BWC Board of Directors

ACTUARIAL COMMITTEE
Thursday, April 29, 2010, 8:00 A.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
Members Absent:	William Lhota, ex officio
Other Directors Present:	Allison Falls, Kenneth Haffey, James Harris, Larry Price, and Bob Smith
Counsel present:	John Williams, Assistant Attorney General F. Ronald O'Keefe, Fiduciary Counsel, Hahn Loeser & Parks LLP

CALL TO ORDER

Mr. Bryan called the meeting to order at 8:00 a.m. and the roll call was taken. Mr. Bryan reported that Mr. Lhota would be absent.

MINUTES OF MARCH 25, 2010

Mr. Bryan requested that the heading of the minutes be corrected to reflect that the meeting occurred in 2010, not 2009. Ms Falls requested that her comment in the last paragraph of page 4 be changed from "profitable" to "productive."

Mr. Hummel moved to approve the minutes of March 25, 2010 as amended. Mr. Pitts seconded and the amended minutes were approved by a roll call vote of five ayes and no nays.

AGENDA

Mr. Bryan added a fifth action item to respond to the request from Service Association of Ohio to change the due date of the group retrospective program from April 30 to May 30.

Mr. Matesich moved to adopt the agenda as amended. Mr. Hummel seconded and the amended agenda was adopted by a roll call vote of five ayes and no nays.

NEW BUSINESS/ACTION ITEMS

RESOLUTION SECOND READING, PRIVATE EMPLOYER PREMIUM RATE CHANGE RECOMMENDATION

John Pedrick, Chief Actuarial Officer, and Elizabeth Bravender, Actuarial Director, made a presentation to the Committee with regard to the BWC's recommendation of a 3.9% reduction in the overall premium rates for the 2010 policy year commencing July 1, 2010 and related matters. The substance of the recommendation, and an explanation of the factors considered in formulating it, was set forth in a document entitled "Private Employer Rates and Rate Reform – Report to the Board of Directors, Actuarial Committee, April 29, 2010." This document, and related materials, including a document prepared for the BWC by Deloitte Consulting LLP entitled "Rate Recommendations for Private Employers – State of Ohio, Bureau of Workers' Compensation, March 12, 2010" had been previously provided to the Board and Committee members with the Board materials in advance of the meeting.

As an introduction to the presentation, Mr. Bryan outlined the requirements and factors in fixing premium rates for private employers. Under Ohio law, the BWC shall fix rates annually on July 1. Other factors considered in fixing premium rates include the competitiveness of Ohio workers' compensation premium rates and the respective roles of the BWC Administrator in recommending the annual premium rates and that of the BWC Board in providing advice and consent. Mr. Bryan noted that BWC will be offering a split experience rating plan to be in effect for the next following premium year, commencing July 1, 2011 and continues to bring greater equity to both group and non-group employers. Mr. Bryan asked Mr. Pedrick to review the written materials and provide an explanation to the Committee regarding the determination of the recommended premium rates for the upcoming fiscal year for group-rated employers and non-group-rated employers.

