BWC Board of Directors

ACTUARIAL COMMITTEE

Thursday, November 21, 2010, 2:10 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:	Alison Falls, James Harris, Larry Price, and Bob Smith
Counsel present:	Ann Shannon, Legal Counsel
Staff present:	Marsha Ryan, Administrator John Pedrick, Chief Actuarial Officer Jon Turnes, Manager of Reserving Terry Potts, Supervisor of Rates
Consultants present:	Jan Lommele, Deloitte Consulting LLP Bob Miccolis, Deloitte Consulting LLP Dave Heppen, Deloitte Consulting LLP Bill Van Dyke, Deloitte Consulting LLP
Scribe:	Larry Rhodebeck, Staff Counsel

CALL TO ORDER

Mr. Bryan called the meeting to order at 2:10 p.m. and the roll call was taken. Six members were present, constituting a quorum.

MINUTES OF OCTOBER 21, 2010

Mr. Bryan requested that on page 2, page 4, line 6, "case reserve" be changed to "case reserves." He requested that in paragraph 5, "affect" be changed to "effect." He also requested that on page 3, paragraph 1, "Taxing District" be changed to "Taxing Districts."

Mr. Matesich asked Jan Lommele, Deloitte Consulting LLP, if he was prepared to present information on rates charged in other states on volunteer safety workers. Mr. Lommele replied that he did not have anything at this time, but could prepare a report for a future meeting.

Mr. Matesich moved to approve the minutes of October 21, 2010. Mr. Hummel seconded and the minutes were approved by a roll call vote of six ayes and no nays.

AGENDA

Mr. Lhota asked if Mr. Bryan intended to hold an executive session. Mr. Bryan replied that he did not.

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

NEW BUSINESS/ACTION ITEMS

SECOND READING, PUBLIC EMPLOYER TAXING DISTRICT BASE RATES AND EXPECTED LOSS RATES, OHIO ADMINISTRATIVE CODE RULE 4123-17-33 & 4123-17-34

John Pedrick, Chief Actuarial Officer, and Terry Potts, Supervisor of Rates, recommended approval of Ohio Administrative Code Rules 4123-17-33 and 4123-17-34, "Public Employer Taxing District Base Rates" and "Expected Loss rates". Reference was made to the Executive Summary of October 21, 2010. Mr. Potts reported that page 4 provides the limited loss ratios that are used to cap rates at the employer's maximum claim value. Pages 7 and 8 show the base rate changes as the result of the 5.5% overall rate reduction. Classification Code 9439 covers safety force volunteers. Their payroll is reported at a minimum of $300 per volunteer if there is no payroll, and a minimum of $4,500 minimum per employer. If there is actual payroll, BWC uses that number, but the actual is subject to the minimum of $300 per volunteer.

Mr. Bryan asked how long BWC has used a minimum of $300. Mr. Potts answered that this rate has been in use since 1983. Mr. Bryan asked if the rate is out-of-date. Mr. Potts replied it is actuarially sound because it raises the correct amount of premium to pay claims costs. If BWC were to raise the minimum to $500, then the rate per $100 would decline, but BWC would still have to collect the same amount of premium.

Mr. Pitts asked if the wide variance in rates between classifications is based on types of public employers. Mr. Pedrick replied in the affirmative and observed that the rate for cities is higher than for villages because cities have more safety forces such as police and firefighters.

Mr. Bryan asked why the rate for Public Works Relief Employees had increased by 36%, when the cap was supposed to be 30%. Mr. Potts replied that the 30% cap applies to base rates; page 3 of the report shows collectible rates, which include base rates plus experience rating. The losses for PWRE are worsening.

Marsha Ryan, Administrator, added that the PWRE program has other anomalies as well. For example, there has been a decline in the number of "employees", which has an effect on payroll and premiums. Mr. Harris asked who the PWRE employees are. Mr. Potts replied that they are not true employees, but individuals working as volunteers to qualify for relief benefits.

