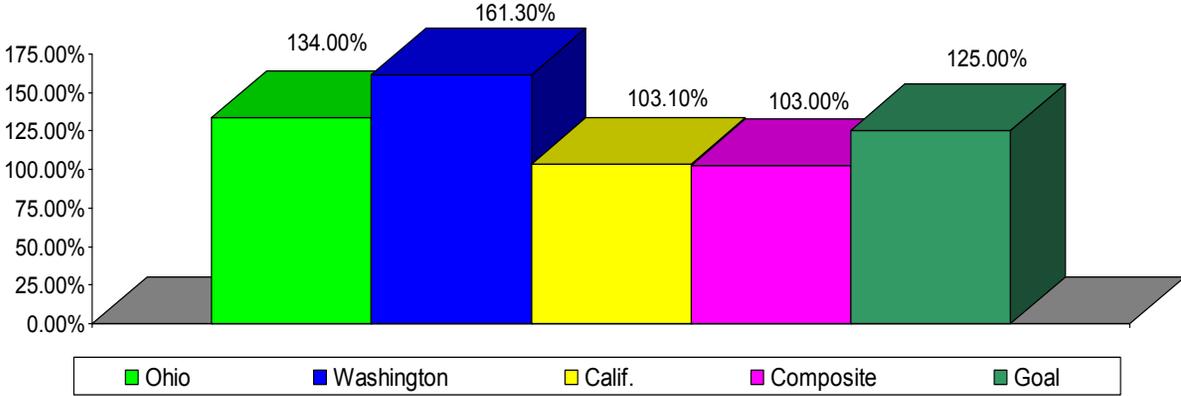
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# Combined Ratio

**Definition:** Measures a company’s overall underwriting profitability

$$(Comp + Comp Adj. + Other Exp / Total Prem + Assessment Inc.)$$

**Why Important:** Results of less than 100% indicates a company is generating a profit from underwriting operations



Without Dividend Impact

Ohio	Washington	California	Composite
122.6%	161.3%	102.8%	100.4%

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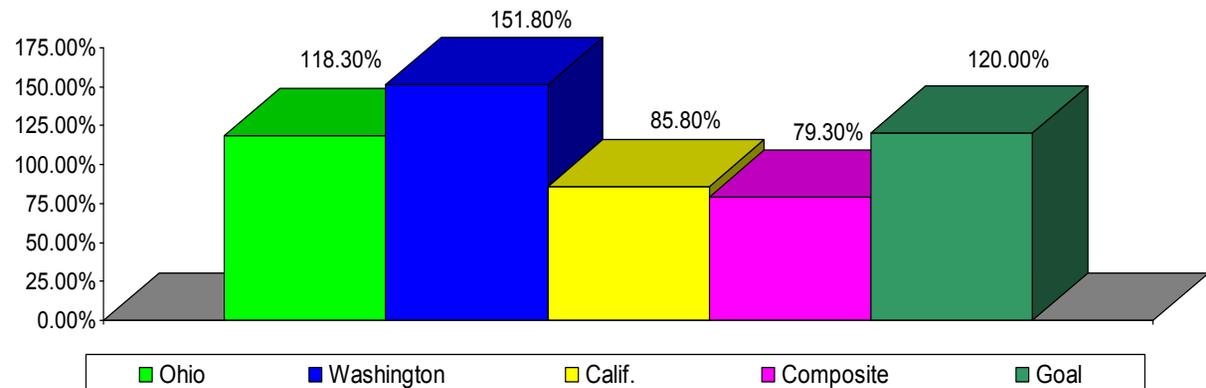
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## Net Loss Ratio

**Definition:** Measures a company's underlying profitability or loss experience on its total book of business

(Comp + Comp Adj Exp / Total Prem + Assessment Inc.)

**Why Important:** Provides information regarding adequacy of premiums and assessments



BWC's 5 year history

2003	2004	2005	2006	2007
150.6%	114.2%	128.5%	89.3%	108.7%

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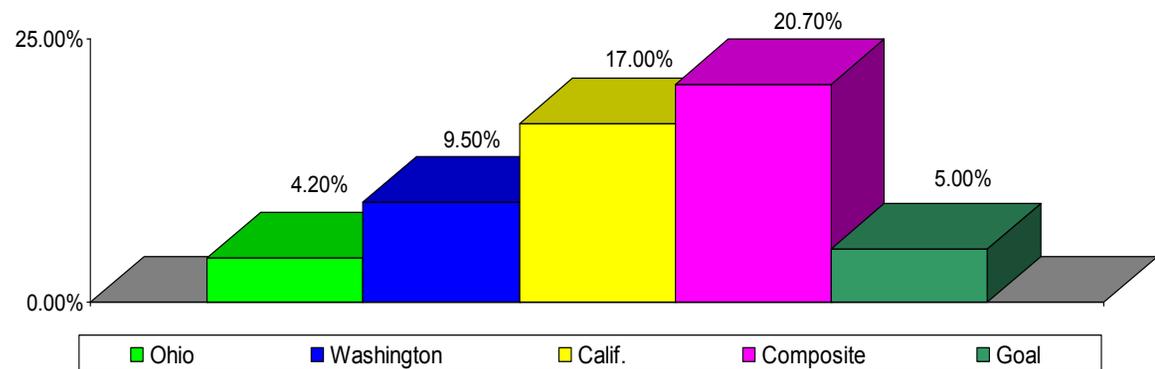
## *Expense Ratio*