Mr. Pedrick provided some background on the rate reform efforts of the BWC. He reported that BWC as a whole came under scrutiny in 2005 for several things. A number of independent studies commissioned by the BWC at that time established the inequity of group rating; that is, that the group-rated employers were not paying their fair share of the overall premium costs from an actuarial point of view. As a result, the then BWC Administrator publicly recognized that the group rating program was not paying its own way. In 2005, the maximum group discount was 95%, and has gradually been reduced in each policy year since then. In 2007, the Ohio Inspector General commented on the inequity of the BWC's group rating system and recommended that BWC follow recommendations in the seven actuarial studies from Oliver Wyman Consulting, a study by Pinnacle Consulting and one by AON Consulting. In the HB 100 comprehensive study, Deloitte Consulting recommended that the BWC revise or replace group experience rating. BWC, with the advice and consent of the BWC Board, reduced the maximum group discount further in 2008 and 2009. The maximum discount for the 2009 policy year is 77%. Recently, in the *San Allen* case, Judge McMonagle of the Cuyahoga County Court of Common Pleas certified a class of non-group employers as plaintiffs in a suit against the BWC seeking damages and other relief due to the group-rating system. The class is all employers that were not in group rating for one or more of the policy years starting July 1, 2001 and ending June 30, 2009. Mr. Pedrick explained that the introduction of the "break-even factor" concept in 2009 as part of the actuarial analysis separated group funding from non-group funding and thus enabled rates to be set at the appropriate level for non-group employers. He stated that there is still much to be done to bring group rates fully up to levels that match the costs these employers bring to the system. For the upcoming policy year, only eight Ohio employers qualify for a 51% discount when rated individually, whereas approximately 41,000 will receive this discount due to their participation in the group rating program.

Mr. Bryan asked whether it was the intent of group rating to give discounts. Mr. Pedrick replied it depends on what the discount is. Historically the group program has not paid its own way. An average 50% reduction from base rates does not cover the cost of claims of group-rated employers.

Mr. Smith asked if rate setting is similar to government agency accrual accounting which retrospectively reconciles claims costs with premiums paid. Mr. Pedrick replied that was a correct description. He elaborated that, for example, the proposed 3.9% overall base rate decrease recommended for the 2010 premium year reflects trends seen in recent claims experience, and results in an estimate of costs for the next year.

Mr. Pedrick further reported that the last study to recommend a decrease of credibility for group discounting as a matter of actuarial soundness was a study produced by Pinnacle Actuarial Resources, Inc. in 2006. That study recommended that a $1 million risk receive 40% credibility, while today we are looking at a maximum credibility of 65% and a maximum discount of 51%. Deloitte Consulting did not offer a credibility recommendation for group because they did not agree with the current approach of using experience rating to set group discounts.

Mr. Hummel asked if BWC will be discontinuing use of the "break even factor" as an actuarial tool and moving to two separate credibility tables for group and non-group employers. Mr. Pedrick responded that the break even factor will be necessary as long as group inequity exists. If BWC adopts two tables, a break even factor may not be necessary. But he also noted that as long as we aggregate the experience of groups, we are likely to need a break-even factor.

Mr. Pedrick summarized the April 29, 2010 report distributed with today's materials and also described the role of the Deloitte report in providing the BWC actuarial staff with support for the current BWC rate change recommendations. Mr. Pedrick pointed out that the report discussed the many considerations that went into the premium rate recommendation for the next premium year that was submitted to the Actuarial Committee today. For example, the change of the credibility table which reduced the maximum from 77% to 65% had the effect of raising all employer rates if BWC does not make additional structural changes such as lowering base rates and the break even factors. Thus, some base rate change was in order.

Mr. Smith stated that group rates for the current premium year appear to be 30% less than average and non-group rates appear to be 30% more. Mr. Pedrick confirmed that observation and stated that, in keeping with the plan to gradually reduce the group/non-group rate disparity at a measured pace, the target for the coming policy year will remain at 30% less than average but the reduction in the credibility table will effectively raise rates for group and lower rates for non-group. He added that the target for the next following policy year commencing in 2011 is to bring group and non-group rates even closer to full parity.

Mr. Bryan asked if BWC could expedite the progress to rate equity. Mr. Pedrick replied that as a monopoly, BWC could make all changes at once. BWC, however, has chosen not to change all at once in order to promote rate stability and relative predictability from year-to-year for the benefit of employers. Mr. Pedrick emphasized that if a group sponsor rejects an employer from the group for having one claim, there is a disparate premium increase for the employer. If the employer had a 90% discount with the group, the resulting increase in premium rates for being out of group could be a 1900% increase. The gradual decreases in the maximum group discount from 90% downward, though resulting in increased premiums for some group employers, have lessened the adverse effect of an employer being eliminated from group.

