

BWC Board of Directors

BOARD MEETING

Friday, August 27, 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
Thomas Pitts
Larry Price
Robert Smith

Member Absent: Jim Matesich

Counsel Present: John Williams, Assistant Attorney General
Ron O'Keefe, Fiduciary Counsel
James Barnes, BWC Chief Counsel

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 ten members were present and constituted a quorum.

MINUTES OF JULY 18, 2010

Mr. Lhota requested that under the Investment Committee section, page 4, that the scribe strikes the 3rd and 4th sentences (from "For this period" . . . to "For July . . ."). On page 5, under Medical Services and Safety Committee, add "committee" between "Safety" and "met" in the first line. On page 2, under Actuary Committee, put a period after "members" in the second line, and delete the rest of the sentence.

Mr. Haffey moved to adopt the minutes of July 29, 2010 as amended. Mr. Caldwell seconded and the minutes were approved by a roll call of ten ayes and no nays.

AGENDA

Mr. Lhota added a report on the Competitive Workers' Compensation Task Force by Mr. Pitts and Ray Mazzotta, Chief Operations Officer, under "Administrator Briefing". He also reserved the right to call a break at an appropriate time.

Mr. Harris moved to adopt the amended agenda. Mr. Caldwell seconded and the amended agenda was adopted by a roll call vote of ten ayes and no nays.

ETHICS TRAINING

David Freel, Executive Director, Ohio Ethics Commission conducted ethics training for the Workers' Compensation Board. The major topics were outside employment and revolving door issues. A number of questions were asked by the Directors.

FIDUCIARY RESPONSIBILITY

Ron O'Keefe, Fiduciary Counsel, led a discussion on fiduciary responsibility. Also participating were John Williams, Assistant Attorney General, and James Barnes, Chief Counsel. Mr. O'Keefe reviewed a memo he had provided earlier to the Directors. The memorandum is included in the minutes by reference. Mr. O'Keefe observed the Directors are meeting their fiduciary responsibilities through the formation of a Governance Committee and adoption of Governance Guidelines. The Committee charters clearly define the responsibilities of the individual committees. The Directors completed the Administrator's evaluation as required by law, with candid comments summarized and shared with the Governor. The Board self-evaluation process is notable for its clarity, quality, completeness of information and steps for improvement. The meeting minutes reflect the length and intensity of discussion – what happened, the factors considered when making the decision and the rationale for the decision.

In response to a question from Mr. Price, Mr. O'Keefe said the board has done a superior job of functioning within the guidelines of the Open Meetings law. There is a spirited and robust discussion of matters. In his experience, the board has done a superior job considering the range of backgrounds and experience of the individual directors. The continuing education component is good.

Assistant Attorney General Williams noted that he uses this board as an example of a board operating with care under the Open Meetings Act. The Board is exemplary of its' knowledge of the Act.

Mr. Lhota recessed the meeting at 10:23 a.m.

CHAIRMAN'S COMMENTS

Mr. Lhota reconvened the meeting at 10:30 a.m. He reported that the Workers' Compensation Board of Directors had just completed its annual ethics and fiduciary training. All directors were present except Mr. Matesich.

Mr. Lhota reminded that it has been three years ago that the Workers' Compensation Board first met. He thanked staff for its excellent support.

At the committee meetings of August 26, one director was unable to participate because of an unavoidable business commitment. Nevertheless, there was 88% attendance and participation by directors.

COMMITTEE REPORTS

ACTUARIAL COMMITTEE

Mr. Bryan reported that the Actuarial Committee had met on August 26 and had two second readings. One was on the deductible program for public employer taxing districts (PEC). BWC took the opportunity to update the entire rule. The deductible program credits were confirmed to be actuarially sound by actuaries of both BWC and Deloitte Consulting LLP. Hazard group labels were added to all tables.

Upon the recommendation of the Actuarial Committee, Mr. Bryan moved that the BWC Board of Directors approve the Administrator's recommendation to amend Rule 4123-17-72 of the Administrative Code, "Public Employer Taxing Districts Deductible Tables," to make changes to the appendices to the rule. The motion consents to the Administrator amending Rule 4123-17-72 as presented at the Actuarial Committee. Mr. Caldwell seconded and the motion was approved by a roll call vote of ten ayes and no nays.

Mr. Bryan also reported that the Actuarial Committee had approved the rules on the PA credibility tables and the break-even factors. This is an extension of current rules, now effective July 1, 2010, to July 1, 2011. BWC is amending this rule early to provide guidance and certainty to group sponsors, TPAs, and employers. The Actuarial Committee voted to extend the rule, effective July 1, 2011.

