

BWC Board of Directors

BOARD MEETING

Friday, July 31, 2009, 8:00 A.M.

William Green Building

30 West Spring St. 2nd Floor (Mezzanine)

Columbus, Ohio 43215

MEMBERS PRESENT: William Lhota, Chair
James Harris, Vice Chair
Charles Bryan
David Caldwell
Alison Falls
Ken Haffey
James Hummel
Jim Matesich
Thomas Pitts
Larry Price
Robert Smith

Members Absent: None

Counsel Present: John Williams, Assistant Attorney General

CALL TO ORDER

Mr. Lhota called the meeting to order at 8:00 a.m. and the roll call was taken.

MINUTES OF JUNE 19, 2009

Mr. Price requested that the first sentence of page 8, paragraph 4 be revised to read, "Mr. Price appreciated the discussion on derivatives and that he missed Ms. Falls in the Investment committee as she is able to help clarify complex issues."

Mr. Lhota requested that page 2, paragraph 1 be revised to show the motion was approved by a "roll call" vote. He requested that page 3, paragraph 2 be revised to show the motion "consents to the Administrator amending five rules, rescinding one rule, and adopting one rule." He also requested that page 8, final paragraph be revised to strike "staff, or Investment Division" from the sentence. Finally, he requested page 12, paragraph 6 be revised to read, "Prior to entering executive session, Mr. Lhota recessed the meeting at 9:50 for fifteen minutes."

Mr. Harris moved to approve the June 19, 2009, minutes as amended. Mr. Haffey seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

AGENDA

Mr. Lhota announced that the executive session would consider a personnel matter and that he would insert a break at an appropriate point.

Mr. Caldwell moved to adopt the agenda as amended. Mr. Pitts seconded and the agenda was adopted by a roll call vote of eleven ayes and no nays.

COMMITTEE REPORTS

Mr. Lhota stated that the heavy lifting of the Workers' Compensation Board is conducted at its committee meetings. These meetings are attended by all essentially all directors and contain robust discussions of the issues before them.

GOVERNANCE COMMITTEE

Ms. Falls reported that the Board advisory structure for input on medical issues was deferred to August. After a review of the Fiscal Year 2009 Education Report, the Governance Committee believes that the Workers' Compensation Board has met all statutory requirements for the fiscal year.

The Governance Committee has proposed a calendar of education programs for fiscal year 2010. The calendar is deemed to be a living document which should be amended as appropriate, and which should be reviewed by the end of the year to determine if it complies with statutory requirements. She asked directors to refer items to Don Berno, Board Liaison, for additions. The fiscal year 2010 education plan is being distributed today to the Board.

Ms. Falls moved that the Workers' Compensation Board of Directors adopt the recommendation of the Governance Committee and approve the FY 2010 Education Plan for the BWC Board of Directors. Mr. Price seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

Ms. Falls reported that the Governance Committee spent 90 minutes on the first readings for four rules. BWC is making excellent progress on the Five-Year Rule Review. She thanked BWC staff for completing reports on stakeholder input. She acknowledged it was time-consuming, but the report gives the Workers' Compensation Board a thorough view.

Of the rules reviewed, the Governance Committee spent the most time on 2009 vocational rehabilitation fee schedules. Other rules concerned the Quality Health Plan (QHP) and the Health Partnership Plan (HPP), which are scheduled to be complete by October. Finally, there was a review of rules on general policy and procedures of BWC. In August, the Governance Committee will begin review of workshop safety rules. Because the rules are more than 180 pages, they will be distributed by CD-ROM.

Ms. Falls reported that the Workers' Compensation Board Self Assessment was deferred to the full Board for consideration in executive session as a personnel issue.

ACTUARIAL COMMITTEE

Mr. Bryan reported that the Actuarial Committee undertook two action items at its meeting. The first was a proposal presented by Tina Kilmeyer, Chief Customer Service, on sponsorship certification for group rating by amending Ohio Administrative Code Rule 4123-17-61.1.

Mr. Bryan moved that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation to amend Rule 4123-17-61.1, Sponsorship Certification Requirements. The motion consents to the Administrator amending Rule 4123-17-61.1 as presented at the Actuarial Committee. Mr. Matesich seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

Mr. Bryan reported that the Actuarial Committee had approved amending a rule on group rating reform.