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**Definition:** Measures a companies operational efficiency in underwriting its book of business

(Other expenses / Total Prem and Assessment Inc.)

**Why Important:** Provides information regarding the cost of administrative operations



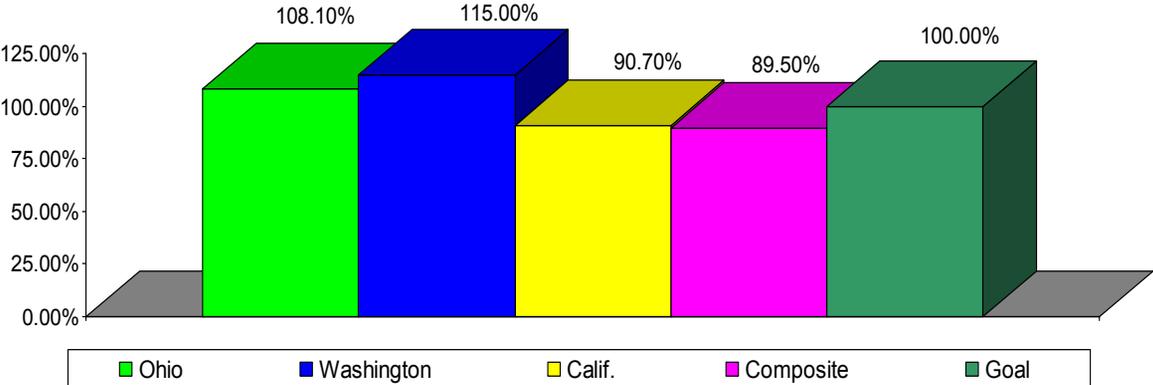
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# Operating Ratio

**Definition:** Measures a company’s overall profitability from underwriting and investing activities

$$(Comp + Comp Adj Exp + Other Exp / Total Prem + Assessment + Investment Inc.)$$

**Why Important:** Results of less than 100% indicates a company is generating a profit from entire operations



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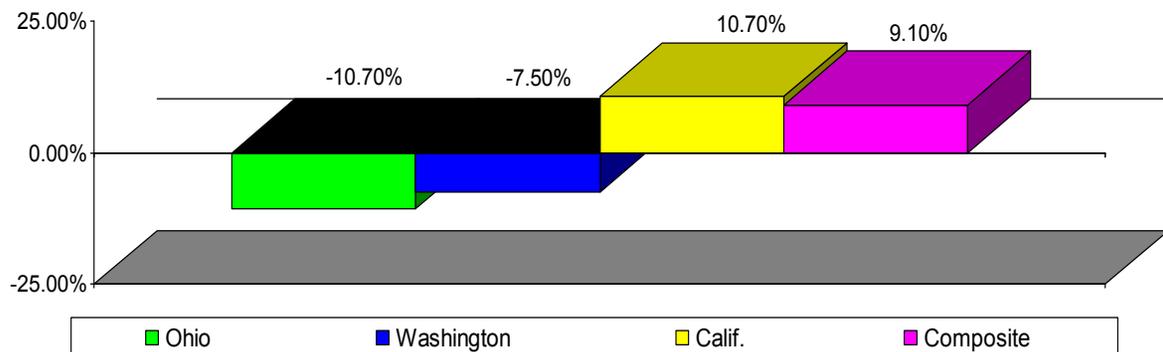
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## Return on Revenue

**Definition:** Measures a company's pre-tax operating profitability before realized/unrealized capital gains and losses

(Pre-tax Operating + Dividend + Int. Inc. / Prem + Assessment Inc.)