Upon the recommendation of the Actuarial Committee, Mr. Bryan moved that the BWC Board of Directors approve the Administrator's recommendation to amend Rule 4123-17-05.1 of the Administrative Code, "Private Employer Credibility Table Used for Experience Rating." The motion consents to the amendment of Rule 4123-17-05.1 effective July 1, 2011, as presented at the Actuarial Committee. Mr.

Hummel seconded and the motion was approved by a roll call vote of ten ayes and no nays.

Upon the recommendation of the Actuarial Committee, Mr. Bryan moved that the BWC Board of Directors approve the Administrator recommendation to adopt rule 4123-17-64.1 of the Administrative Code, "Private Employer Group Experience Break Even Factors." The rule establishes break-even factors to be applied to group experience modification for private employers effective July 1, 2011. The motion consents to the Administrator amending the rule as presented at the Actuarial Committee. Mr. Caldwell seconded and the motion was approved by a roll call vote of ten ayes and no nays.

Mr. Bryan also reported that there was a first reading of the modification of several rules in chapter 4123-17 of the Administrative Code. The modifications reflect terrific staff work and the details were forwarded to the directors in advance of the meeting.

The Actuarial Committee also reviewed the final reserve audit using data for June 30. This process reflects the use of a new actuarial consultant. The audit is supported with a five volume report which is available to the Workers' Compensation Board and anyone who requests it. Deloitte reports only a small change from March 31, 2010, to June 30, 2010. Deloitte also reported to the Actuarial Committee that it was preparing (as consistent with best practices) to provide an opinion on the estimates of unpaid loss and loss adjustment expense. BWC has a nominal undiscounted liability for loss and loss adjustments expense of \$32 billion. At a 4% discount rate, the liability will appear as \$19.8 billion on the balance sheets for fiscal year 2010. On the asset side of the balance sheet, there is a \$3.4 billion account receivable for uncollected premiums based on a going concern assumption. The change in the discount rate led to a \$934 million increase. A change of almost \$1 billion shows the interrelationship with the investment policy.

Mr. Bryan stated that the BWC lost one credentialed actuary and that recruitment of a replacement is underway. The rate stability project commenced in July; the Committee expects a report in January 2011.

Mr. Smith remarked that the Actuarial Committee also had a discussion on the differences between a competitive insurance workers' compensation market and the Ohio workers' compensation system. He said that while the free market concept is desirable, there are many benefits of the current Ohio approach that deserve discussion.

AUDIT COMMITTEE

Mr. Haffey reported that the Audit Committee met for 90 minutes on August 26. Mr. Barnes led a discussion on the BWC code of ethics. BWC has an ethics web-site and mail box available to BWC employees with links to the Ohio Ethics Commission and the Ohio Inspector General. BWC requires ethics training of its employees and had 100% attendance by its employees in 2008. Mr. Barnes confirmed that the ethics policy is in compliance with Ohio laws and the Governor's Executive Order.

Tracy Valentino, Chief of Fiscal and Planning, reported on the biennial budget for fiscal years 2012 through 2013. BWC proposes a budget of \$300 million for each year. There were no material changes from the July committee report. There will be a 5% increase for 2012 reflecting the elimination of the savings resulting from Cost Savings Days. However, the budget is \$38 million less than the previous biennium request. The July report did not contain a presentation of the line-item appropriation version of the budget.

Mr. Haffey moved that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation for the Biennial Budget for fiscal years 2012—2013 for submission to the Office of Budget and Management, as recommended by the Audit Committee. Mr. Smith seconded and the motion was approved by a roll call vote of ten ayes and no nays.

Mr. Haffey stated that Caren Murdock, Chief of Internal Audit, also reported on the division. She described staff resources and projects in process. The division is busy validating prior audit comments. Ms. Murdock reported that the division is adequately staffed. Also, two audits are in planning, three are in field work, and one is finalized. Four projects will be reported in September. There has also been a change in prioritization of resources to assist in the external audit. Finally, Ms. Murdock reported on three special projects, enterprise risk management, internal audit training, and goals and objectives of the division.

Finally, after the required motion and roll call vote, the Audit Committee went into executive session to discuss the external audit and to receive a litigation update from Mr. Barnes.

