BWC Board of Directors

AUDIT COMMITTEE

Thursday, July 30, 2009, 2:30 p.m.
William Green Building
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

Members Present: Kenneth Haffey, Chair
Robert Smith, Vice Chair
William Lhota
James Harris
James Matesich

Members Absent: None

Other Directors Present: David Caldwell, James Hummel, Charles Bryan, Thomas Pitts, Alison Falls

CALL TO ORDER

Mr. Haffey called the meeting to order at 2:34 PM and the roll call was taken.

MINUTES OF JUNE 18, 2009

The minutes were approved by unanimous roll call vote on a motion by Mr. Matesich, seconded by Mr. Smith.

REVIEW/APPROVE AGENDA

Mr. Haffey advised one change in that agenda items 3 and 4 in "New Business" will be presented in reverse order. The agenda was approved by unanimous roll call vote on a motion by Mr. Lhota, seconded by Mr. Smith.

NEW BUSINESS / ACTION ITEMS

1. Internal Audit Update

Caren Murdock, Chief of Internal Audit, initially noted that due to the delay in OBM transition to June 2011 Internal Audit is in the process of updating its policies and procedures, and preparing a process-map to detail the audit processes. The FY09 internal audit annual report is being finalized for presentation at the August Audit Committee meeting. Five (5) audits have been completed and will be discussed at the September Audit Committee meeting. Outstanding management comments are being validated and the unit continues to provide external audit support.

2. Re-insurance Intermediary

Tracy Valentino, Chief of Fiscal and Planning, introduced the Towers Perrin firm as the retained re-insurance intermediary. Bruce Hockman, Executive Vice-President and Workers' Compensation Practice Group leader for the firm, spoke to the Committee, outlining the firm's consulting experience and background. Towers Perrin will be merging with a similar firm, Watson Wyatt Worldwide, by year-end, creating Towers Watson.

Mr. Hockman explained that re-insurance is what an insurance company purchases to reduce its own risk and limit volatility. In the course of the next 60-90 days, they will determine whether re-insurance would be of benefit to BWC. He and his team look forward to working with BWC.

3. Net Asset Policy

Ms. Valentino and Don Berno, Board Liaison, presented further updates to the funding policy. The policy is consistent with Deloitte guidelines. It uses Funding Ratio and Net Leverage Ratios to indicate financial strength in the State Insurance Fund. The policy establishes guidelines for these ratios, which will be monitored monthly and evaluated annually for approval by the Board. The minimum guideline for the Funding Ratio is 1.0, and the ratio should never be below this number.

Ms. Valentino reviewed peer comparisons with state funds and private carriers, along with actual BWC numbers as of 6/20/2008, 10/31/2008, and 12/31/2008 to show what the ratios would have been. The October ratios were well outside the proposed guidelines due to the temporary market decline. They had recovered substantially by year-end.

The recommended guidelines for Funding Ratio are between 1.02 and 1.35. The recommended guidelines for Net Leverage Ratio are between 3.0:1 and 8.0:1. Ms. Valentino opined that in the short term, Funding Ratio would be within the guidelines, but Net Leverage Ratio would remain slightly above the 8.0:1 guideline. As of 6/30/2009, the Funding Ratio was 1.14; the Net Leverage Ratio was 8.22:1. This will be the starting point for analysis if the guidelines and policy are approved.

Mr. Haffey noted that he, Mr. Bryan and Mr. Smith, as Committee Chairs, met in late June to discuss the net asset policy. Administrator Ryan said this is a monumental step for BWC in terms of transparency to stakeholders.

Mr. Matesich asked what time frame was used to analyze Net Leverage Ratio for other states, and why would BWC choose a number where the starting point is outside of the range. Mr. Berno responded to Mr. Matesich that this was based upon a five-year average quoted from the Deloitte report. Mr. Lhota noted for the record that BWC does not have the full faith and credit of the State of Ohio behind it.