Mr. Bryan asked Mr. Pedrick to summarize the BWC premium rate recommendation for the coming policy year. Mr. Pedrick reported that a 3.9% decrease in the overall base rate is the largest decrease BWC can recommend at this time that is actuarially sound.

Mr. Matesich stated that he has followed the reasoning advanced by Mr. Pedrick and agrees with the BWC conclusion. He requested further explanation of how BWC intends to achieve homogeneity and continuity in group rating. Mr. Pedrick replied that BWC could follow the recommendation of Deloitte Consulting LLP and create another system that sets the price at the correct levels for group employers, eliminating much of the group discount we see today. That would appear to be a very disruptive choice. The direction chosen by BWC, however, is to reform group rating and make it work. In that regard, BWC could insist on a tough continuity standard, for example, requiring that sponsors keep 95% of members from year to year. The feedback from sponsors was that this standard would not work for them. Mr. Matesich asked if BWC could insist on a more liberal standard of continuity. Mr. Pedrick replied that even if BWC could insist on 90% continuity for each year without decreasing the maximum group discount, it would still take seven years for the experience modifier for a group to reach its appropriate level.

Mr. Matesich stated another consideration is whether the total financial performance of BWC is considered when making a rate recommendation. Mr. Pedrick replied that consideration of the total financial performance of BWC was part of the actuarial considerations resulting in rate determination. For example, there is an actuarial assumption that premium dollars are collected and invested with a 4% return to pay all claims costs. Accordingly, if the actual return on investments ranges from 6% to 7% in portfolio growth, then this overage may be a factor to consider when determining rates for future premium years. He described the elements of the BWC balance sheet. The net asset in the current month's Enterprise Report is $4.3 billion. But close examination of the report shows almost the same amount as an asset called "accrued premiums." Pursuant to government accounting standards, these are premiums which are not yet collected. While the net asset is a large figure, it is the result of applying government accounting standards when valuing assets and liabilities. This provides a fair statement of BWC's finances, but a close reading is necessary to see that financial strength is measured by more than just the net asset. In addition, while the income statement shows strong investment income, much of that consists of unrealized gains and losses. The need to understand what the report says and what it does not say has led to the use of the funding ratio as a measure of performance and, eventually, as a factor considered in the setting of premium rates.

Mr. Price asked why there is opposition to requiring greater homogeneity in terms of industry groups. Mr. Pedrick replied that currently BWC has ten industry groups and many employers can find a variety of opportunities for group rating. The proposal to increase the number to twenty industry groups arouses opposition because employers may have more limited options for group rating,

Ms. Falls stated she greatly appreciated the description of the context in which this year's rate recommendation is being made and thanked BWC staff for its comments. She would appreciate being provided with more information regarding the Deloitte recommendation for a different group rating system for future discussion. She further commented that the memorandum prepared by Mr. Pedrick and distributed in advance of the meeting addressed the concerns she voiced at last month's Board meeting.

Mr. Bryan asked if the 3.9% overall rate decrease included the impact of the break even factor. Mr. Pedrick replied that the break even factor was one of the influences resulting in the 3.9% rate decrease from the prior policy year, along with the decision approved by the Board in October 2009 to further limit credibility by decreasing the maximum group discount rate.

Mr. Matesich moved that the Actuarial Committee recommend that the BWC Board of Directors consent to the Administrator fixing private employer rates beginning July 1, 2010, to achieve an overall Three Point Nine percent (3.9%) decrease in the total collectible premium rate from the previous year. This motion also consents to the Administrator preparing private employer rate rules to present to the Board consistent with this overall rate recommendation. Mr. Hummel seconded and the motion was approved by a roll call vote of five ayes and no nays.

Mr. Price asked if any proposal will include homogeneity and continuity as requirements. Mr. Pedrick replied that BWC has been meeting with Deloitte to examine options for fixing the group rating program.

