BWC Board of Directors

ACTUARIAL COMMITTEE
Thursday, March 25, 2009, 2:19 P.M.
William Green Building
30 West Spring St. 2nd Floor (Mezzanine)
Columbus, Ohio 43215

MEMBERS PRESENT: Charles Bryan, Chair
Jim Matesich, Vice Chair
David Caldwell
James Hummel
Thomas Pitts
William Lhota, ex officio

Members Absent: None

Other Directors Present: Allison Falls, Kenneth Haffey, James Harris, Larry Price, and Bob Smith

Counsel present: James Barnes, Chief Legal Counsel

CALL TO ORDER

Mr. Bryan called the meeting to order at 2:19 p.m. and the roll call was taken. Mr. Pitts reported at 2:21p.m.

MINUTES OF FEBRUARY 25, 2010

Mr. Caldwell moved to approve the minutes of February 25, 2010. Mr. Matesich seconded and the minutes were approved by a roll call vote of six ayes and no nays.

AGENDA

Mr. Bryan reported that the Drug Free Safety Program (DFSP) structure had been approved by the Medical Services and Safety Committee and would be presented to the Workers' Compensation Board by Mr. Harris. The Actuarial Committee would consider the pricing of this program.

Mr. Matesich moved to adopt the agenda. Mr. Pitts seconded and the agenda was adopted by a roll call vote of six ayes and no nays.

NEW BUSINESS/ ACTION ITEMS

RULE FOR SECOND READING: DRUG FREE SAFETY PLAN PRICING, OHIO ADMINISTRATIVE CODE RULE 4123-17-58

John Pedrick, Chief Actuarial Officer, recommended amendment of Ohio Administrative Code Rule 4123-17-58 to adopt the Drug-Free Safety Program (DFSP). Assisting him were Joy Bush, New Program Development Director, and Dave Heppen, Deloitte Consulting LLP.

Ms. Bush reported that the key issue before this committee regarding the DFSP rule is Appendix A, which establishes that employers are entitled to a 4% discount for participation in the basic program, 7% discount for the advanced program, and a 3% discount for group employers implementing the advanced program.

Mr. Bryan asked why these discount rates are not higher considering that the DFWP had higher rates for participation. Mr. Heppen reported that Deloitte looked at other states and most gave 5% for participation. Ohio had the highest discounts of any state. The indication was that employers, by participating in the DFSP, would save the fund 3% to 5% rate over several years of participation; so the proposal is actuarially sound.

Mr. Hummel asked if other states have limits on years of participation. Mr. Heppen replied it was mixed -- some states were limited, some were unlimited. Ms. Bush added that BWC felt that by lowering the discount, BWC could lengthen the years of eligibility.

Mr. Bryan asked if there is statistical coding that enables evaluation of the program. Mr. Pedrick replied BWC will do evaluation of the program as it does with all other programs. BWC periodically reviews all programs for effectiveness. The first policy under this program will end June 30, 2011 so BWC will evaluate and bring any loss experience and possible changes to the Workers' Compensation Board in 2012. Thereafter, review of the discounts will probably be on a three year cycle.

Mr. Matesich moved that the Actuarial Committee recommend that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation to adopt the Appendix to new rule 4123-17-58 of the Administrative Code, "Drug-Free Safety Program Rule," and to rescind existing rules 4123-17-58 and 4123-17-58.1. The motion consents to the Administrator adopting and rescinding the rules as presented and approved at the Medical

Services and Safety Committee and as presented here today at the Actuarial Committee. Mr. Hummel seconded and the motion was approved by a roll call vote of six ayes and no nays.

RULE FOR FIRST READING, DEDUCTIBLE PROGRAM, OHIO ADMINISTRATIVE CODE RULE 4123-17-72

Ms. Bush recommended amendment of Ohio Administrative Code Rule 4123-17-72. The approval of the DFSP requires a small change in the large deductible program because employers who participate at certain levels will not be eligible for the DFSP discount.

