BWC Board of Directors

AUDIT COMMITTEE

Thursday, April 29, 2010, 4:00 p.m.
William Green Building
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

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

Members Absent: None

Other Directors Present: James Hummel, Thomas Pitts, Alison Falls, Larry Price.

CALL TO ORDER – APRIL 29, 2010

Mr. Haffey called the meeting to order at 4:06 PM and the roll call was taken.

MINUTES OF MARCH 25-26, 2010

The minutes were approved without changes by unanimous roll call vote on a motion by Mr. Smith, seconded by Mr. Lhota.

REVIEW/APPROVE AGENDA

Mr. Haffey noted several changes to the Agenda. The external audit discussion and quarterly litigation update will be moved to the May meeting. There will be a presentation concerning a request to transfer funds from the Coal Workers' Pneumoconiosis Fund (Coal Fund) to the Ohio Department of Natural Resources (ODNR) Division of Mineral Resources Management to support the Coal Regulatory program, which is responsible for permit approval and inspection services. The agenda as amended was approved by unanimous roll call vote on a motion by Mr. Lhota, seconded by Mr. Smith.

NEW BUSINESS / ACTION ITEMS

1. Motion for Board Consideration

A. For Second Reading

1. Discount Rate and Financial Metrics

Tracy Valentino, Chief of Fiscal and Planning, presented a second reading of the proposed changes to the discount rate, which would reduce the current rate of 4.5% to 4.0%. In response to a question from the March discussion, Ms. Valentino reported that changing the reserve discount rate from 4.25 to 4.0 increases our reserves an additional $450 million.

This reduction is consistent with conservative fiscal views and the Deloitte recommendations, and has the concurrence of Mercer Consulting. Mr. Matesich questioned how the discount rate reduction from 7.0 in 1996 to the present recommendation of 4.0 meets Mercer's criteria that the discount rate be relatively stable from year to year. Ms. Valentino explained that the 7.0 figure was recognized as very high, but a one-time drastic reduction would have had a substantial negative impact on employer's premiums. The goal has always been to slowly bring the discount rate to a conservative, stable number and leave it there. Ms. Valentino is "reasonably confident" the discount rate will not change in 2011. Mr. Matesich expressed appreciation for the historical perspective. Mr. Smith noted that interest rates have also been unstable over the period in question, and commended the thorough, unbiased process which resulted in the current proposed rate. Ms. Falls stated that keeping the discount rate stable is a linchpin to keep employer premiums stable prospectively, and the directors should expect no further changes.

Mr. Smith moved that the Audit Committee recommend that the Bureau of Workers' Compensation Board of Directors concur with the Administrator's recommendation to adopt a 4% discount rate. This rate will be utilized by BWC's external actuarial consultant, Deloitte Consulting LLP, and BWC's external audit firm, Schneider Downs & Co., Inc., for purposes of the reserve for compensation and compensation adjustment expenses as of June 30, 2010. Mr. Lhota seconded and the motion was approved by unanimous roll call vote.

After this motion was approved, Ms. Falls questioned whether it was clear that the decision also changed the discount rate policy itself. Mr. Lhota then moved to reconsider the prior motion, seconded by Mr. Haffey, and approved by unanimous roll call vote.

Mr. Smith moved that the Audit Committee recommend that the Bureau of Workers' Compensation Board of Directors concur with the Administrator's recommendation to adopt a 4% discount rate and revise the discount rate policy accordingly. This rate will be utilized by BWC's external actuarial consultant, Deloitte Consulting LLP, and BWC's external audit firm, Schneider Downs & Co., Inc., for purposes of the reserve for compensation and compensation adjustment expenses as of June 30, 2010. The motion as amended was seconded by Mr. Lhota and approved by unanimous roll call vote.

Ms. Valentino then addressed financial metrics, including additional information to clarify recommendations subsequent to the discussion at the March meeting. The Funding Ratio (funded assets v. funded liabilities) range is now 1.02 to 1.35, and the staff recommendation is 1.15 to 1.35, while the Net Leverage Ratio is a now a range of 3.0 to 8.0 and staff recommends 3.0 to 7.0. Other types of ratios, such as Net Loss Ratio and Expense Ratio, are included as a guide for management, but do not have to be Board-approved.