Mr. Price asked if other classifications are affected by experience rates. Mr. Potts replied that the 30% cap is applied to just base rates. Mr. Price asked how often the cap affects other manual rates. Mr. Potts replied he will research this issue for the next meeting. Mr. Bryan also requested a future report on how BWC calculated the PWRE base rate, its experience rate, and how BWC arrived at a 36% increase.

Mr. Pedrick also added that the rates actually collected change after the beginning of a policy year due to adjustments to losses and other discounts not known at the time rates are set. Accordingly, BWC sets rates at levels that will produce the collectible rate in anticipation of these changes.

Mr. Pitts asked if base-rating is a sign of good experience. Mr. Pedrick replied that an employer that pays at the base rate usually means that the employer is too small to qualify for experience rating. There are also a few employers that are experience-rated and whose experience modifier equals 1.00, effectively meaning they will pay at the base rate.

Mr. Bryan asked if BWC Actuarial staff and Deloitte Consulting support the rates as set forth in the amended rules as actuarially sound. Mr. Pedrick affirmed their actuarial soundness.

Mr. Matesich moved that the Actuarial Committee recommend that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendations relating to the public employer rate rules, beginning January 1, 2011. The motion consents to the Administrator amending Rules 4123-17-33 and 4123-17-34 of the Administrative Code as presented here today. Mr. Caldwell seconded and the motion was approved by a roll call vote of six ayes and no nays.

SECOND READING, COMMITTEE CHARTER

Don Berno, Board Liaison, and Ann Shannon, Legal Counsel, submitted the amended Actuarial Committee Charter for approval. Mr. Berno reviewed the current draft with changes made at the Governance Committee meeting earlier in the day.

Mr. Bryan asked if the Actuarial Committee Charter conformed to the Governance Committee Charter and Audit Committee Charter approved in earlier meetings. Mr. Berno confirmed that it did conform.

Mr. Pitts moved that the Actuarial Committee of the Workers' Compensation Board of Directors approve its amended charter and refer it to the Board of Director for review and approval. Mr. Hummel seconded and the motion was approved by a roll call vote of six ayes and no nays.

DISCUSSION ITEMS

QUARTERLY RESERVE UPDATE

Jan Lommele, Bob Miccolis, Dave Heppen, and Bill Van Dyke, Deloitte Consulting, LLP, delivered the "Ohio Bureau of Workers' Compensation September 30, 2010, Quarterly Reserve Update." Mr. Pedrick and Jon Turnes, Manager of Reserving, assisted in the presentation.

Mr. Van Dyke reported that Deloitte had been retained by BWC to determine an actuarial central estimate of the unpaid loss and loss adjustment expense (LAE) as of June 30, 2011. This estimation procedure is a quarterly update using data as of September 30, 2010. Deloitte has determined the unpaid loss and LAE estimates on both a nominal and on a discounted basis for all eight of the BWC funds. The report presents the Deloitte findings to the Actuarial Committee of the Workers' Compensation Board of Directors.

The general process incorporated into the analysis is to estimate ultimate, full-dollar loss and loss adjustment expenses as of June 30, 2011, subtract payments projected through June 30, 2011, and then discount the result at a rate of 4.0%. This procedure produces the discounted unpaid loss and loss adjustment expense estimates as of June 30, 2011. Mr. Bryan emphasized that Deloitte creates separate estimates for each accident year from 1977 through 2011. Mr. Van Dyke reported that for accident years prior to 1977, unpaid loss estimates were determined based on analyzing historical incremental annual payments for accident years 1953 and subsequent. Mr. Bryan added that workers' compensation has long tail claims. Mr. Van Dyke stated there are some active claims that date from the 1940s.

Mr. Van Dyke further reported that the September 30 quarterly update made no changes in methodology, assumptions, or parameters from the June 30 annual evaluation. The change in estimate was driven by changes in data. Specifically, the estimate changes by how actual payments varied from expected payments during the first quarter of fiscal year 2011. The two main components that changed were payroll and medical payments.