Mr. Bryan asked for the rationale for this recommendation. Ms. Bush replied that the deductible program is a cost plus program with the employer paying a smaller premium up front and then paying loss amounts up to the deductible over several years based on actual frequency and cost. Mr. Pedrick added that participation in the DFSP leads to immediate savings, whereas the deductible will require initial payment and flow-through of claims costs. A large deductible program employer that succeeds in decreasing the frequency of workplace injuries receives an immediate cost reduction because it would have fewer deductible amounts to pay.

Ms. Falls asked how other states have handled stacking of discounts. Marsha Ryan, BWC Administrator, replied the program should not emphasize the discount, but rather should emphasize safety in the workplace and safety for the sake of safety. Employers who elect a deductible plan with BWC will work harder to prevent accidents.

Mr. Price stated he did not disagree, but participation of many employers was motivated by the discount.

Mr. Matesich added that in the current environment, exclusion from programs becomes a disincentive.

Ms. Bush also presented an amendment on the public employer taxing district (PEC) large deducible program. The amendment is supported by the Oliver Wyman Consulting report and is under consideration by Deloitte.

Mr. Bryan asked if Deloitte would be providing an opinion on the actuarial soundness. Mr. Heppen replied that it would. Ms. Bush added that in the future BWC will combine recommendations on private employers and PECs.

RULE FOR FIRST READING, 2010 NCCI CLASSIFICATION CODE CHANGES, OHIO ADMINISTRATIVE CODE RULE 4123-17-04

Tom Prunte, Director of Employer Management Services and Michael Glass, Director of Underwriting and Premium Audit recommended amendment of Ohio Administrative Code Rule 4123-17-04 regarding classifications of the National Council on Compensation Insurance (NCCI). Mr. Pedrick first noted that the Ohio Revised Code requires BWC to use NCCI classifications for manuals; Ohio data is not reported to NCCI.

Mr. Bryan asked why Ohio does not report its experience so that its statistics could be used in determining class issues. Mr. Pedrick replied that NCCI examines the job requirements and activity for those in a classification, which are the same everywhere. The rates that BWC proposes are entirely based on Ohio experience.

Mr. Prunte reported that NCCI gathers data to define manuals. The proposed changes are effective July 1, 2010.

Mr. Glass reported that there are eight changes. New manual 8725 is for inventory takers and reflects intermediate exposure between inspectors and accountants.

Mr. Bryan asked how BWC will put this change into effect. Mr. Glass replied BWC will communicate the change to all employers with the existing two codes.

Mr. Bryan requested BWC summarize the remainder. Mr. Glass replied that most are phraseology changes. For example, horticulture no longer includes nursery landscaping. The change to daycare reflects the industry trend not to segregate caregivers from support staff.

Mr. Hummel asked where the stakeholder comments can be found. Mr. Glass replied that comments were solicited from each industry, but none were received. Mr. Hummel asked that this be reflected in future reports.

Mr. Lhota noted that moving employers into manual 8725 would raise rates for employers in manual 8803 and rates remain the same in manual 8720, Mr. Pedrick added that with a new class, it generally takes at least two to three years of experience to create a new rate.

Ms. Falls stated that since NCCI classifications are mandatory, solicitation of stakeholder input is not profitable or necessary. Ms. Ryan concurred. So BWC will have to shape its communication to inform stakeholders of changes and the effect on their rates.

Mr. Matesich added that because the Grocers Association was not contacted, BWC should have a second reading for feedback. Mr. Glass answered that manual 8725 would not be part of the grocers' manuals. Mr. Matesich responded that BWC still needed to properly communicate changes. Mr. Glass replied that BWC tried to find an inventory counters association, but could not; Mr. Haffey reported that there are four to five firms in Ohio that do this, reaching out to individual employers should be easy.

Mr. Bryan stated there was no sentiment for waiver of the first reading, so he requested that outreach to employers before the second reading.

