BWC Board of Directors

BOARD MEETING

Thursday, July 29, 2010, 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
Member Absent:	None
Counsel Present:	John Williams, Assistant Attorney General
Scribe:	Larry Rhodebeck, Staff Counsel

CALL TO ORDER

Mr. Lhota called the meeting to order at 8:00 a.m. and the roll call was taken. Mr. Lhota reported that all eleven members were present and constituted a quorum.

MINUTES OF JUNE 18, 2010

Mr. Bryan requested that page 2, paragraph 5, lines 1-2 be changed to read, "the committees of the Workers' Compensation Board met in five meetings on June 17." He requested that in paragraph 6, lines 4-5 be changed to read, "After ~~deciding to endorse~~ *accepting* the Administrator's recommendation," He also requested that the sentence straddling page 2-3 be changed to read, "the Workers' Compensation Board now ~~has a greater appreciation~~ *recognizes* the complexity of the pneumoconiosis issues.

Mr. Bryan moved to adopt the minutes of June 18, 2010 as amended. Mr. Harris seconded and the minutes were approved by a roll call of eleven ayes and no nays.

AGENDA

Mr. Lhota added an "Administrator Briefing" by Ray Mazzotta, Chief Operating Officer, for Marsha Ryan, Administrator, to follow the "Quarterly Update on the HB100". Mr. Lhota announced that there would be an executive session on the self-assessment of the Workers' Compensation Board. It is the intention to approve the self-review as the only item of business after conclusion of the executive session.

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

COMMENTS

Mr. Lhota commended the committees of the Workers' Compensation Board for their meetings and discussion on July 26 and 28. Mercer Consulting LLC commented in one of its Investment Committee presentations that one of the strengths of the board was the full participation of Directors in committee meetings. One member was unable to attend meetings on July 28. With an adjustment for that conflict, of the 44 attendance opportunities there was a 90% attendance rate.

ACTUARIAL COMMITTEE

Mr. Bryan reported that the Actuarial Committee met on July 26 and there was 100% attendance of its members, if not all of the Workers' Compensation Board. There were no action items, two first readings, and one education session. The Actuarial Committee will adopt the practice of having a representative of Deloitte Consulting at all meetings. On July 26, there were nine credentialed actuaries in attendance.

There was a first reading regarding a recommendation to amend Rule 4123-17-72 of the Administrative Code, "Deductible Rule," to add tables for credits to public employer taxing districts. The original tables were withdrawn and these are the corrected credits. The deductible program is a new program, and it will be critically important for Customer Service to explain the advantages and disadvantages of the program to potential insureds. At some low-deductible levels, the employers will not reach the deductible limits.

There was also a first reading on group credibility table and break-even factors, which BWC is recommending leaving unchanged for policy year 2011. This decision is requested now so that group sponsors and their third-party administrators will have sufficient time to market their groups for next year. BWC staff recommended keeping the tables the same as for 2010 because the next step will be the final transition to a split experience rating program in 2012. An unresolved issue is homogeneity of groups. This continues as a concern for BWC and its efforts at group reform.

Mr. Bryan reported the Actuarial Committee had an excellent education session on reserves. BWC now uses data as of March 31 to project the required reserves for the end of the fiscal year on June 30. The last quarter of data will be included in the final report, but no material change is expected. BWC has an undiscounted reserve of $32 billion. Based on the 4% discount rate, that reserve can be stated at $19.8 billion, which leads to a heavy responsibility for investment returns and a 39% reduction of the liability on the balance sheet. Among the impacts of the recent reduction of the discount rate from 4.5% to 4% is an increase in the loss reserves of $965 million.

Mr. Bryan indicated the report of the Actuarial Committee was concluded.

AUDIT COMMITTEE

Mr. Haffey reported that the Audit Committee met on July 28 for two and one-half hours. Caren Murdock, Chief of Internal Audit, presented the Third Quarter Fiscal Year 2010 Quarterly Executive Summary detailing the results of three new consulting engagements, two new audits, and the progress made on the outstanding comments from prior periods. Ms Murdock discussed specific measures taken on a number of comments. She also answered questions about materiality ratings, how items of material significance could impact BWC financials, and how far in advance BWC operating units learn of audit projects.