The detailed methodology for the unpaid estimates consists of taking the June 30, 2010, recorded reserve and subtracting it from the initial June 30, 2011 unpaid discounted estimate, to calculate the estimate of the fiscal year 2011 change – an increase of $251 million. Then, the initial estimate is subtracted from the current unpaid discounted estimate for June 30, 2011, to calculate the change from the June 30 estimate compared to the September 30 estimate in discounted unpaid estimate – an increase of $5 million for all eight BWC funds. The value of the discount for all funds as of June 30, 2011 is $12,551,000,000.

The initial fiscal year end 2011 unpaid estimate, using data evaluated as of June 30, 2010, is $256 million higher than the fiscal year 2010 ending recorded reserves. Losses for private employers (PA), public employer taxing districts (PEC), and public employer state agencies (PES) account for $243 million of the increase. The current fiscal year 2011 ending unpaid estimate using data evaluated as of September 30, 2010, is only $5 million higher than the initial estimate using data evaluated as of June 30, 2010. Discounted unpaid estimates anticipate $12.6 billion of future investment income earned on invested funds, or collected in premium assessments for unfunded liabilities, in order to provide sufficient funds to pay all required future claim payments associated with claims occurring on June 30, 2011 and prior.

On page 6, the fiscal year 2011 initial change in PA, PEC, and PES unpaid losses are calculated at $243 million. The discounted unpaid losses of June 30, 2010 are $14,767 million; the additional ultimate losses for the fiscal year are $2,222 million; and the fiscal year additional discount is negative $744 million. The fiscal year interest accretion is $617 million and the expected payments are $1,852 million. So the discounted unpaid losses as of June 30, 2011, are $15,011 million. The ultimate losses of $2,222 million exceed expected payments of $1,852 million.

In other highlights, PA loss costs by fiscal year have declined substantially since 1987. The change in the June 30, 2011, unpaid estimates shows a minimal increase of $4.6 million. The current June 30, 2011, discounted unpaid estimate of $20.6 billion is $5 million higher than the prior discounted unpaid estimate which was based on data as of June 30, 2010.

Page 9 shows that the drivers of change in the State Insurance Fund in June 30, 2011, loss estimate were a decline in the ultimate (nominal) losses of $15 million. There were no significant changes in payroll or changes to parameters from the June 30, 2010, analysis. The lower than expected payments of $17 million during the first quarter and the corresponding decrease in the ultimate loss of $15 million has led to a $19 million reduction in expected payments for the full 2011 fiscal year. This more than offsets the $15 million reduction in ultimate loss leading to a slight increase in the unpaid estimate.

In comparing employer group actual versus expected losses based on the period June 30, 2010, to September 30, 2010, PA showed the most variance with $15 million better than expected losses. For PEC the variance was $2 million and for PES it was $1 million.

Payments are $17 million, or 4.1%, lower than expected for fiscal year 2011 through the first quarter, driven by injury years 2009 and 2010. Incurred losses (paid + reserves determined by the MIRA system) are $308 million or 57% lower than expected for fiscal year 2011 through the first quarter due to reductions in the MIRA case reserves. Mr. Pedrick added that BWC has seen a significant decrease in MIRA reserves recently. BWC is investigating this issue and has contacted the vendor, Fair Isaac, for further explanation. Mr. Bryan asked if a drop in reserves could mean an improvement in claims management and Mr. Pedrick confirmed that was a possibility.

Page 11 sets forth actual versus expected loss payments for the three employer groups. Medical payments were $18.6 million lower than expected; indemnity was near expectation with payments $1.1 million higher than expected; temporary total disability, wage loss, living maintenance, and living maintenance wage loss benefits were $17 million higher than expected; and lump-sum settlement losses were $15 million lower than expected. Page 12 highlights the break-down of components by accident year for the three employer groups.

For four of the eight funds there was little change. The current June 30, 2011, discounted unpaid estimate of approximately $4.1 billion for the Disabled Workers Relief Fund, Coal Workers Pneumoconiosis Fund, Self-Insuring Employers' Guaranty Fund, and Administrative Cost Fund, combined, increased by only $2 million from the June 30, 2010, evaluation. There were no changes in methodology, assumptions, or parameters for these funds.