Mr. Lhota stated that the discrepancy between elevator inspectors and accountants seems large. Mr. Pedrick replied that risks associated with taking a grocery inventory are higher than most duties in accounting. Mr. Glass added that grocers are already in manual 8720.

RULE FOR FIRST READING, PRIVATE EMPLOYER RATE CHANGE RECOMMENDATION

Mr. Pedrick and Deloitte Consulting reported on the private employer rate level indication for rates effective July 1, 2010. Mr. Pedrick first reported on the schedule for the adoption. In March, BWC makes the recommendation and the presentation of analysis. April will see the second reading of the recommendation and possible vote, and the first reading on manual rates and the second reading on the NCCI amendments. In May, there will be the second reading on classification rates. The rates are effective July 1, 2010 and employers will make their first payment six months later after January 1, 2011.

Jan Lommele introduced the Deloitte team consisting of Bill Van Dyke, Bob Miccolis, Mr. Heppen, and himself. He reported that Deloitte is using the same methodology as used in HB100 study to determine the actuarially indicated rate change for private employers.

Mr. Heppen reported that the recommendation is based on use of a 4.0% discount rate. A key component is the December 2009 reserve analysis. Claim frequency is in decline in Ohio and countrywide. This is a favorable trend, but will stop, eventually, flatten out, and perhaps start to rise. Severity trends in Ohio are increasing faster than countrywide. Indemnity rates are higher in Ohio. Ohio also grants permanent total disability benefits (PTD) and lump-sum settlements more frequently.

Mr. Lhota asked if Ohio were included in the NCCI data, would the rate indication change. Mr. Heppen replied there would be little impact because there are thirty-seven states providing data to NCCI and a 5% trend selection for 2009 to 2010.

Mr. Heppen further reported that medical severity in Ohio is similar to the NCCI, with a 6% trend.

Ms. Falls asked how long a period does Deloitte use in determining a trend. Mr. Heppen replied the trend is considered using 5-6 years of premiums and losses.

With respect to Deloitte's overall observations, Mr. Heppen reported that the overall loss experience (combining frequency and severity trends) in Ohio continues to improve relative to past estimates. BWC should pay close attention to indemnity severity as it is outpacing the NCCI benchmark in that category. This could be driven by lump sum settlements. BWC's medical trends appear to be in line with industry norms. Finally, discounting reserves results in BWC collecting premiums that are approximately $600 million to $700 million lower than undiscounted premium levels.

Mr. Pitts asked if indemnity increased because of increases in the average weekly wage. Mr. Heppen replied that would be one component, but not the sole reason. Mr. Lommele added that higher utilization is another factor.

Mr. Smith asked whether high utilization is a red flag on medical expense. Mr. Lommele replied that utilization is an issue that the workers' compensation insurance industry has identified and received attention. Mr. Miccolis added that other factors include prolonged temporary total disability (TTD) and the economic environment. Mr. Lommele stated Deloitte will address these factors later in 2010 in its claims analysis.

Mr. Matesich asked what the recommendation would be if the discount rate remained at 4.5%. Employers are concerned, struggling to stay in business, and trying to make payrolls. They want to know how to understand their rates when BWC has $18 billion in assets. Mr. Pedrick replied that a 3.9% decrease represents $70 million reduction. Section 1, exhibit 3b of the Deloitte recommendation shows that the discount rate results in $700 million less premium to collect. BWC is counting on investment income to make up the difference. The State Insurance Fund's rates are highly leveraged and the investment assumption means BWC is asking 37% less than it is predicting it will need for claims. That is how BWC differs from the insurance industry.

Mr. Matesich reported that this still hard to understand the rates when BWC reports $1.6 billion in investment income in recent years.

Mr. Smith stated that with $19 billion in assets and $27 billion in liability, the process for setting premiums should be as thorough as the process in setting discount rate.