Mr. Bryan moved that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation to amend Rule 4123-17-62, Application for Group Experience Rating, to extend the deadline for filing Public Employer Taxing District Group Rating Applications. The motion consents to the Administrator amending rule 4123-17-62 as presented at the Actuarial Committee. Mr. Hummel seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

Mr. Bryan reported that the Actuarial Committee spent more time on reserves than in past meetings. The Actuarial Committee reviewed the June 20, 2009, Loss and Loss Adjustment Reserves data obtained by John Pedrick, Chief Actuarial Officer. The major reason for the change in the reserve was the reduction of the discount rate from 5% to 4.5% (which raised the reserve) and the decrease in the medical inflation rate. Mr. Bryan noted the back-up data for the reserve calculation is available on disk for Directors who would like a copy. Comprehensive rate

reform is still underway and future items will be undertaken by the Actuarial Committee.

Jim Fograscher, Project Manager, gave a report on implementation of the Deloitte Study Report. BWC intends to implement many reforms in fiscal year 2010. Many reforms will require statutory changes. Finally, the Actuarial Committee met members of the team of Deloitte Consulting LLC, the new actuarial consultant. This was a landmark because this is the first change of the actuarial consultant vendor in twenty years.

AUDIT COMMITTEE

Mr. Haffey reported that the Audit Committee received reports regarding current audit projects from Caren Murdock, Chief of Internal Audit. Internal Audit is updating Internal Audit policies and procedures and also preparing a process map that details current audit processes. She reported the Internal Audit Annual Report for FY 2009 is being finalized, and will be presented at the August 2009 meeting. Five audits are finished and six are in process.

Tracy Valentino, Chief, Fiscal and Planning, reported on the retention of Towers Perrin to determine the potential benefits and cost to obtain reinsurance for the State Insurance Fund. The goals include determining risk tolerance and control of volatility.

Ms. Valentino and Mr. Berno reported on the proposed Net Asset Policy, which has been distributed to the Workers' Compensation Board today. The policy proposes to set the funding ratio guideline between 1.02 to 1.35 and the net leverage ratio guideline between 3.0 to 1 and 8.0 to 1. Mr. Haffey complimented the staff on the good research that led to this recommendation, and noted there was a very thorough discussion during the committee meeting.

Mr. Haffey moved that the Board of Directors accept the recommendation of the Audit Committee to approve the Net Asset Policy, as outlined in the document dated July 30, 2009. Mr. Smith seconded the motion.

Ms. Falls stated that adoption of the Net Asset Policy is a tremendous step forward in oversight of the State Insurance Fund. She added that she believed the upper limit of 8 is justifiable, and that she does support that figure. However, she did indicate her belief that an upper limit of 7 would be preferable. Mr. Pitts added that the Net Asset Policy ensures that future decisions on the State Insurance Fund will be conducted openly and in accordance with the fiduciary responsibility of the Workers' Compensation Board.

The motion was approved by a roll call vote of eleven ayes and no nays.

Mr. Haffey moved that the Board of Directors accept the recommendation of the Audit Committee and 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 31, 2009. Mr. Smith seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

Mr. Haffey further reported that Administrator Marsha Ryan had commented on the leap forward in BWC's policy of transparency and accountability brought by the adoption of the Net Asset Policy.

Ms. Valentino reported on the fiscal year 2010 financial projections. Directors asked a number of detailed and pointed questions during this presentation. Additional projections are needed from Mr. Pedrick and on economic performance.

Joe Bell, Director, Office of Budget & Management, provided an update on the Office of Internal Audit. Mr. Bell has begun with a risk analysis of twenty-one state agencies. Many of the internal audit processes will be based on BWC practices.

The Audit Committee had an executive session with Schneider Downs on the fiscal year 2009 external audit. The external audit will be completed in September, and publicized in November. The executive session also had a litigation update.

INVESTMENT COMMITTEE

Mr. Smith began his report by noting that every director attended the Investment Committee meeting. Mr. Smith reported that for fiscal year 2009, net assets had declined to \$2.456 billion. The BWC total investment portfolio return declined by 1.1% for fiscal year 2009, whereas, in comparison, the S & P Index declined by 26%. However, as of July 29, net assets had increased by \$235 million, an increase of 1.4% in estimated portfolio market value from June 30, 2009. The State Insurance Fund portfolio is allocated at 76% in bonds, 21.6% in equities, and 2% in cash. BWC will transition more assets into equities, to increase it from 20% to 30%, through international investments and a reduction in bond holdings. This follows the recommendation of Mercer Consulting to obtain higher investment returns that was recently approved by the Investment Committee and Board.