INVESTMENT COMMITTEE

Mr. Smith reported that the Investment Committee met on August 26, but had no action items to present to the Workers' Compensation Board today. As of August 25, the value of the BWC portfolio stood at \$19.769 billion consisting of 71% in bonds, 27.5% in equities, and 1.5% in cash. The July 2010 monthly performance of the BWC portfolio was a positive 2.1% and net investment income was \$557

million. August performance to date showed a market value increase in the stock and bond portfolio of \$172 million, of which bonds provided a 3% positive return and equities reflected a 3.7% negative return.

Mercer Investment Consulting, Inc., reported on capital markets and the effect of high unemployment, housing, consumer spending, and the shift of retail investors to bond investments. Bruce Dunn, Chief Investment Officer, shared Investment Division goals for FY 2011. Among the goals the Investment Division will explore are a cash overlay strategy in which BWC will use an outside advisor to better manage excess cash balances. BWC will propose to merge certain specialty funds in order increase investment efficiency.

Mercer led a discussion on Minority and Women Business Enterprise (MWBE). The Investment Committee has requested that Mercer draft a policy on MWBE. Mercer also conducted a one hour discussion on real estate as an asset class and discussion of risks of this potential new asset class for BWC.

MEDICAL SERVICES AND SAFETY COMMITTEE

Mr. Harris reported that the Medical Services and Safety Committee had a second reading on the rule regarding transcutaneous electrical nerve stimulators. After the first reading in July, the Managed Care Organizations (MCOs) commented on the thirty day contact requirement and there was an amendment in the final proposed rule.

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 4123-6-43 of the Administrative Code, "Payment for Transcutaneous Electrical Nerve Stimulators and Neuromuscular Electrical Stimulators." Mr. Pitts seconded and the motion was approved by a roll call vote of ten ayes and no nays.

Mr. Harris further reported that Dr. Robert Balchick, Medical Director, conducted a first reading on the rule on pharmacy and therapeutics committee, Rule 4123-6-21.2. This is another step in the revitalization of the pharmacy department. Bob Coury, Chief, Medical Services Division, reported on the pro-active allowance program; MCO performance measures; and redesign of rehabilitation delivery. BWC proposes six system enhancements.

FISCAL YEAR 2011 AGENCY GOALS

Mr. Mazzotta delivered the report "FY 2011 Agency Objectives" of August 27, 2010. The report is derived from the flexible performance agreement between

Marsha Ryan, BWC Administrator, and Governor Ted Strickland and includes achievements of FY 2010.

The first objective is to make the Ohio workers' compensation system more competitive. The first new major initiative is to develop a group rating structure, so group rating is actuarially sound. A second is to implement a split experience rating plan. These two initiatives will be effective July 1, 2012. BWC will also implement measures of performance for all pricing programs; utilize claim analytic methodologies to determine drivers of increased medical and claim costs as a joint effort of the Actuarial and Medical Services Divisions; execute the current Investment Policy Statement (IPS); and explore further diversification in active management, MWBE, real estate, cash management, and pursuit of legislation allowing combination of funds. BWC will seek increased identification and prosecution of fraud through greater outreach and training, such as recent training sessions with the MCOs.

The accomplishments under this objective for FY 2010 are: separating base rates from the impact of group rating; benchmarking Ohio performance against other states and private carriers; addressing remaining Deloitte HB100 study recommendations; successful transition to the new IPS; introduction of new insurance products for employers; and focus on employer and provider fraud, resulting in increased prosecutions and convictions.

The second objective is maintaining the highest level of quality care and loss protection for workers. The first new initiative for this objective is to redesign the safety intervention grant program and the safety service delivery model so, in the words of Abe Al-Tarawneh, Superintendent of Safety and Hygiene, BWC takes care of workers, not injuries. BWC will assign claims by complexity categories to ensure effective claim management and have more effective identification of serious injury. BWC will create an effective injury prevention and medical treatment research program. The first study for this program was the partnership with The Ohio State University resulting in a pharmacy services report. Three more are planned for the coal industry and prescription opiates. BWC will also establish a Medical Services Quality Assurance Unit; redesign vocational rehabilitation strategy; and enhance MCO performance metrics including DoDM. This will include stakeholders input and consultants and include claims outside the experience period.

Other accomplishments under this objective for FY 2010 include implementing a new drug-free safety program; establishing a Medical Services and Safety Committee; implementing a "Blue Ribbon Provider Panel" pilot with state agencies; and establishing systemic process to update the medical fee schedules.