Mr. Price commented the Workers' Compensation Board is privy to information the public does not have. So he can understand the frustration of the public.

Mr. Harris stated there is no great appreciation when premiums are high, but employers appreciate stability in premiums.

Mr. Caldwell commented that the Workers' Compensation Board should also consider the recent threat of a General Motors default and the need to have reserves for future costs.

Ms. Ryan stated that in the United States, informed and educated people in business all should know that 2-3% of payroll is the cost for workers' compensation coverage and this coverage helps employers to insure against suits from employees which would be possible without no-fault workers' compensation. Ohio is distinct from other states in having an environment of expectation of low workers' compensation premium rates. So this is a hard discussion to have until all the background facts are studied and understood.

Mr. Matesich stated that he did not disagree with anyone on these issues, but still needs to put these comments on the table.

Ms. Falls stated that for the second reading, the Workers' Compensation Board needs the rate changes for the last five years; the differences between group and non-group employers and how they are computed; and the group and non-group financial impact over the last 5—6 years. She indicated it would be helpful to discuss some of the alternatives considered.

Mr. Pitts added that employers need better awareness that workers' compensation is protection from litigation.

Mr. Bryan summarized that the Actuarial Committee will see rates by classification; and will see break-down between group and non-group. He asked directors to contact Mr. Pedrick with any questions.

RULE FOR FIRST READING, PUBLIC EMPLOYER STATE AGENCY RATE CHANGE RECOMMENDATION PROGRAM, OHIO ADMINISTRATIVE CODE RULE 4123-17-35

Mr. Pedrick recommended amendment of Ohio Administrative Code Rule 4123-17-35 on Public Employer State Agency (PES) rates. The amended rule includes new rates for each agency. PES premiums differ from private employer and PEC rates because PES rates are based on payments made, not future reserves. The payments reflect costs for all active claims, going back many years, but paid during the fiscal year. Fundamentally, the state is a pay-as-you-go system. BWC recommends an overall 4.3% reduction.

Mr. Smith asked why the state doesn't reserve its own claims. Mr. Pedrick replied because it is the state of Ohio and can in essence set up self-insurance. The calculation is based on projection of payroll and payments, along with a true up each year. Page 4 of the PowerPoint shows how annual trends increased costs over time. In recent years, state agencies ran a deficit, which BWC closed up through a "mean reverting approach." The proposed MCO assessment rate is 10.12% of premium before adjustment for 2009 actual costs. The effective assessment is 10.23%. For 2009, the rate before adjustment was 9.91% and the effective rate was 10.42%. Mr. Pedrick reviewed the premium and MCO assessment collection methodology and gave an example of a true-up.

Mr. Matesich asked why page 4 shows $63.2 million in premium projection and page 6 is $61 million. Elizabeth Bravender, Actuarial Director, reported that on page five of the report there is a $2.7 million surplus for 2009.

Mr. Lhota asked why Ohio University and Miami University have rates that are five times larger than Youngstown State University. Mr. Pedrick responded that he was not aware of details, but a few high-cost claims mean higher rates for individual employers. Mr. Bryan added that was the inherent instability in a "pay-as-you-go" system.

Mr. Pedrick finally commented that small boards and agencies are grouped together for rating purposes.

<u>DISCUSSION ITEMS</u>

<u>QUARTERLY RESERVE ANALYSIS FOR FINANCIAL REPORTING FOR FISCAL YEAR ENDING JUNE 30, 2010</u>

Mr. Van Dyke led the presentation of the December 31, 2009 Reserve Analysis for Unpaid Loss and Loss Adjustment Expense as of June 30, 2010. He was assisted by Mr. Lommele, Mr. Heppen, and Mr. Miccolis. Deloitte Consulting LLP has been retained by BWC to determine an actuarial central estimate of the unpaid loss and loss adjustment expense (LAE) as of June 30, 2010. The data was evaluated as of December 31, 2009. Deloitte determined unpaid loss and LAE estimates on both a nominal and discounted basis for the State Insurance Fund and the six ancillary funds.