Mr. Van Dyke further reported that the original projection for payroll was that there would be no change in 2010. However, initial payroll figures for the first six months of 2010 show a 4.4% reduction compared to 2009. As payroll declines, the reserve for the current year also declines. If the 4.4% reduction holds, that would imply between a $50-$60 million decrease (improvement) in reserves.

Mr. Matesich asked if the reserve estimate is affected by differences in classifications. Mr. Van Dyke replied that economic downturns affect higher-rated payroll classifications, leading to less payroll and fewer claims. The distribution of payroll by employer class will be examined in March.

Mr. Van Dyke continued, reporting that on page 15, that according to the Bureau of Labor statistics, the Ohio unemployment rate rose throughout 2009 and in the first part of 2010. The reduction in the payroll for the first half of 2010 over 2009 is consistent with the monthly increase in the unemployment rate. The Ohio monthly unemployment rate has been declining since April. If this trend continues for remaining part of the year, it is possible that the 2010 full year payroll will be similar to 2009. Thus, there will not be a 4.4% full decrease for the entire reporting period.

Mr. Smith stated that the reports he heard were that manufacturing employment was increasing faster than service sector employment. Mr. Van Dyke stated that would not be reflected in the reserves. Mr. Pedrick added that BWC is looking at that more closely.

Mr. Miccolis added that the page 14 graph shows if a trend persists, then there are lower costs to the system. However, BWC should not overreact by lowering premiums too far. Mr. Bryan added that the BWC should be careful to avoid big changes derived from a severe drop in payroll because such a decrease could be followed by big increases in payroll. Mr. Lommele stated that the drop would show little impact on net assets and the rate indicators. Mr. Pitts asked if these are long-term trends. Mr. Lommele replied Deloitte would need to do more research.

Mr. Van Dyke reported that the graph on page 6 shows payroll rose over time, every year until 2009 and 2010.

Mr. Caldwell commented that the increase in manufacturing payroll is good news whatever the impact it may have on reserves.

Mr. Pedrick emphasized that on page 5, the $32.6 billion reserve is reduced by $12.6 billion in anticipation of investment returns to compute the $20 billion discounted liability.

Mr. Smith asked if use of a discount rate is a characteristic of a monopolistic insurance fund. Mr. Pedrick stated it is because a government entity using government accounting standards is permitted to discount.

Mr. Price asked then, so where is the "excess" that is part of the public discussion at the General Assembly. Mr. Pedrick replied that the undiscounted liability is the full $32 billion, but only $20 billion enters into the calculation of net assets. Mr. Pedrick added that the total assets are $25 billion because BWC can include $5 billion in uncollected accrued receivables. These uncollected accrued receivables are not cash items. The $32 billion liability does not appear on the balance sheet.

Mr. Price stated he was still concerned that there was an inadequate understanding of the net assets. Ms. Ryan explained that Mary Jo Hudson, Director of the Ohio Department of Insurance, has informed her that her agency would not permit a private insurance company to book its liabilities with a discount rate since such discounting is not permitted by statutory accounting rules. Mr. Price requested an additional explanation after close of the meeting.

Mr. Bryan reported that additional back-up data is available from the Actuarial Department. He requested Ms. Valentino provide further discussion on how the reserve is used in financial statements.

Ms. Valentino reported that, on an annual basis and during the year, BWC takes the difference between the June 30, 2010 reserve and the Deloitte reserve estimate for June 30, 2011, divides it by 12 and then accrues that each month on the financial statements. This monthly accrual permits BWC to have a better idea of the net assets and to take corrective action if needed.

Ms. Falls stated the small changes in the reserve are noted, through September. However, the change may be material by December.

Mr. Bryan thanked Jon Turnes for his contribution to the report.