The third objective is to reinforce the BWC brand of operational excellence through efficiency, improved customer service, and expanded capabilities and skills. The first new major initiative is to evaluate and remediate system support for core processes such as claims, premiums, and medical payments. This will involve bringing in an IT consultant for evaluation. BWC will establish a financial underwriting function for all product lines. This is a new unit, combining individuals from several divisions under Ms. Valentino. With a new tracking system, the unit will look at BWC exposures and obtain sufficient collateral in self-insuring employers. BWC will develop broader training offerings to cover major functional and leadership needs. A final initiative is to expand e-business capabilities with customers and stakeholders.

In FY 2010, BWC accomplishments included improved customer service by adding electronic payroll, an e-newsletter, and streamlined routing of calls to the contact center. BWC retooled customer correspondence, including revision of 150 to 300 common letters. BWC reduced field office square footage and sublet offices in the William Green Building. Some office spaces were reduced by 40%.

The last objective is to develop and implement strategies to improve financial and operational soundness and stability. The major new initiatives are to institute an Enterprise Risk Management (ERM) initiative including financial, actuarial, and operational needs; and implement redesigned self-insured underwriting processes. A meeting will be held August 30 on the latter point to wrap-up work on a new securitization process. BWC will explore initiatives to improve cash flow through improved collections and cash management tools. Much of BWC bad debt is derived from audits and adjustments. BWC will refine long-term financial and operational performance metrics in collaboration with Deloitte and Mercer. The goal is to revise before BWC reviews premium rates. BWC will develop a framework for Enterprise Risk Management, which includes an enterprise-wide risk assessment related to financial and legal exposure. Mr. Barnes has identified 47 risk exposures.

Ms. Falls asked who will head the Medical Services Quality Assurance. Mr. Mazzotta replied it will be Freddie Johnson, Director of Managed Care Services. Concerning the 250 completed BWC process maps, Ms. Falls also asked for a specific example of use to spot inefficiencies. Mr. Mazzotta replied an example would be those completed for the Kaizen events.

Mr. Smith stated he would encourage more process mapping and Kaizen events.

MONTHLY ENTERPRISE REPORT

Ms. Valentino provided the "Enterprise Report" for August 2010. She made two points. First, the June and year-end references are unaudited figures. Second,

because it is only for one month, the “year-to-date” performance equals the month. The financial projections discussed in July are now part of the July report. BWC will re-evaluate the estimates throughout the year and discuss changes with the Workers' Compensation Board before making them.

BWC net assets increased by \$530 million in July, resulting in net assets of \$4.3 billion at July 31, 2010, compared to \$3.8 billion at June, 30, 2010. All references to financial results as of June 30 are unaudited as of now. Premium and assessment income of \$168 million net of a \$9 million for provision for uncollectible accounts receivable and net \$0.4 million in ceded reinsurance premiums resulted in operating revenues of \$159 million. The accrual of ceded reinsurance premiums is netted against earned premiums in the Statement of Operations. Benefits and compensation adjustment expenses were \$179 million. A new chart on page 4 compares this with the same time last year. July expenses include an \$18 million increase in reserves for compensation and compensation adjustment expenses and \$161 million in net payments for benefits and compensation adjustment expenses. Benefit payments issued in July decreased by \$13 million compared to June payments primarily as a result of an \$8 million decrease in medical payments, a \$2 million decrease in settlements and decrease in temporary total, permanent total, and percent permanent partial benefits totaling \$3 million.

A \$499 million increase in the fair value of the investment portfolio in July along with interest and dividend income of \$58 million resulted in net investment income of \$557 million for the month after investment expenses of \$0.5 million. The increase in the fair value of the portfolio is comprised of \$492 million in net unrealized gains and \$7 million in net realized gains. Cash and cash equivalents include \$184 million in money market holdings in the outside investment manager accounts. Premium and assessment receipts of \$158 million were collected in July. Receipts in July 2010 are \$29 million lower than collections during this same period last year, reflecting decreases in premium rates and timing differences in the payment of premiums.

Private employer reported payroll and premiums for January 1, 2010 through the June 30, 2010, are due by August 31. Through August 12, 2010, approximately 54% of the employers have filed their reports compared to approximately 52% during this same time frame for the January/February reporting period. Premium receipts are approximately \$5 million higher than during this same time frame. As of this report, employers still have three more days to pay.