RULE FOR SECOND 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. BWC recommends an overall 4.3% reduction. Slide 4 and 5 of the PowerPoint handout show the calculations of the rates. Slide four shows the projections of the costs. Slide five shows the true-up BWC has undertaken for past years' funding deficits. Slide six shows the calculation of the decrease in cost allowances for the Managed Care Organizations (MCOs).

Mr. Hummel asked if BWC had discussed the rate changes with the agencies. Mr. Pedrick replied that both claims costs and MCO costs were discussed with the agencies.

Mr. Hummel moved that the Actuarial Committee recommend that the Bureau of Workers' Compensation Board of Directors consent to the Administrator fixing State Agency rates beginning July 1, 2010, to achieve an overall Four Point Three Three per cent (4.33%) decrease in the total collectible premium rate from the previous year. This motion also consents to the Administrator amending Rule 4123-17-35, "Public Employer State Agency Contribution to the State Insurance Fund," consistent with this overall rate recommendation. Mr. Caldwell seconded and the motion was approved by a roll call vote of five ayes and no nays.

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

Joy Bush, New Program Development Director, and Dave Heppen, Deloitte Consulting LLP, requested amendment of Ohio Administrative Code Rule 4123-17-72, the deductible program rule. The approval of the Drug-Free Safety Program (DFSP) requires a small change in the large deductible program because employers who participate at certain levels will not get the DFSP discount. The change is to paragraph (M). Most states use limits on employer discounts involved in multiple programs. Stakeholders were solicited through the DFSP workgroup under Abe Al-Tarawneh, Superintendent of Safety and Hygiene. There were no challenges or comments. Appendix F is also added as the discount table for Public Employer Taxing Districts.

Mr. Heppen reported that he had reviewed the report from Oliver Wyman Consulting on the deductible program. In his opinion, the recommendations are reasonable and actuarially sound.

Mr. Harris asked if Mr. Heppen disagreed with another consultant, would he so state? Mr. Heppen replied that he would be required professionally to do so.

Mr. Matesich moved that the Actuarial Committee recommend that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation to amend Rule 4123-17-72 of the Administrative Code, "Deductible Rule." The motion consents to the Administrator amending Rule 4123-17-72 as presented here today. Mr. Pitts seconded and the motion was approved by a roll call vote of five ayes and no nays.

RULE FOR SECOND 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 on classifications of the National Council on Compensation Insurance (NCCI). Mr. Prunte clarified the proposal by indicating that BWC is required to use the NCCI classifications, but the Workers' Compensation Board may adopt state-special classifications if it elects to.

Mr. Glass reported that BWC solicited feedback directly from employers because five of the types of industry had no associations to contact. BWC received nothing in writing, so made telephone calls to individual employers on April 26. BWC received no opposition to the changes.

Mr. Price thanked BWC for taking the extra step and contacting employers directly for comments.

Mr. Pitts moved that the Actuarial Committee recommend that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation to amend Rule 4123-17-04 of the Administrative Code, "Classification of Occupations or Industries," to adopt new NCCI classifications. The motion consents to the Administrator amending Rule 4123-17-03 as presented here today. Mr. Caldwell seconded and the motion was approved by a roll call vote of five ayes and no nays.

GROUP RETROSPECTIVE RATING APPLICATION DEADLINE

Ray Mazzotta, Chief Operating Officer, discussed a letter from the Service Association of Ohio requesting a thirty day extension of the deadline for applications for group retrospective rating from April 30 to May 30. Mr. Mazzotta reported the April 30 date was not chosen arbitrarily. Stakeholders had asked for a uniform date for applications for several programs, falling between February 28 (group rating deadline) and July 1 (the new policy year). BWC is operationally capable of moving this date forward. However, BWC opposes multiple dates for programs because it encourages serial tasking by sponsors. Rather, a sponsor should work with its employer clients over the course of a year to find the best programs.