**Why Important:** Results provide information on a company's operating profitability



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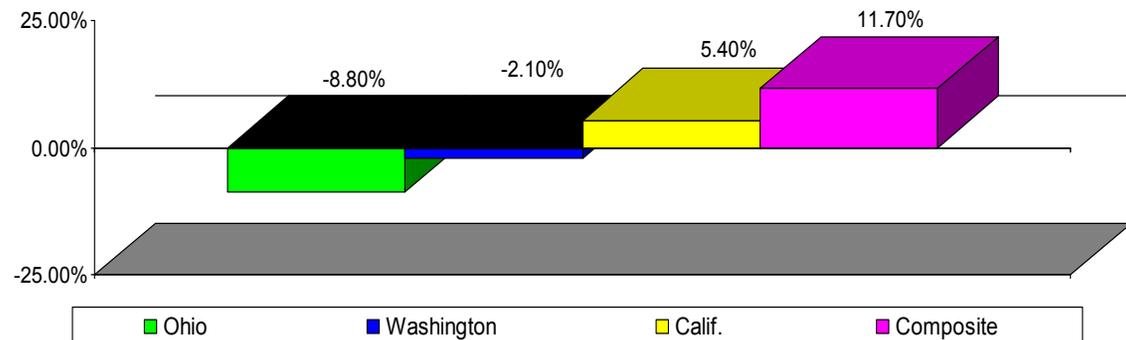
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## Net Operating Income to Surplus

**Definition:** Measures a company's efficiency in utilizing its surplus without the impact of investment capital gains and losses

(Pre-tax Operating + Dividend + Interest Inc. / Mean of prior and current year end Net Assets)

**Why Important:** Provides information on efficiency in utilizing surplus



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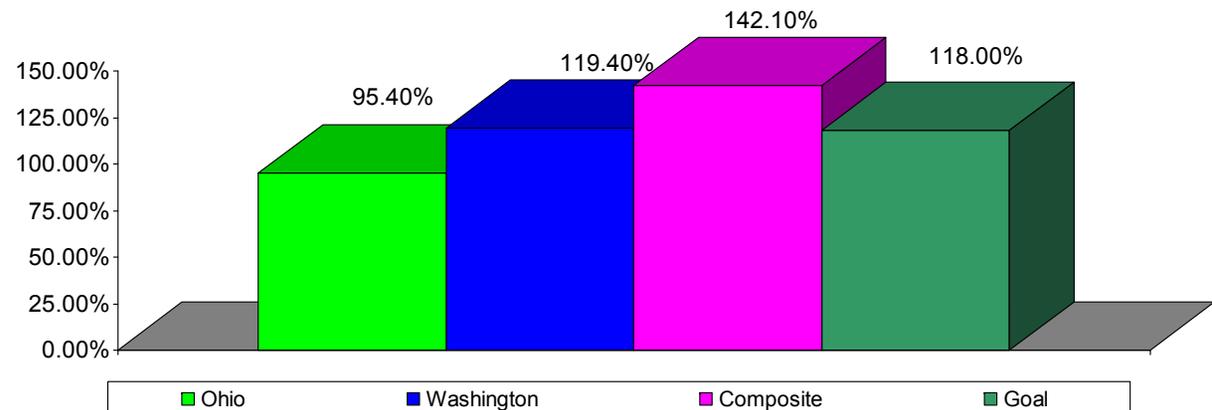
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## Operating Cash Flow Ratio

**Definition:** Measures the relationship between operating receipts and disbursements

(Collections from all income sources / Disbursements for all expenses)

**Why Important:** Results of greater than 100% indicates a company is generating positive cash flow from entire operations



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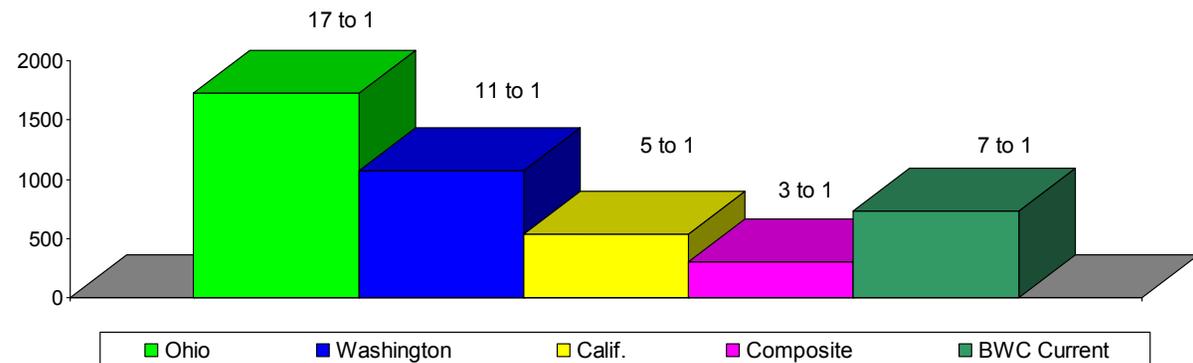
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## *Loss and LAE Reserves to Surplus*

