OHIO BUREAU OF WORKERS' COMPENSATION BOARD MEETING

AGENDA

Bill Lhota, Chairman
September 27, 2007
Level 2, Room 2
8:00 a.m. – 1:30 p.m.

8:00 a.m. Call to order

Bill Lhota, Chairman

- Approval of minutes for August 23, 2007 meeting
- Review meeting agenda
- Governance committee update and appointments

8:10 a.m. Rule making process

Tom Sico, Law Director

8:20 a.m. Committee Reports

Audit Committee
Ken Haffey, Committee Chairman

- Rules: Application for Coverage*
  Inpatient Hospital reimbursement update – 2007
  Medicare DRG*

Report on response to Inspector General audit re: Manual Overrides

Actuarial Committee
Chuck Bryan, Committee Chairman

- PEC rate recommendation*
- Rule: Annuity Table update*

Investment Committee
Bob Smith, Committee Chairman

- Issuance of RFP for Investment Consultant*
- Revise Section V.A. of BWC Investment Policy and Guidelines (Long Duration Fixed Income benchmark)*
- Temporary waiver of Appendix XV (Calendar of Reports) of BWC Investment Policy and Guidelines*

9:00 a.m. Monthly Financial Report

Tracy Valentino, Interim Chief Financial Officer

9:15 a.m.	Administrator Briefing **Marsha Ryan, Administrator** ➢ **Introduction of Gary Diceglio, Chairman Industrial Commission of Ohio** ➢ Introduction of Group Rating Program
9:30 a.m.	Governance Issues/Training **Jeff Rodek, OSU Fisher College of Business**
11:30 a.m.	Adjourn to Executive Session *Executive Session* **Presentation of Inspector General Thomas P. Charles.**
1:30 p.m.	Adjourn Executive Session Adjourn Board Meeting

* Consideration and possible vote

Next meeting: October 26, 2007 8:00 am – 1:30 pm

BOARD OF DIRECTORS MEETING MINUTES 08/23/07

MEETING CALLED TO ORDER:

OATH OF OFFICE:

Meeting called to order by Chairman Lhota @ 1 pm 8/23/07

Board members sworn in by Chairman Lhota 1 pm; certificates presented to members by Administrator Ryan

ROLL CALL:

Minute taker took roll call – all members present; quorum present

INTRODUCTIONS:

Self introduction of all members

Introduction of BWC by Administrator Ryan:

- Expressed appreciation of board members
- Provided BWC background to members
- Introduction of senior management team: James Barnes, Toni Brokaw; Bob Coury, Bruce Dunn, Leo Genders, Tina Kielmeyer, Keary McCarthy, John Petrick, Tracy Valentino, Christina Madriguera, David Hollingsworth, Don Berno, AAG John Williams, Deputy Inspector General Joe Montgomery
- Reviewed HB 100 issues, particularly, bonding issues
- Covered administrative issues
- Discussed preparation of fiscal year 07 reports, prepared for governor (financial audit; year end report RC 4123.22)
- Discussed fiduciary duties / discussed other duties required of Board

ORGANIZATION DISCUSSION:

BOARD TRAINING:

Chairman Lhota provided overview of training (2 presentations) for the meeting.

Discussed Board Governance issues for September meeting discussion

BOARD GOVERNANCE:

Chairman Lhota discussed format of future meetings, referred to attachment 3 in "meeting binder" given to members; suggested that each monthly meeting include an in depth discussion of a particular area of BWC; emphasized board's role of governance; emphasized importance that all members play a role in meeting agendas

Chairman Lhota emphasized importance of following Open Meetings Laws requirements; AAG Williams / ALD Ann Shannon provided brief background on Open Meetings laws / Public Records law and fulfilling requirements; emphasized that if a member is on the telephone, they are not present for a meeting; discussed process of executive session / notice (meetings) requirements; discussed committee meetings

Member Fulton raised issue of participation in discussion by attendees of meetings

COMMITTEE STRUCTURE:

Discussion of three committees: Chairman Lhota discussed conduct of the three committee meetings, whether they be held concurrent or consecutive, board unanimous with conducting committees consecutively

Chairman Lhota raised idea of creating a Board Governance Committee, as authorized by law

Motion by member Bryan, seconded by Mr. Caldwell to create a Governance Committee,

- motion passed unanimously to create this committee;
- roll call taken by minute taker

COMMITTEE ASSIGNMENTS:

Chairman Lhota suggested that committees have odd number of members

Motion made by member Caldwell, seconded by member Matesich to approve committee assignments as proposed in attachment 3 of binder

- motion passed unanimously

Motion, made by member Price, seconded by Member Fulton, to appoint member Harris as Vice Chairman

- motion approved unanimously
- member Harris abstained from voting

ACTUARIAL:

i) Charles Bryan (chair)
ii) James Hummel
iii) Jim Matesich

INVESTMENT:

i) David Caldwell
ii) Alison Falls (vice chair)
iii) James Harris
iv) Larry Price
v) Robert Smith (chair)

AUDIT:

i) Philip Fulton
ii) Kenneth Haffey (chair)
iii) Bill Lhota

FUTURE MEETING DATES:

December meeting date changed to December 19.