EXPERIENCE RATING EDUCATION, PART 1

Mr. Pedrick provided an education session on experience rating. The reason for the current presentation was because BWC will present a split experience rating proposal to the Workers' Compensation Board at its January 2011 meeting. Part 1 of the training is given this date on, "Why we do it, how we do it now, and how we plan to do it."

After Mr. Pedrick reported that experience rating is based on statistics and the actuarial study of credibility, Mr. Bryan asked if the same factors apply in competitive workers' compensation states. Mr. Pedrick replied that on a large scale, Ohio is not different. Ohio uses the oldest four of the previous five years. However, Ohio only uses losses, while most states use a split experience plan. Also, most states authorize the National Council on Compensation Insurance (NCCI) to calculate the experience rating adjustments.

Mr. Pitts asked if the experience rating uses loss and loss adjustment expense. Mr. Pedrick replied that experience rating encompasses all costs. He added that other states include agent commission, fees, capital risk, and profits.

Mr. Pedrick explained the arguments for improving the current Ohio experience rating system. Concerning the point that Ohio is not completely consistent with insurance industry practices across the country, Ms. Falls asked, given the simplicity of the Ohio system, if it is really an experience rating standard. Mr. Pedrick replied that even though it is simpler, it is still experience rating.

Mr. Pedrick reported that the split experience rating formula was developed by Francis Perryman in the 1930s, shortly after the introduction of workers compensation coverage. The underlying formula is used by NCCI. Employer reports prepared from NCCI look different from the formula because they use an approach that was required before computer technology reached the level we see today. BWC is implementing the split plan with the same underlying mathematical formula but without the cumbersome presentation seen in the NCCI experience rating plan.

After Mr. Pedrick explained that the split experience plan works better than a no-split plan, Ms. Falls asked for an explanation of “better”. Mr. Pedrick replied that it is more accurate, more equitable, and works regardless of the size of the employer,. Mr. Pedrick agreed to expand upon the definition and meaning of “better” in future meetings.

Mr. Smith commented that it was his understanding that frequency is a better indicator of risk.

Mr. Price requested additional explanation after the meeting on why this was so.
Mr. Pedrick replied that will be the topic of future education sessions.

Mr. Pitts reported that under the current system, there is an incentive to the employer to contest medical treatment and shift costs from the employer to BWC. Mr. Pedrick added that under the current system, there may be too much emphasis on contesting benefits. Split experience will not lose focus on the costs of claims, but the emphasis will decline.

Ms. Falls added that BWC should include lower volatility in premiums as an argument in favor of moving to the split experience rating plan.

Mr. Pedrick reported that the next education session will be in December and the presentation of a split-rating plan to the Workers' Compensation Board will be in January for a first reading. He further stated that that the most important time for the split plan is July 1, 2013, when the plan begins the second year and the BWC can see its actual impact on the size of claims and the volatility of premiums.

Mr. Pitts noted that it seemed in the split-experience formula that primary and excess loss seems equal. Mr. Pedrick replied that credibility factor in the primary loss is larger than the credibility factor in excess loss.

Ms. Falls asked when the Workers' Compensation Board will get employer feedback. She would prefer it sooner rather than later. Mr. Pedrick stated he did not have the answer, but will include it in the planning.

LEGISLATIVE DISCUSSION AND ANALYSIS

There was no discussion of pending legislation.

CHIEF ACTUARY REPORT

Mr. Pedrick emphasized three things in the CAO Report. BWC has not taken any action on candidates for the open position for a credentialed actuary since BWC is in transition to a new administration. Second, BWC is making progress in creating the split experience plan. Third, BWC is completing a base-rate analysis project. The goal is to bring more stability to rates.

COMMITTEE CALENDAR

Mr. Bryan reported that in December the Actuarial Committee would undertake an examination of base rates.

EXECUTIVE SESSION

There was no executive session.

ADJOURNMENT

Mr. Caldwell departed from the meeting at 4:00 p.m.

Mr. Matesich moved to adjourn. Mr. Hummel seconded. Mr. Bryan adjourned at 4:02 p.m. after a roll call vote of five ayes and no nays.

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November 15, 2010