Mr. Haffey moved that the Audit Committee recommend that the Bureau of Workers' Compensation Board of Directors concur with the revisions of the net asset policy as presented and discussed today. The motion was seconded by Mr. Smith and approved by unanimous roll call vote.

B. For First Reading
1. FY 2011 Administrative Budget

Ms. Valentino reviewed the proposed annual administrative budget for FY 2011. It was noted the date on the executive summary is incorrect and should be April 9, 2010. Ms. Valentino reviewed various comparative charts to show the variances between actual spending and appropriated amounts for the past two fiscal years. The FY 2011 budget does not take into account the impact of cost saving days, at the request of the Department of Administrative Services.

Rent decreases are correlated to bonds and will continue over the next three years. Decreases in amounts for software and equipment for 2010 are based upon space reduction and renegotiation of leases. Reduction in amounts for equipment relates to automobiles. Per a question from Mr. Lhota, the BWC fleet of approximately 300 vehicles is very well-maintained. Vehicles are replaced when maintenance costs become excessive.

Amounts allocated for strategic projects in 2010 were to replace the medical bill payment system. This did not occur as planned, and has again been budgeted for FY 2011. This will not cause any increase in employer administrative assessments.

Ms. Falls expressed the thought that the Board could perhaps consider paying the requested assistance from ODNR from administrative budget funds, as opposed to the specialty coal fund.

<u>DISCUSSION ITEMS</u>

1. Open Discussion with Internal Auditor

Caren Murdock, Chief of Internal Audit, reported that Internal Audit management is completing the work on the risk assessment for the 2011 audit plan. BWC processes are being rated across risk factors based on the likelihood of the risk and the impact of the event. The audit plan will be presented at the June meeting. Preliminary work on the external audit will begin in mid-May.

There are 9 current internal audit projects. The death benefits and Self-Insured underwriting reviews are in the final phase. Thirteen auditors have been divided into five teams and all projects are being completed on schedule. OBM IT auditors are also performing the data warehouse review, which will be completed in May.

2. Committee Calendar

Mr. Haffey noted the External Audit discussion will now be presented in May.

3. ODNR Coal Regulatory Funding Request

Mike Carey, Ohio Coal Association (OCA) President, and Sean Logan, ODNR Director, gave a presentation to the Committee regarding proposed legislation to transfer a portion of the Coal Fund to support the FY 2011 operations of the ODNR Coal Regulatory Program (CRP). Babe Erdos of the United Mine Workers was also present.

Historically, the CRP has been funded by a severance tax on mined coal, the General Revenue Fund, and federal grants. In the biennial budget for FY 2010-2011, ODNR proposed to institute an extraction fee on coal operators per ton of coal mined, which failed to pass the General Assembly. In addition, there was no budgetary allocation for the CRP for FY 2011.

The parties are now requesting that the CRP be funded for FY 2011 by legislative approval of a one-time transfer of $2.2 million from the Coal Fund to the Strip Mining Administrative Fee Fund. Any funds not expended for FY 2011 will be returned to BWC.

Per a question from Mr. Smith, the procedure is for the legislature to first adopt the proposed legislation, then for Administrator Ryan to request the Board approve rules necessary for the transfer.

Mr. Harris asked if the OCA opposed the extraction fee. Mr. Carey replied that OCA did oppose the concept of a fee, rather than raising the severance tax. Mr. Harris asked Mr. Carey if he agreed the purpose of the Coal Fund was to pay claims to injured coal workers, their widows and orphans, not to subsidize the coal companies. Mr. Carey emphasized that the CRP has historically received general funding, and referred to Page 2 of the ODNR "white paper" dated April 12, 2010, which discusses safety as part of the permitting process. Mr. Harris asked if the proposed legislation would specify this is a one-time transfer. Mr. Carey answered in the affirmative, then elaborated that while he could justifiably agree with a one-year drawdown, any further comment would be speculative.