The Investment Committee and Board previously approved a change in the benchmark from the S & P 500 to the Russell 3000 Equity Index.

Mr. Smith moved that the Workers' Compensation Board of Directors adopt the recommendation of the Investment Committee that the Board authorize the BWC Investment Division staff to implement the Third Priority Transition Mandate of the 21st Century Transition Strategy Option for the State Insurance Fund, commencing in September 2009, as that mandate is outlined in the memorandum

of the Chief Investment Officer dated July 15, 2009, and supported by the memorandum of Mercer Investment Consulting, Inc., dated July 21, 2009. Mr. Pitts seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

Mr. Smith further reported that per Bruce Dunn, Chief Investment Officer, the transition to non-United States equities through the use of derivatives was discussed in June. However, the selected transition strategy proposal approved by the BWC Transition Manager Evaluation Committee did not include derivatives as the primary instruments used to execute this specific transition. Mr. Price noted that although the use of derivatives is a permissible tool for the BWC staff to use, the staff should be commended for finding another option.

MONTHLY ENTERPRISE REPORT

Ms. Valentino provided the July Enterprise Report. She began with the unaudited financial highlights from the end of fiscal year 2009. BWC is in the middle of the external audit. It will be delivered to the Auditor of State in September and the Audit Committee in September. The release to the public will be in early November. Few changes from today's reported results are anticipated. The largest would be in changes in the actuarial reserve.

BWC net assets increased by \$563 million in June because of a \$20 million adjustment in premium income from private employers, a \$75 million increase from Public Employer Taxing Districts, and \$51 million in net audit adjustments posted to employer accounts. Benefit and compensation adjustment expenses were reduced by \$57 million as a result of the recently completed Oliver Wyman actuarial audit. There was a \$248 million operating gain and \$315 million in net investment income after expenses.

There was a \$247 million increase in the portfolio market value, with \$69 million in interest and dividend income. The \$563 million in net asset increase led to \$2,456 million in net assets.

In the 50/50 payment plan, there were 21,000 participants, of whom 600 did not make the second payment and their balances have been certified to the Attorney General for collection. Total cash receipts for June were \$65 million.

In the year to date there has been a \$47 million decrease in net assets. Benefit and compensation adjustment expenses decreased by \$469 million in fiscal year 2009. This was primarily caused by a decrease in the change in reserves for compensation and compensation adjustment expense, another product of the reserve audit. The changes in reserves were the subject of an Actuarial Committee discussion.

There was a net investment loss of \$192 million for the year, consisting of \$355 million in net realized losses and unrealized losses of \$570 million, offset by \$738 million in interest and dividend income. BWC redeemed \$185 million from investment managers in fiscal year 2009 to meet operating cash flow needs. Premium collections were \$28 million less than the prior fiscal year, but \$119 more than anticipated.

Cash receipts from premiums were \$119 million better than expected and cash disbursements were \$41 million better than expected. The cash balance at the end of fiscal year was \$503 million.

Expenses for the Administrative Cost Fund (ACF) were 9% below projections. The BWC budget is under strict travel and expense control. When projects are completed under budget, their funds are moved to other items.

With respect to the ACF budget, Mr. Matesich requested explanation of why the column for the Budgeted Fiscal Year 2009 payroll was identical to the column for the Fiscal Year 2009 Budget payroll. Ms. Valentino replied that actual payroll expenditures should meet budget projections at the beginning of the fiscal year. In June they will be equal. Mr. Haffey asked why there is a \$300,000 difference in the totals due to Actuarial Division. Ms. Valentino replied she would research the discrepancy.

Ms. Valentino further reported that net leverage ratios are added this month as a new item. They follow adoption of the Net Asset Policy.

Ms. Falls asked if target ratios will be removed from this portion in future reports and replaced with policy guidelines. Ms. Valentino replied that there is value in keeping targets in the reports because of how they evaluate the metrics. Mr. Haffey asked for additional information on setting of the targets. Ms. Falls commented that two financial guidelines have been adopted, so additional ones obscure these two.