Joe Bell, Office of Budget & Management (OBM), presented information about the Information Technology audits being scheduled by OBM to perform at BWC during fiscal 2011. He also discussed the interaction between the internal audit units of OBM and BWC. There are two IT audits scheduled to be completed during FY 2011. The Cambridge audit will focus on controls such as user permissions and if the "read only" setting functions properly. The IT General Controls project is a broad scope project. Discussions with BWC management are expected to help narrow the scope to critical needs.
Mr. Haffey reported that Tracy Valentino, Chief of Fiscal and Planning, and Mr. Mazzotta presented the fiscal year 2011 financial projections for the BWC Statement of Operations, Statement of Cash Flows, and Projected Insurance ratios. BWC does not project a balance sheet. Ms. Valentino also explained the

assumptions reflected in the projected numbers and there was a discussion of guidelines used.

Mr. Haffey also reported that Ms. Valentino presented the first reading of the fiscal year 2012—2013 biennial budget, which is due November 11. BWC will request $300 million for each fiscal year, reflecting a $5.6 million increase over fiscal year 2010 expenditures. Most of the increase is due to elimination of cost savings days. Next month, the Audit Committee will review the budget by appropriation line item.

Mr. Haffey also reported that Ms. Murdock discussed Internal Audit staff resources and audit projects. These include validation activities and internal comments; external auditor status update meeting; and adequacy of Internal Audit staff resources. BWC does not expect the loss of one auditor in the past month to materially impact services. There was also a discussion of three projects in the planning phases: Investment Department Request for Proposal process review; new claims audit; and claims quality assurance engagement.

Finally, the Audit Committee went into executive session for the quarterly litigation review by James Barnes, General Counsel.

Mr. Bryan asked what the timeline of the external audit is. Mr. Haffey replied that during May and June Schneider Downs conducted internal testing of BWC. Schneider Downs is currently in a pull-out period. There was a recent meeting between Schneider Downs, Administrator Ryan, Mr. Haffey and Ms. Valentino on the audit. There are no areas of concern. BWC is now closing its books, and once that is completed Schneider Downs resumes their work. Ms. Valentino added that Schneider Downs outsourced its actuarial review to Pinnacle and the goal is to finish this portion in August. Mr. Bryan responded that then the Workers' Compensation Board will have the results of the actuarial audit in August. Mr. Haffey added that with all other activities, the audited financial statements are due for submission to the State Auditor on September 30.

Mr. Haffey indicated the report of the Audit Committee was concluded.

INVESTMENT COMMITTEE

Mr. Smith reported that the portfolio value is $19.357 billion as of July 27, 2010 and allocated at 70.2% to bonds, 28.9% to stocks, and 0.9% to cash. For the fiscal year ended June 30, 2010, the portfolio had a net return of 12%. For this period, bonds returned 13.0% and stocks returned 12.3% which is very balanced. However, balanced returns are untypical on a month-to-month basis. For July, 2010 through July 27, the bond and stock portfolios combined increased in market

value by $426 million, all contributed by equities which increased in market value by $427 million.

Mercer Consulting led a discussion on Minority and/or Women-Owned Business Enterprises (MWBE) and how other public funds handle them. BWC will request Mercer provide the next steps in investing in MWBEs. Mercer also led a presentation on looking backwards and looking forwards. Looking backwards at three years' service, the Workers' Compensation Board steps have been measured, steady, disciplined, built on consensus, flexible, keeping on timelines, appropriate use of transition managers, inclusion of all members in investment decision-making, and adept leadership. This all took place during the most uncertain and volatile market environment that most participants in the investment community have experienced. Mercer proposed three priorities for the investment agenda for the balance of 2010: explore investment in private real estate; explore investments utilizing minority-owned investment managers; and explore shifting a portion of the existing passive investments in long duration credit fixed income to active investment managers.

Mr. Price thanked Mercer for the thorough research on MWBE because it enables the full Workers' Compensation Board to participate.

Mr. Smith indicated the report of the Investment Committee was concluded.

MEDICAL SERVICES & SAFETY COMMITTEE

Mr. Harris reported that the Medical Services and Safety met on July 28 for two hours. Ann Shannon, Legal Counsel, served as scribe and Mr. Harris thanked her for her service.

The Medical Services and Safety Committee conducted a second reading of rules on the provider fee schedule. The presentation was by Freddie Johnson, Director of Managed Care Services, and Jean Stevens, ICD-9 Specialist, and there was an exhaustive discussion of the proposed fee schedule.