Ms. Falls commended the work of the staff on the new Net Asset Policy and guidelines recommendation. Ms. Falls indicated that her personal opinion was that while the net leverage upper guideline of 8.0:1 was justifiable, an upper guideline of 7.0:1 was preferable for several reasons. First, the margin for error implied in an 8.0:1 net leverage ratio was approximately 12%, compared to a 14% margin of error with a 7.0:1 net leverage ratio. Second, a 12% margin for error should be thought of in the context that the actuarial estimates on BWC reserves could change by 10% or more, and that a 2 standard deviation event could cause the market value of the investment portfolio to decline by approximately 15%. Third, one of the key lessons of the 2008 financial crisis is that the system needed to reduce risk - reduce leverage - and that even entities such as Fannie Mae, so-called Government Supported Enterprises (GSE's), were too leveraged. Therefore, setting an upper guideline of 7.0:1 for the Net Leverage Ratio would improve the BWC's ability to absorb volatility in market conditions and would be preferable, in her opinion.

Mr. Lhota suggested the following language changes on page 5 of the policy: item 3, should read as follows: "Deviations from the established guidelines shall be reported monthly and evaluated at least annually." In the following sentence, "At least annually" should be added at the beginning of the sentence, and the word "should" be replaced by the word "shall."

Ms. Falls suggested that on page 4, "policyholder surplus" should be changed to "policyholder net assets". Ms. Valentino asked if inserting language defining net leverage ratio as used in the enterprise report would be acceptable. Mr. Haffey responded in the affirmative.

Mr. Smith moved that the Audit Committee recommend to the Board of Directors that it approve the net asset policy, as outlined in the document dated July 30, 2009 and as amended in discussion. Mr. Matesich seconded, and the motion was approved by unanimous roll call vote.

Mr. Smith moved that the Audit Committee recommend to the Board of Directors that it approve the Funding Ratio guidelines and Net Leverage Ratio guidelines of the net asset policy, as recommended by the Administrator and outlined in the document dated July 30, 2009. Mr. Matesich seconded, and the motion was approved by unanimous roll call vote.

4. FY2010 Financial Projections

Ms. Valentino reviewed the projected statement of operations for FY2010. This consists mostly of unaudited information, plus audited information from June 30, 2008. Premiums will decrease $225 million to $2.2 billion. Recession impact has yet to be felt with respect to state fund employers, although it has been seen for self-insured employers.

Ms. Valentino stated BWC actually collected more premium than projected in FY2009. She will compile macro data used for this report and circulate to the Board. Reserve projections will become more finite by the next meeting. It is expected that net assets will increase by $150 million in FY2010, even though premiums will drop due to the rate decrease. $213 million will be realized through cash redemption from investment managers.

DISCUSSION ITEMS

1. OBM Office of Internal Audit Update

The OBM Chief Audit Executive, Joe Bell, discussed risk assessments were prepared for twenty-one (21) state agencies, and an audit plan was prepared and presented to the State Audit Committee in June. Two BWC IT auditors joined the OBM audit staff at the end of June. OBM will begin performing audit work at BWC during the third and fourth quarter of this year. Mr. Haffey noted that he and Mr. Bell continue to communicate.

2. Committee Calendar

Mr. Haffey reviewed the calendar for the next several sessions.

3. External Audit and Litigation Update, Executive Session

At 3:47 PM, Mr. Haffey moved to recess to Executive Session for updates on the external audit and litigation, seconded by Mr. Matesich and approved by unanimous roll call vote.

Mr. Haffey moved to return from Executive Session at 4:24 PM, seconded by Mr. Harris and approved by unanimous roll call vote

ADJOURNMENT

Mr. Haffey moved to adjourn the meeting at 4:25 PM, seconded by Mr. Smith and approved by unanimous roll call vote.

Prepared by Jill Whitworth, Staff Counsel
July 31, 2009