Mr. Pitts noted there were 130,000 claims in June 2009, a reduction from 260,000 in the June 2006. He asked what the effect on future staffing levels is. Ms. Valentino reported that BWC reviews this information on an ongoing basis, and will incorporate this into its budgeting process. Ms. Ryan added that the decline in workplace accidents is a national trend.

ADMINISTRATOR BRIEFING

Ms. Ryan reported that the budget bill, HB15, had been approved in June and signed by Governor Strickland. The governor vetoed four sections, three of which

were based on their impinging the independence and expertise of the Workers' Compensation Board.

BWC senior team is now working on annual objectives. They will be presented to the Workers' Compensation Board at the August meeting.

The William Green Building has received its first tenant other than BWC and the Industrial Commission. The Ohio Administrative Knowledge System (OAKS) will now occupy the entire L12 level.

The Ohio General Assembly is in recess after approving the general operating budget. It will reconvene on September 8 and consider three pending bills. HB 249 gives trade and business associations access to confidential injured worker and dependent contact information. It expands the current journalist exception of Ohio Revised Code § 4123.88 (D). SB 94 would create a rebuttable presumption on certain types of cancers for firefighters, police officers, and emergency medical service workers. This follows a national trend. HB 216 makes changes in the law concerning Professional Employer Organizations (PEOs). Premium reporting is a key issue in this industry.

On July 29, Rep. William Bachelder reintroduced legislation in the form of HB 259, which removes the "prudent person" requirement from investment of the State Insurance Fund and specifies the types of investment BWC could make. More details on legislation are available from Greg Paul, Legislative Liaison, and the senior team.

On the federal level, HB 635, co-sponsored by Reps. Marcy Kaptur and Dennis Kucinich, would establish a national task force to identify reforms in workers' compensation. The bill has not moved from its committee. It is opposed by the National Association of Insurance Compensation and there is much attention to this legislation in industry trade publications.

Maria Smith, Chief of Communications, has prepared an overview on accomplishments of BWC in 2008 and 2009. It provides a review of accomplishments over two years.

BWC has changed its pharmacy benefits manager to SXC Health Solutions Corporation. We spend \$120 million a year on prescriptions. The Request for Proposal (RFP) was conducted by both BWC and the Department of Administrative Services. SXC has the most innovative concepts in prescription management. The BWC RFP team was led by Bob Coury and Doctor Robert Balchick. SXC has begun its contract.

BWC looked into the old pharmacy benefits contract to determine if rebates could be obtained. BWC was able to identify \$1.5 million in rebates for 2009, with expenses for the project of \$300,000.

Mr. Harris asked if the submission of HB 259 by Rep Bachelder was a surprise. Ms. Ryan replied that BWC was not informed of the bill introduction, however BWC is not surprised. The bill reflects the expertise of Rep. Bachelder and his interest in the investments of the State Insurance Fund.

Mr. Lhota reported that the August meeting will begin with a presentation on ethics by David Freel, Executive Director of the Ohio Ethics Commission. It will run two hours, and fulfill the statutory requirement of two hours of Ethics training during the biennium. It will be followed by the annual half hour fiduciary briefing by Ron O'Keefe, Fiduciary Counsel. So the business agenda will start about 10:30 a.m. and adjournment will come about 12:30 p.m.

EXECUTIVE SESSION

Mr. Lhota moved to enter executive session pursuant to Ohio Revised Code §121.22(G) (3) for the purpose of discussing employment issues. Mr. Bryan seconded and the motion was approved by unanimous roll call vote of eleven ayes and no nays.

Prior to entering the executive session, Mr. Lhota recessed the meeting at 9:10 a.m. for fifteen minutes. The Executive Session convened at 9:25 a.m.

ADJOURNMENT FROM EXECUTIVE SESSION

Mr. Lhota moved to adjourn from executive session at 10:35 a.m. Mr. Bryan seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

Ms. Falls moved that the Workers' Compensation Board of Directors approve the Workers' Compensation Board of Directors' Self-Assessment, Summary of Director Responses. Mr. Bryan seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

ADJOURNMENT

Mr. Matesich moved to adjourn the meeting at 10:38 a.m. Mr. Haffey seconded and Mr. Lhota adjourned the meeting after the motion was approved by a roll call vote of eleven ayes and no nays.

Prepared by: Larry Rhodebeck, Staff Counsel
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