Upon the recommendation of the Medical Services and Safety Committee, Mr. Harris moved that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation to amend Rule 4123-6-08 of the Administrative Code, "Bureau Fee Schedule," to adopt the provider fee schedule effective October 25, 2010. The motion consents to the Administrator amending Rule 4123-6-08 and enacting Appendix A to the rule as presented at the Medical Services and Safety Committee. Mr. Pitts seconded the motion.

Mr. Pitts stated that there was very specific discussion during the committee meeting on stakeholder comment and input on the final rule.

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

Mr. Harris reported there was a first reading led by Mr. Johnson of the rule on transcutaneous electrical nerve stimulators and neuromuscular electrical stimulators. There will be a house-cleaning of the rule to make it easier for injured workers and Managed Care Organizations (MCOs) to obtain units. Ms. Kielmeyer led a discussion on the Customer Services Division. The number of issues was broad, with many interesting details. Another discussion was conducted by Dr. Robert Balchick, BWC Chief Medical Officer, and Jim Landon, BWC Industrial Rehabilitation Nurse, on the recently completed seminar on treatment for workers who have suffered a work-related amputation. The presentation included a video of an injured worker.

Mr. Harris indicated the report of the Medical Services and Safety Committee was concluded.

MONTHLY ENTERPRISE REPORT

Ms. Valentino provided the Enterprise Report for June. The report includes the unaudited financial results for the fiscal year which are being reviewed by Schneider Downs. The audited report is due to the State Auditor by September 30, but is not released by the Auditor of State until a later time. The report will incorporate the actuarial reserve study by Deloitte Consulting.

BWC net assets increased by $36 million in June resulting in net assets of $3.8 billion for June 30, 2010, compared to $3.76 billion at May 31, 2010. Premium and assessment income of $163 million net of a $4 million provision for uncollectible accounts receivable and net of $0.4 million in ceded reinsurance premiums resulted in operating revenues of $159 million in June. The accrual of ceded reinsurance premiums is netted against earned premiums in the Statement of Operations. Premium and assessment income in June included a $22 million decrease from the true-up adjustment of accruals to actual premiums and assessments reported by public employer taxing districts for the policy ended December 31, 2009. All public employers pay one year in arrears. June income included a net increase of $15 million in unbilled premium receivables compared to May's net increase, resulting from the actuarial analysis completed using payment data through March 31, 2010. The Ohio Revised Code allows premiums for state agencies and assessments for self-insured employers and for the Disabled Workers' Relief Fund (DWRF) to be paid on a pay-as-you-go basis. Because BWC has the statutory authority to assess employers in future periods, an unbilled premium receivable equal to their share of the discounted reserves for compensation and compensation adjustment expenses is recorded in the statement of net assets.

Benefits and compensation adjustment expenses of $234 million along with other expenses of $13 million resulted in operating expenses of $247 million. May expenses included a net increase of $492 million in benefits and compensation adjustment expenses as a result of the recently completed actuarial analysis. Benefit payments issued in June increased by $12 million primarily as a result of a $9 million increase in medical payments and a $1 million increase in temporary total benefits.

A $65 million increase in the fair value of the investment portfolio in June along with interest and dividend income of $61 million for the month, resulted in net investment income of $125 million for the month after investment expenses of $0.6 million. The increase in the fair value of the portfolio is comprised of $56 million in net unrealized gains and $9 million in net realized gains. Cash and cash equivalents include $170 million in money market holdings in the outside investment manager accounts. These funds are committed to covering a $103 million net investment trade payable for transactions that will settle in July. Premium and assessment receipts of $58 million were collected in June, primarily from the 50/50 program. Receipts in June 2010 are $7 million lower than collections during the same period last year, reflecting decreases in premium rates and lower payroll. Because of fewer employers in the 50/50 program, there is lower reported payroll and fewer payments.

BWC total net assets have increased by $1.3 billion for fiscal year 2012 resulting in net assets of $3.8 billion at June 30, 2010, compared to $2.5 billion at June 30, 2009. Ms. Falls added that in comparing this information with page 9 of the report appears to be unfavorable comparison. However, the difference is derived from the decrease in the discount rate. BWC had a favorable performance that is not reflected because of the change in the discount rate.