Committee meetings will meet concurrently, August 24, 2007, 8:00 am as follows:

- audit – room 1
- investment – room 2
- actuarial – room 3

Break taken for members to complete administrative paperwork

All members reconvened at 2:30 pm

FIDUCIARY DISCUSSION:

Presentation by Thomas R. Anderson: discussion of governance of public funds, in particular, large institutional public funds

- elements of fiduciary responsibility
- reasonably prudent standard by which board will be measured
- seeking of expert advice
- utilization of fiduciary counsel
- documentation of processes / decisions
- solid administrative systems in place
- exclusive benefit rule
- three levels of fiduciary

i) governing
ii) managing
iii) operating

- asset allocation decision making
- setting of contribution rates
- metrics for evaluation

presentation followed by general discussion between speaker and board members of issues raised in presentation

meeting adjourned for a break at 3:17 pm

ETHICS TRAINING:

Reconvened at 3:30 pm

Presentation by David Freel, as described in attachment 5 of member binder.

Chairman Lhota raised issue of moving date of September meeting to September 26, with committee meetings on September 27. The date change was made.

Motion to adjourn meeting made and seconded. Meeting adjourned at 5:35 pm, August 23, 2007.

Minutes prepared by Tom Woodruff BWC Staff Counsel.

THE RULE-MAKING PROCESS EXPLAINED

The state legislature has given state agencies the ability to adopt rules to implement and/or clarify laws. Agencies can use one of two methods. These methods are named after the Ohio Revised Code citation -- a "119" rule or a "111.15" rule.

The "119" rule-making process is mandatory, unless the legislature exempts an agency from that process, and allows them to use the 111.15 rule process. For BWC, the exempt (111.15) rules are generally related to rate rules.

1. BWC's Rule Making Process

- Rules are proposed by interested BWC Departments.
- BWC's Legal Division helps prepare rules & handles filing process with Register of Ohio and JCARR.
- To enact any BWC rule, the Board must first give its advice & consent.

2. Basic Chapter 119 rule process (106-115 days for completion)

- After BWC files proposed rule on-line at the Register of Ohio, BWC conducts public hearing on the rule (within 31 to 40 days of filing rule).
- Joint Committee on Agency Rule Review (J.C.A.R.R.) holds hearing on the rule within 65 days of rule filing. JCARR reviews the rules to determine that:
  - The rules do not exceed the scope of the rule-making agency's statutory authority;
  - The rules do not conflict with a rule of that agency or another rule-making agency;
  - The rules do not conflict with the intent of the legislature in enacting the statute under which the rule is proposed; and,
  - The rule-making agency has prepared a complete and accurate rule summary and fiscal analysis of the proposed rule, amendment, or rescission.
- JCARR's *only* option is to recommend that a rule be invalidated.
- If JCARR does not take action to invalidate a rule, at the end of JCARR's jurisdiction, BWC "final files" the rule to be effective no sooner than 10 days later.
- Properly promulgated rules have the force and effect of law.
- Public participation: BWC's public hearing

3. R.C. 111.15 rules (10 days for completion)

- The exempt rules are generally BWC rate rules
- These rules are filed with the Register of Ohio, but are not subject to public hearing or JCARR review.
- These rules are effective no sooner than 10 days from filing.
- Public participation: interested parties can provide informal input during rule preparation; proposed rules are distributed to interested parties.

- At a minimum, BWC must review its rules every 5 years to determine whether to:
  - Continue the rule without amendment;
  - Rescind the rule; or,
  - Amend the rule.

Ohio Bureau of Workers' Compensation
Financial Highlights
Fiscal Years 2005 (audited), 2006 (audited), 2007 (unaudited)

Operating Revenues

Net Investment Income

Operating Expenses

Net Assets

'05 '06 '07

*Significant increase is a result of a statutory change impacting the Disabled Workers' Relief Fund.

Financial**Report**

September '07

Ohio Bureau of Workers' Compensation

Printed within BWC

Financial **Report**

September '07

Net assets have increased from $2.3 billion at June 30, 2007 to $2.5 billion at August 31, 2007. The June 30, 2007 reported net assets have been updated to include impacts from the actuarial audit and Ohio House Bill 100, which granted BWC the authority to assess employers in future periods for the amounts needed to fund the Disabled Workers' Relief Fund (DWRF). The 2008 fiscal year-to-date increase in net assets is due to the following:

- Net investment income of $383 million, which includes interest and dividends of $131 million, an increase of $253 million in the fair value of the investment portfolio, and investment expenses of $1 million.
- Operating losses of $145 million, which partially off-set net investment income.