Mr. Hummel asked when the date was set. Mr. Mazzotta replied that it was set in the autumn of 2009. Mr. Hummel asked how many years has group retrospective rating been available. Mr. Mazzotta replied that this was the second year.

Mr. Bryan solicited a motion to extend the group retrospective rating deadline as requested by the Service Association of Ohio. None was offered and, accordingly, the request died for lack of a motion.

FIRST READING: PRIVATE EMPLOYER BASE RATES AND EXPECTED LOSS RATES, OHIO ADMINISTRATIVE CODE RULES 4123-17-05 & 4123-17-06.

Mr. Pedrick recommended amendment of Ohio Administrative Code Rules 4123-17-05 and 4123-17-06 to adopt the base rate recommendation approved today by the Actuarial Committee. The handout for this action item includes base rates for 2009 and 2010 years and rule amendments.

Mr. Bryan asked why there is a 30% cap on increases, but not on decreases. Mr. Pedrick replied that BWC has traditionally put a cap on both. However, in 2009, there was a 25% decrease for non-group employers so no floor was used.

Mr. Bryan asked what the legal or regulatory basis for a cap is. Mr. Pedrick replied that it is an industry practice and reflected in the Deloitte report. Mr. Bryan asked if the requirement that BWC use the four oldest of the previous five years is also an industry practice. Mr. Pedrick replied that requirement is in the statutes.

Mr. Bryan remarked that page 19 of the handout has a chart reflecting rate stability.

Mr. Matesich asked if employers with large premium increases were directed to the Division of Safety and Hygiene or other programs. Mr. Pedrick replied Mr. Al-Tarawneh is undertaking complete study of cost drivers of claims expense.

Ms. Falls requested the page 19 chart, be supplemented with the number of employers affected by rate change and amount of payroll. Mr. Bryan asked if estimates could be produced by the second reading of the rule. Mr. Pedrick replied BWC can do it.

FIRST READING: MARINE INDUSTRY FUND, OHIO ADMINISTRATIVE CODE RULE 4123-17-19

Mr. Pedrick, Ms. Bravender, and Jan Lommele, Bob Miccolis, and Mr. Heppen, Deloitte Consulting, presented the rate recommendation for the Marine Industry Fund. Mr. Heppen reported that the recommendation is a 25% reduction. The indication range is even larger, from 45% to 73%. The loss costs used to determine the indicated rate changes are derived from the Deloitte Consulting December 2009 Marine Industry Fund Reserve Analysis. There are potential risks of increased Marine Fund losses from HB 562, effective January 1, 2009, which prevents individuals covered by the Marine Fund from receiving state benefits. In consideration of this new legislation and the volatility of past Marine Fund results, the large indicated rate decreases have been tempered in Deloitte's recommended range of rate change. The chart showing the fund history shows the funding ratios. In 2009, the fund is healthy, but the history is volatile.

Mr. Pedrick reported that BWC had contacted the Ohio Department of Insurance on the activities of Longshoremen & Harbor Workers program carriers. Most private insurers are using BWC rates. They could use those of other private insurers or develop their own.

Ms. Falls added that in re-examining the asset allocation and rates, she was surprised by the volatility of the Marine Fund. For this fund, the conclusion is that BWC should look at the asset allocation policy more often than every two or three years.

FIRST READING, DISABLED WORKERS' RELIEF FUND, OHIO ADMINISTRATIVE CODE RULE 4123-17-29

Concerning the Disabled Workers' Relief Funds, Mr. Heppen recommended no change for either DWRF 1 or DWRF 2. The indicated rates are the same as the rates for July 1, 2009.

Mr. Bryan asked about the Deloitte comment that DWRF would be in a deficit position of $700 million without its asset for future unbilled premiums. Mr. Heppen replied that is the risk of a program which is pay-as-you-go. Mr. Miccolis added that risk is addressed in the HB 100 Comprehensive study. Any pay-as-you-go program creates deficits.