Ms. Valentino further reported that benefit and compensation adjustment expenses increased by $698 million for fiscal year-to-date 2010. The decline in the discount rate from 4.5% to 4.0% is the primary reason for the increase in reserves for compensation and compensation adjustment expenses in 2010. Other expenses have increased by $36 million primarily as a result of the change in the compensation adjustment expense allocation from 82% to 68.8% and decreases in administrative spending following the BWC review of expenses. The BWC net investment income for fiscal year 2010 totaled $2.0 billion, comprised of $404 million in net realized losses and $1,738 million in net unrealized gains, along with $719 million of interest and dividend income, $3 million from corporate actions and settlements, net of $7 million in investment expenses. Declines in employer payroll and decreases in premium rates have contributed to premium collections being $312 million less than prior fiscal year collections. BWC is now in the next collection cycle, with 284,000 payroll reports being mailed and 2,000 electronic reports transmitted.

Ms. Valentino stated the chart on page 4 shows the increase in net assets over the fiscal year. The added footnotes on page 5 stated that fiscal year 2007 operating revenues were significantly impacted by a statutory change in accounting for the DWRF that increased premium and assessment income by $1.9 billion. Fiscal year 2010 operating expenses increased by $734 million primarily as a result of the decrease in the discount rate from 4.5% to 4.0%.

For the Administrative Cost Fund (ACF) budget results, encumbrances allow BWC to make payment no later than November 30, so the budget is not yet closed-out. Mr. Haffey added that the settling-out in November is typical of fund accounting. Ms. Valentino added this is true of every government agency.

BWC ACF expenses are approximately $26.6 million (9%) less than the budget and approximately 5% less than last fiscal year for the second consecutive year. The savings from decreases in payroll, including Customer Service, Infrastructure and Technology, Special Investigations, Medical Services, and Communications are due to decreases in staff as a result of hiring controls implemented by OBM, a July payroll period not requiring a health care premium, and use of cost savings days. The timing of the receipt of invoices for payment in fiscal year 2010 contributed to actual expenditures being less than the amount budgeted through June. Purchase orders have been completed that will allow payments to be made through November 2010 from the fiscal year 2010 budget for IT and other Personal Services, Software and Equipment Maintenance and Repairs and Other Rent and Leases. A review of postage accounts resulted in the identification of the availability of postage purchased in previous fiscal years, resulting in a favorable variance in fiscal year 2010 Communications costs. An evaluation of consultant resources in IT resulted in a reduction in the number of consultants and personal service costs. Consultant rates were also renegotiated, which contributed to the decrease in fiscal year 2010 from 2009.

Wrapping up several court cases has resulted in the reduction of fiscal year 2010 Special Counsel expenses. The increase in Inter Agency Expense in fiscal year 2010 compared to fiscal year 2009 is the result of moving BWC printing to Department of Administrative Service State Printing. The increase is partially offset by reductions in postage in the Communications line, lease payments, maintenance costs, and equipment. A reduced number of safety grant applications resulted in lower expenditures in fiscal year 2010. Purchase orders have been completed for the remaining equipment budget with payments being made in future months. Delays in project plans in fiscal year 2009 caused delays in equipment purchases resulting in an increase in equipment expenditures over fiscal year 2009. The BWC current fiscal year 2010 budget is approximately $41.4 million (12.6%) less than appropriated by the General Assembly.

The chart on page 11, Statement of Cash Flows, shows the premium receipt pattern. The June amount reflects the 50/50 payment. The table on page 13 itemizes the undiscounted reserves. The total for all funds is $32.2 billion. The Funding Ratio of 1.22 and Net Leverage ratio of 5.24 are both within the guidelines. The other financial ratios are higher than the targets as a result of the change of the discount rate. The premium stability graph on page 17 is modified to include more detail. The definition of "instability" is a change of 5% and a change of $500. The graph shows the number of policy holders which have had instability because of premium increase and premium decrease.

Mr. Bryan commented that the changes are a product of getting rate reform correct. Ms. Valentino explained that about 10% of employers have unstable premiums due to decreases.
Mr. Pitts added that page 15 shows claims filing has stabilized, rather than continuing the decline for the past three years.

QUARTERLY UPDATE ON THE HB 100 COMPREHENSIVE REPORT RECOMMENDATIONS

Jim Fograscher, Project Manager, gave the quarterly update on the HB100 Comprehensive Report Recommendations. Reference was made to the "BWC Implementation Quarterly Progress Report" of July 2010, which is included in the minutes by reference. The Deloitte Study contains 146 recommendations. As BWC transitions to a new fiscal year, accomplishments in implementing the recommendations are detailed.