The differences between the ACF and the budget are primarily in timing of payments. Decreases in payroll from July 2009 to July 2010 are due to a decrease in staff as a result of hiring controls. The decrease was partially offset by the use of fewer Cost Savings Days in July 2010 than in July 2009. Through July journal

entries, BWC staff have taken almost 13,000 (7%) of the available 179,300 hours for a savings of approximately \$350,000. BWC made no payments in July from the ACF to the Workers' Compensation Council or from Coal Workers' Pneumoconiosis Fund to the Ohio Department of Natural Resources (ODNR). BWC is finalizing memoranda of understanding with ODNR and will make a payment in August. July 2010 cash flows are down from July 2009 because of the reduction in premium rates. The net assets of the State Insurance Fund are \$3.8 billion. The Deloitte Consulting reserve audit adjustment from the June audit will be posted on the August financial statements.

The funding ratio and net leverage ratio for July are both well within the ranges of the guidelines. In addition the net loss ratio for July of 106.3% is less than the projected ratio of 117.5% and the actual ratio of July 2009 of 108.8%. The operating Ratio for July was 76.2%, compared to a projected ratio of 86.0% and the July 2009 ratio of 74.5%.

Ms. Valentino finally reported that the reference to the "domestic water supply" refers to the water pumps for domestic use in the William Green Building. The pumps are part of the original equipment.

ADMINISTRATOR BRIEFING

Ms. Ryan reported that the Joint Committee on Agency Rule Review (JCARR) met on August 19 and approved all of the BWC rules on Confidential Personal Information.

Regarding the Workers' Compensation Council, there are continuing discussions with the three former employees on settlement of their employment discrimination suits. The House of Representatives has passed a bill to defund the Workers' Compensation Council and it is now pending in the Ohio Senate.

Senator Sherrod Brown has introduced federal legislation, S.3254, to address abuses of the independent contractor relationship. There is a similar initiative in the United States House of Representatives, H.5107. There are also two bills in the Ohio General Assembly to create a uniform definition of independent contractor. The Federal legislation will mandate new record-keeping standards, a new definition of independent contractor, and notice for Federal contractors.

The workers' compensation competitiveness Task Force met on August 19, with Mr. Pitts and Mr. Mazzotta attending. Mr. Pitts reported the session was co-chaired by Senator Tim Grendell and Mary Jo Hudson, Director, Department of Insurance. The task force took testimony from Dr. Robert Hartwig, economist, of The Insurance Information Institute. He discussed the origins and history of the Ohio workers' compensation system and the potential benefits of competition.

There was a long discussion of monopolies. Ohio is not strictly a monopoly because of the option some employers have for self-insurance. He discussed the European origins of workers' compensation and that Ohio is one of six early adopters. There was also a long discussion on Ohio and market-place changes using out-of-date information. His conclusion is that Ohio should open-up competition for employers. The September meeting will have an open forum. The draft report will be available in October for comment, with the final report due in November.

Mr. Mazzotta added that it was a theoretical presentation and did not use any Ohio data.

Mr. Smith stated that he is a believer free in markets. In attending sessions of the task force he has heard mostly insurance company testimony. The discounting of the State Insurance Fund reduces the amount that employers pay in premiums. Removal of discounting will impact employers greatly.

Mr. Mazzotta also reported that concerning the history of workers' compensation, only seven states have ever used monopoly, and four still do. The Deloitte reserve audit report of August 26 shows that the states have flexibility in managing workers' compensation. A State Insurance Fund makes the entire workers' compensation system more honest.

Mr. Harris requested that BWC prepare talking points on the impact on employers of privatization.

Mr. Pitts further reported that Dr. Hartwig's report is available from the task force web site. Mr. Lhota requested a link be available to the Workers' Compensation Board. Mr. Mazzotta responded that the mission of BWC is to provide care for the injured worker at the lowest possible cost. The task force does not address this.

Ms. Ryan commented that today's meeting marks the third anniversary of the Workers' Compensation Board. It has been marked with a discussion on ethics, solvency, and duties to injured workers. This bespeaks of the three years of devotion by the Workers' Compensation Board.

CHAIRMAN'S COMMENTS

Mr. Lhota reported that the next meetings of the Workers' Compensation Board will be on September 23 and 24. There will be a public forum on rehabilitation.

ADJOURNMENT

Mr. Haffey moved to adjourn the meeting. Mr. Caldwell seconded and Mr. Lhota adjourned the meeting at 12:00 noon after the motion was approved by a roll call vote of ten ayes and no nays.

H:\Word\ldr\WCB 0710.doc
September 3, 2010