Mr. Pedrick commented on the "right to collect." BWC has none for the Administrative Cost Fund (ACF) after the expiration of the biennial budget. Not so for DWRF, so accrued premiums appear as a balance sheet asset each year. Marsha Ryan, BWC Administrator, added that, however, the statute did not give BWC any ability to fund that accrual.

Mr. Smith asked if the Deloitte report gives BWC direction for change. Ms. Ryan added the best place to put such changes is in the budget bill. Major changes would require employer input that proper DWRF funding would be an advantage. Tracy Valentino, Chief, Fiscal & Planning, reported that recording of the DWRF asset was addressed in the 2007 budget after a comment from the external auditor. Prior to then, BWC had a booked liability, but no authority to show an asset.

Mr. Bryan indicated that further discussion will be deferred until a later date.

Mr. Heppen further reported there is no recommended change to DWRF 2. However, the indicated rate is 1.3%. No change is recommended because BWC is not permitted to make one.

Mr. Bryan asked if Mr. Heppen were stating that the legislation is not actuarially sound. Mr. Heppen affirmed that he was stating that the legislation is not actuarially sound.

FIRST READING, SPONSORSHIP CERTIFICATION REQUIREMENTS, OHIO ADMINISTRATIVE CODE RULE 4123-17-61.1

Mr. Prunte and Sherri Simpson, Management Analyst Supervisor, recommended amendment of Ohio Administrative Code Rule 4123-17-61.1 on sponsor certifications. Ms. Simpson reported that the changes are not significant, but necessary to make the rule conform to other changes. The dates in paragraphs (A) and (D) need to be replaced with more generic language to make the rule usable in the future. The change in paragraph (K) makes the marketing regulations applicable to both private and public employers. The stakeholders meeting involved both the Ohio Manufacturer’s Association and the Ohio Chamber of Commerce.

Ms. Simpson further reported that paragraph (K)(3) requires an annual report to the Workers' Compensation Board of violations. Since August 2009, BWC received ten complaints, of which six were found valid and four invalid. Of the six, all involved inaccurate marketing materials. All sponsors corrected their materials after being contacted by BWC.

Mr. Hummel asked if all six were against six different sponsors. Ms. Simpson answered that there were two complaints on one sponsor.

Mr. Hummel asked how BWC measures improvement in accident prevention as required in paragraph (D). Ms. Simpson replied that Employer Management Services is working with the Division of Safety and Hygiene to determine measurements in connection with the same requirements for group programs and group retrospective programs.

DISCUSSION ITEMS

PRIVATE EMPLOYER GROUP BREAK EVEN FACTOR, OHIO ADMINISTRATIVE CODE RULE 4123-17-64.1

Mr. Pedrick reported BWC has no proposal to change the break even factors. The information on group structures for the 2010 policy year has come in and there are few changes. BWC predicted a need for a break even factor of 1.27, and the data shows a result that is slightly less than 1.27, so no change is needed.

LEGISLATIVE DISCUSSION AND ANALYSIS

There was no discussion of pending legislation.

CAO REPORT

Mr. Pedrick reported that the CAO Report sets forth a calendar for first and second readings for the next several months. The next important activity is the public employer taxing district rates, effective January 1, 2011.

Mr. Matesich thanked Ms. Falls for requesting additional information on rates. The discussion was fruitful in understanding rate setting.

COMMITTEE CALENDAR

There were no additions or changes suggested for the committee calendar.

EXECUTIVE SESSION

Mr. Bryan reported he had no request for an executive session or litigation update.

ADJOURNMENT

Mr. Hummel moved to adjourn and Mr. Pitts seconded. Mr. Bryan adjourned the meeting at 9:55 a.m. after the motion was approved by a roll call vote of five ayes and no nays.

Prepared by: Larry Rhodebeck, Staff Counsel
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May 4, 2010