Accomplishments since the April report show eight more recommendations are in place and four more recommendations have received "no action" decisions. Fiscal year 2010 accomplishments include fifty-nine recommendations addressed (the goal had been seventy) and forty-six recommendations have been implemented. Delays have largely resulted because of the need to include stakeholder involvement and the need of legislation to make some changes. Deloitte Consulting expressed satisfaction with BWC's implementation pace, focus, and priorities. There is a one to three-year projected period of implementation.

Mr. Fograscher continued, stating the up-coming fiscal year 2011 includes thirty-six recommendations. BWC will be designing multi-year projects, in contrast to the previous year. Themes will include continuing of comprehensive rate reform; imposition of cost controls, especially self-insurance securitization and governance implementation; and improving quality of care for injured workers. The latter theme will include MCO effectiveness implementation and medical payments implementation, but does not include financial stability or protection of the workforce as these were addressed in fiscal year 2010.

Those items completed during the quarter include: disclosure of margins and discounts for reserves; consideration of supplementing public employer historical development patterns; re-evaluate the portion of administrative expense allocated to loss adjustment expense; apply individual experience rating off-balance adjustment to individual experience rating risks only; limit impact of catastrophic events to 5 to 10% of net assets through reinsurance; update all fee schedules every one to two years; use an audit scoring tool to prioritize audits; and combine the two Drug-free Workplace programs. The emphasis for the first quarter of 2011 will be the self-insurance securitization.

A bar graph on page 2 of the quarterly report tracks implementation progress. As fiscal year 2011 progresses, the columns for "evaluation", "planning" and "design" will not progress as much as the columns for "implementation" and "in place". Details on changes are outlined in pages 3—7.

Mr. Matesich asked what the different colors of the triangles signify. Jim Fograscher replied that red signifies change from the last quarter and black signifies no change.

Mr. Matesich requested a report to the Workers' Compensation Board on what recommendations BWC determines to be "no action" items.

Mr. Bryan commended the insistence of Ms. Falls that BWC prepare a study report in this fashion. It has worked out well, compared with other similar large studies prepared for other institutions he has worked with. Mr. Lhota added that he also had seen some large studies sit on the shelf after completion.

ADMINISTRATOR BRIEFING

Mr. Mazzotta delivered the monthly report on behalf of Ms. Ryan. The Special Investigations Division (SID) set records during the fiscal year 2010 by bringing 240 prosecutions, 141 indictments, and 143 convictions. This is the highest level since 2003. SID now placed more emphasis on employer and provider fraud, using fewer investigative staff than in the past. Mr. Mazzotta congratulated Tom Wersell, Director, and his staff.

The year 2011 will be the centennial of workers' compensation in the United States. The State of Wisconsin was the first state to adopt workers' compensation and will take the lead in the observance and coordination with other states. There is a planned documentary for PBS with bi-partisan support. Maryann Heil, Executive Assistant, is the BWC coordinator and has participated in a teleconference.

Mr. Harris stated he wanted the commemoration to have something meaningful occur. He also requested that the Board be kept informed of Ohio's efforts for this anniversary.

CHAIRMAN'S COMMENTS

Mr. Lhota reported that there will be meetings of the Workers' Compensation Board committees on August 26. On August 27, the BWC will undergo its annual ethics training with David Freel, Executive Director of the Ohio Ethics Commission. Following that will be fiduciary training by Ron O'Keefe, Fiduciary Counsel. The business session of the meeting will begin about 10:30 a.m.

Don Berno, Board Liaison, distributed amended versions of the 2011 calendar. The directors discussed their individual requests for changing dates of the meetings during January, February, March, and June. Mr. Lhota requested that directors make their comments to Mr. Berno. Mr. Price reminded directors that moving dates of meetings to earlier in the month can put a crush on staff.

Mr. Lhota reported that the meeting would recess at 9:15 a.m. and reconvene at 9:20 a.m. in executive session to discuss the self-assessment of the Workers' Compensation Board.

EXECUTIVE SESSION

Mr. Caldwell moved to enter executive session pursuant to Ohio Revised Code §121.22(G) (1) to discuss personnel matters. Mr. Haffey seconded and the motion was approved by a roll call vote of eleven ayes and no nays.

BOARD SELF-ASSESSMENT

The Board returned from the executive session.

Ms. Falls moved that the Workers' Compensation Board of Directors approve the Workers' Compensation Board of Directors FY 2010 Self-Assessment, Summary of Director responses. Mr. Caldwell 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. Mr. Hummel seconded and Mr. Lhota adjourned the meeting after the motion was approved by a roll call vote of eleven ayes and no nays.