**Definition:** Measures the relationship between future claims liabilities and surplus

$(\text{Loss} + \text{Loss Adj. Exp. Reserves} / \text{Net Assets})$

**Why Important:** Measures the exposure to errors in estimating future claim related liabilities



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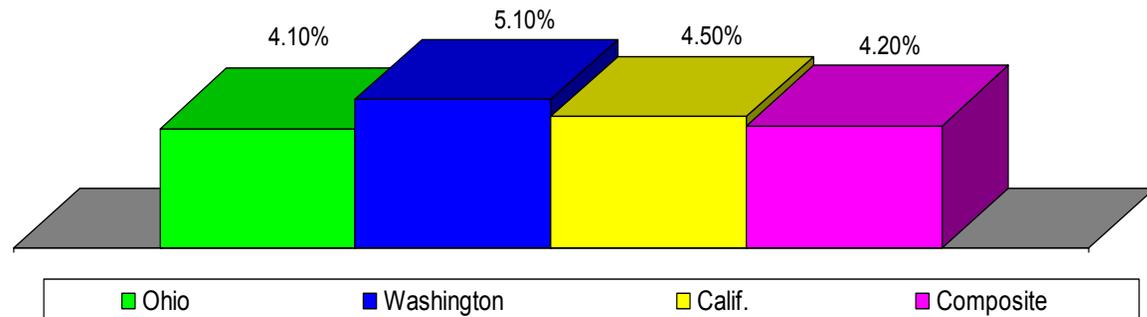
## *Net Investment Yield*

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**Definition:** Measures the average return on invested assets

(Investment Income / Avg. Invested Assets)

**Why Important:** Results provide information regarding the performance of the investment portfolio



BWC's 5 year history

2003	2004	2005	2006	2007
4.81%	4.40%	3.71%	3.51%	3.87%

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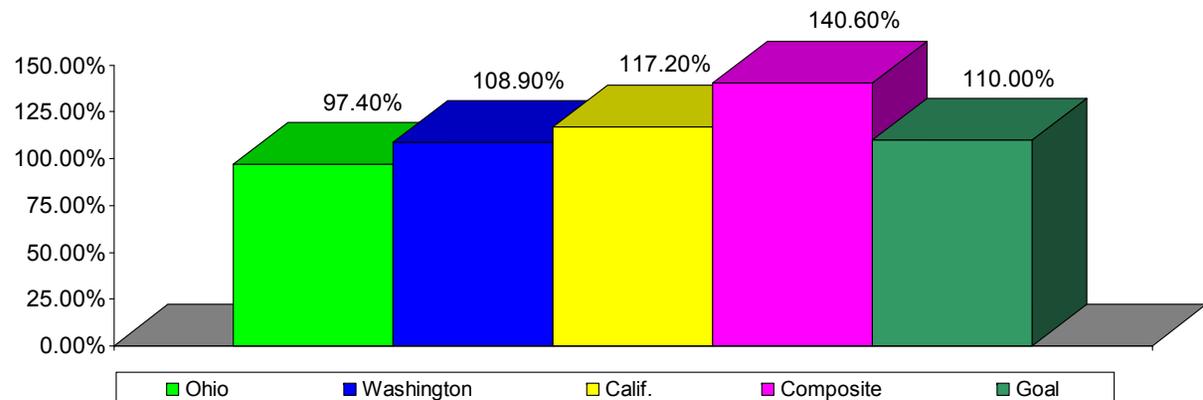
## *Investments to Loss Reserves*

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**Definition:** Measures the relationship of the investment portfolio to loss and loss adjustment expense reserves

(Total Cash + Investments / Loss + Loss Adj. Exp. Reserves)

**Why Important:** Provides information of the adequacy of the investment portfolio to support current and future claim liabilities



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## *Investment Portfolio Composition*

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**Definition:** Represents the major components of a company's investment portfolio expressed as a percentage of total invested assets

	Bonds	Stocks	Cash & Cash Equivalents
Ohio	65%	24%	7%
Washington	78%	17%	2%
California	86%	2%	9%
Composite	78%	9%	9%
▪ Current IPS	79%	20%	1%

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## *Equities and Bonds to Surplus*

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**Definition:** Measures the exposure of a company's Net Assets to different investments

	Equities	Bonds
Ohio	4.86 to 1	9.95 to 1
Washington	1.97 to 1	9.91 to 1
California	Not Available	5.44 to 1
Composite	1.42 to 1	3.29 to 1
▪ Current	1.24 to 1	5.10 to 1

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## *Next Steps:*

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### **Financial Soundness**

- Performance Indicators: Finalize appropriate measures, begin reporting (4/08)
- Balance Sheet Risk: Under development, pending results from various studies

### **Operational Soundness**

- Leading Indicators: Identification of measures (7/08)
- Business Drivers: Finalize report format (3/08)
- Customer Satisfaction: Development of measurement tools (7/08)
- Operational Risk: Under development, pending results from various studies

### **BWC Employee Satisfaction**

- Identification of appropriate measures (5/08)