The previous actuarial consultant provided a preliminary estimate of the needed reserves for June 30, 2010. Deloitte estimates ultimate losses, then deducts actual losses paid to calculate reserves and then discounts the reserve. Deloitte calculated separate estimates for each accident year from 1977 through 2010. For accident years 1976 and prior, unpaid loss estimates were determined based on analyzing historical incremental annual payments for accident years 1953 and subsequent.

The BWC preliminary discounted reserve as of June 30, 2010 is $19.3 billion and is $318 million, or 2%, above the Deloitte estimated discounted unpaid estimate of $19.0 billion based on data as of December 31, 2009. The BWC preliminary reserve as of June 30, 2010, is primarily based on the unpaid estimate as of June 30, 2009. The discounted unpaid estimate using a discount rate of 4.5% reflects $13.5 billion of future investment income, which must be realized to provide sufficient funds to make all future claim payments associated with claims occurring on June 30, 2010 and prior years.

Changing the discount rate from 4.5% to 4.0% would increase the discounted unpaid estimate by $919 million or 4.8% from $19.0 billion to $19.9 billion. This would require an increase of $601 million over the BWC preliminary reserve as of June 30, 2010 of $19.3 billion. A portion of this is offset by an unbilled premium receivable of $3.16 billion as of June 30, 2010 and is consistent with the BWC recorded unbilled premium receivable as of June 30, 2009, of $3.21 billion. Changing the discount rate from 4.5% to 4.0% would increase the unbilled premium receivable by $183 million to $3.34 billion and partially offset the increase in the Deloitte unpaid claim estimate of $191 million.

Deloitte's discounted unpaid claim estimate of $15.1 billion is $271 million or 1.8% less than the BWC preliminary reserve of $15.4 billion for the State Insurance Fund only. The difference of $291 million for private employers, public employer state agencies, and public employer taxing districts is primarily associated with lower medical estimates, partially offset by higher compensation estimates. For the Self-Insured portion of the Surplus fund, Deloitte is $38 million lower than the BWC preliminary reserve primarily from a change in the expected recovery rate from surety bonds from 15% to 35% based on recent observed recovery rates. The Deloitte estimate for the Health Partnership Program is $57 million, or 9%, higher than the BWC preliminary reserve.

The BWC recorded reserves associated with State Insurance Fund medical have decreased over time for private employers, taxing districts, and State agencies as a result of continued decrease in frequency and lower than expected medical inflation. The prior analysis relied on a methodology that removed historical medical inflation from the development (persistency) factors and incorporates explicit future medical inflation assumptions. The analysis underlying the BWC preliminary reserve as of June 30, 2010, incorporated medical inflation of 6% for 2010, 7% for 2011, 8% from 2012, and 9% for 2013 and subsequent. Deloitte has utilized common accident year development methods that incorporate cumulative data and medical inflation directly in the historical development factors. This approach assumes future medical inflation will be similar to historical inflation experience by BWC, which is approximately 6% to 7%. BWC medical inflation is very similar to that reported by NCCI and is higher than the medical inflation of the Consumer Price Index.

Compensation estimates for the State Insurance Fund have been relatively consistent over time, but have experienced a modest increase in recent years due to additional uncertainty introduced from an emphasis on lump sum settlements (LSS). The increase in LSS activity from 2006 through 2009 may result in ultimate cost savings, but measurement of the cost savings benefit is difficult to assess due to limited information. The Deloitte approach does not directly recognize potential savings from the increase in LSS due to the added increase in uncertainty. In this approach recognition of savings will occur over time as future payments emerge better than expected to the extent savings do exist. Similar to medical expense, Deloitte utilized common accident year development methods that incorporate cumulative data. Estimates were determined separately by compensation type (PTD, death, TT, etc.).