Per questioning from Mr. Lhota, Mr. Carey explained he represents all Ohio coal producers. Mr. Lhota asked if the transfer would benefit both surface and underground mining operations. Mr. Carey stated the transfer would benefit all Ohio residents, because the funds would not have to come from the General Assembly and inspections could continue without interruption. Ohio currently produces 24.5-25 million tons of coal annually.

Mr. Lhota expressed his familiarity with the coal mining process from his tenure at AEP, and strongly encouraged that this only be a one-time event because it could set a dangerous precedent. Mr. Smith agreed that although the Board would follow a legislative directive, there is recent history of another "one-time" Coal Fund transfer to ODNR in 2008 for the Mine Safety Program. Mr. Carey replied that worker safety is at the heart of this request and regulatory functions must be maintained.

Mr. Pitts stated he was troubled by the perceived cost-shifting in that the worker is paying for his or her own safety from funds held in trust for the worker. Although it is a worthy purpose, the operators should be responsible for bearing this cost. Mr. Carey expressed his disagreement with Mr. Pitts' view.

Mr. Matesich questioned why, if the coal operators would have previously accepted an increased tax, they simply don't return to the legislature and ask for it. Mr. Carey said such an approach would now be unsuccessful. Mr. Matesich suggested the OCA commit to an increased tax in the next budget to reimburse BWC for this proposed transfer. Mr. Carey stated any such commitment could not presently be addressed. Mr. Matesich expressed his concern that such a transfer could compromise the integrity of the Coal Fund, which must be actuarially sound. The directors have a fiduciary duty to ensure this.

Mr. Price asked if this legislation would be difficult to pass, or subject to a possible veto by the Governor, and the impact of Board opposition. Mr. Carey admitted there are many challenges but believes there is Senate support. A lack of support by BWC would "drastically" hurt the effort to pass the legislation.

Ms. Falls requested the current balance in the Strip Mining Administrative Fee Fund. Mr. Logan stated he could not give a figure. The fund is presently not at zero, but cannot last past September 2010 without additional funding. This would produce layoffs and very few, if any, new permits. Ms. Falls believes it would be appropriate to know the current size of this fund.

Mr. Harris compared this situation to paying for a construction permit, and that he feels coal operators are shirking their responsibilities. While he empathizes with ODNR's situation, he opposes this request, unlike the prior request for funding the Mine Safety Program in 2008.

Mr. Logan reiterated this request does have a direct connection to safety in terms of professionally reviewing mine plans, including dust control and ventilation. He expressed appreciation for BWC's funding the Mine Safety Program, which has led to updated programs and equipment, producing substantial benefit. While this current request is an unfortunate situation, it is the only option and there is a very small window of legislative opportunity.

Mr. Haffey emphasized that the charge of the Board is to preserve the BWC funds and protect stakeholders. Funds which are designed for long-term usage should not be depleted for current operations. He too is concerned that this is the second "one-time" requested transfer from the Coal Fund in two years, and reminded those present that BWC lost billions in surplus in 2008.

Mr. Matesich questioned the last sentence of the proposed legislative amendment, stating that the Administrator, with the advice and consent of the Board, "shall approve the transfer in order to ensure the solvency of the coal-workers pneumoconiosis fund." Administrator Ryan stated this was similar to HB 562 in that BWC must adopt a rule to take money from the Coal Fund. Chief Legal Counsel James Barnes agreed that the language needs to be changed to delineate that the solvency of the Coal Fund will not be negatively impacted.

Administrator Ryan expressed her appreciation for the directors' comments. She believes the legislation will pass, but has what she needs to prepare testimony acknowledging the Board's concerns, and requesting that language be clear this can only happen one time. Dollars can be better spent in this area on research and the impact of the new federal health care legislation.

ADJOURNMENT

Mr. Smith moved to adjourn the meeting at 5:29 PM, seconded by Mr. Matesich and approved by unanimous roll call vote.

Prepared by Jill Whitworth, Staff Counsel
May 3, 2010