Mr. Bryan asked if Deloitte would be monitoring the impact of LSS and Mr. Van Dyke confirmed Deloitte would be.

Mr. Pitts asked does not LSS impact the length of the claim tail, not immediate expense and Mr. Van Dyke confirmed.

Mr. Van Dyke also reported that as part of the actuarial transition, Deloitte performed a preliminary analysis of the private and public employers business within the State Insurance Fund, using data evaluated as of June 30, 2009. Payments were $37 million or 4%, lower than expected from June 30, 2009, to December 31, 2009. Incurred expenses (paid plus MIRA reserves) were $296 million higher than expected due to a change in the MIRA discount rate from 5% to 4.5% and higher MIRA estimates associated with new PTD claims. These trends led to a decrease in ultimate losses of $82 million for the accident year 2010 and prior along with a reduction in projected 2010 payroll. The goal is to achieve less volatility in the rate.

In computing the DWRF reserve, Deloitte discounted the unpaid estimate of $1.91 billion, which is $70 million or 3.5% lower than the BWC preliminary estimate of $1.96 billion. The majority of the difference is related to LAE where Deloitte relied on a lower paid LAE to paid loss ratio of 0.5% based on observed ACF LAE payments. Similar to the State Insurance Fund, Deloitte employed common cumulative development methods that incorporate DWRF payments and ratios of DWRF payments to State Insurance Fund loss payments. The unpaid claim obligations of the DWRF are subject to more risk and uncertainty than other funds due to a potentially high leverage effect of future inflation based on the nature of the coverage.

The Deloitte discounted unpaid estimate of $65 million for the Coal Workers Fund is similar to the preliminary reserve of $69 million. The Deloitte approach for the Coal Workers Fund uses mortality assumption and methods based on frequency of claims and average value of claims. Deloitte includes provisions for known claims, pending claims, future claims, and currently active or working miners. The national health care reform bill has changes in the Coal Workers Fund which will increase the number of cases. West Virginia has estimated the cost increase at $50 million to $100 million. For the Self-Insuring Employers' Guaranty Fund, the discounted unpaid estimate by Deliotte of $820 million is $34 million or 4% higher than the BWC preliminary reserve of $786 million as of June 30, 2010. The difference is primarily a result of a higher Guaranty Fund DWRF estimate partially offset by a lower Guaranty Fund loss estimate.

The BWC preliminary reserve is based on a methodology that segregated payments into accident/injury years. In this approach, the loss development includes a provision for future bankruptcies to the extent they have occurred historically. The Deloitte approach determines separate estimates of future SIEGF loss payments for known and future bankruptcies, which allows for varying assumptions related to future bankruptcies. The difference in the estimate of future bankruptcies is not included, because Deloitte used bankruptcy years, not accident years. Mr. Lommele added that all factors are related together. For the ACF, the Deloitte discounted unpaid estimate of $1,074 million is only $7 million or 1% lower than the BWC preliminary reserve of $1,081 million of June 30, 2010. With respect to the volatility of the funding ratio, there is substantial uncertainty because of the changes in the factors: increase in asset values and decreases in estimated liabilities. The supporting documentation is available to all directors in CD-ROM form.

<u>LEGISLATIVE DISCUSSION AND ANALYSIS</u>

There was no discussion of pending legislation.

<u>CAO REPORT</u>

Mr. Pedrick reported that the CAO Report sets forth a summary of events for the next few months' activities.

COMMITTEE CALENDAR

Mr. Bryan requested suggestions for inclusion in the committee calendar, but none were offered.

EXECUTIVE SESSION

There was no executive session or litigation update.

ADJOURNMENT

Mr. Matesich moved to adjourn and Mr. Pitts seconded. Mr. Bryan adjourned the meeting at 4:45 p.m. after the motion was approved by a roll call vote of six ayes and no nays.

Prepared by: Larry Rhodebeck, Staff Counsel
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April 2, 2010