The statutory change, granting BWC the authority to assess employers in future periods for amounts needed to fund DWRF increased net assets by $1.9 billion during fiscal year 2007.

Net Deficit at June 30, 2006	$127 million
Net Assets at June 30, 2007	$2.3 billion
Net Assets at August 31, 2007	$2.5 billion

	FY 2008 As of 8/31	FY 2007 As of 8/31	
Operating Revenues	$427 million	$419 million	$8 million increase
Operating Expenses	$572 million	$523 million	$49 million increase
Net Investment Income	$383 million	$457 million	$74 million decrease
Increase in Net Assets	$238 million	$353 million	$115 million decrease

Operating expenses for fiscal year-to-date 2008, include the latest reserve projections prepared by BWC's actuarial consultants. These projections are based on payment trends and assumptions from the recently completed fiscal year 2007 actuarial audit. The projections for fiscal year-to-date 2008 have increased reserves for compensation and compensation adjustment expenses by almost $40 million. A significant factor in this increase is the change in the discount rate from 5.25% to 5.0% at June 30, 2007.

Statement of **Operations**

Fiscal year to date August 31, 2007

(in millions)	Actual	Projected	Variance	Prior Yr. Actual	Increase (Decrease)
Total Operating Revenues	$ 427	$ 408	$ 19	$ 419	$ 8
Total Operating Expenses	572	507	(65)	523	49
Net Operating Gain (Loss)	(145)	(99)	(46)	(104)	(41)
Net Investment Income	383	169	214	457	(74)
Increase (Decrease) in Net Assets	238	70	168	353	(115)
Net Assets Beginning of Period	2,306	2,306	–	(127)	2,433
Net Assets End of Period	$ 2,544	$ 2,376	$ 168	$ 226	$ 2,318

Statement of **Operations**

Fiscal year to date August 31, 2007

(in millions)	Actual	Projected	Variance	Prior Yr. Actual	Increase (Decrease)
Operating Revenues					
Premium & Assessment Income	$ 428	$ 411	$ 17	$ 426	$ 2
Provision for Uncollectibles	(1)	(3)	2	(8)	7
Other Income	–	–	–	1	(1)
Total Operating Revenue	427	408	19	419	8
Operating Expenses					
Benefits & Compensation Adj. Expense	554	489	(65)	505	49
Other Expenses	18	18	–	18	–
Total Operating Expenses	572	507	(65)	523	49
Net Operating Gain (Loss)	(145)	(99)	(46)	(104)	(41)
Investment Income					
Interest and dividend income	131	135	(4)	148	(17)
Realized & unrealized capital gains (losses)	253	36	217	312	(59)
Investment manager and operational fees	(1)	(2)	1	(3)	(2)
Gain (loss) on disposal of fixed assets	–	–	–	–	–
Net Investment Income	383	169	214	457	(74)
Increase (Decrease) in Net Assets	238	70	168	353	(115)
Net Assets Beginning of Period	2,306	2,306	–	(127)	2,433
Net Assets End of Period	$ 2,544	$ 2,376	$ 168	$ 226	$ 2,318

Statement of **Operations Combining** Schedule

Fiscal year to date August 31, 2007

(in thousands)	State Insurance Fund Account	Disabled Workers' Relief Fund Account	Coal-Workers Pneumoconiosis Fund Account	Public Work-Relief Employees' Fund Account	Marine Industry Fund Account	Self-Insuring Employers' Guaranty Fund Account	Administrative Cost Fund Account	Totals
Operating Revenues								
Premium & Assessment Income	$ 316,136	$ 37,127	$ –	$ 36	$ 88	$ 10,482	$ 64,721	$ 428,590
Provision for Uncollectibles	(916)	(479)	–	–	–	(34)	(3)	(1,432)
Other Income	(23)	–	–	–	–	–	402	379
Total Operating Revenue	315,197	36,648	–	36	88	10,448	65,120	427,537
Operating Expenses								
Benefits & Compensation Adj. Expense	463,654	36,178	128	127	283	10,417	43,369	554,156
Other Expenses	2,941	44	12	–	7	–	15,088	18,092
Total Operating Expenses	466,595	36,222	140	127	290	10,417	58,457	572,248
Net Operating Income (loss) before operating transfers out	(151,398)	426	(140)	(91)	(202)	31	6,663	(144,711)
Operating transfers out	–	–	–	–	–	–	–	–
Net operating income (loss)	(151,398)	426	(140)	(91)	(202)	31	6,663	(144,711)
Investment Income								
Investment income	118,356	9,625	2,037	134	99	401	516	131,168
Realized & unrealized capital gains (losses)	234,686	15,016	3,180	50	35	–	–	252,967
Investment manager and operational fees	(1,151)	–	–	–	–	–	–	(1,151)
Gain (loss) on disposal of fixed assets	–	–	–	–	–	–	–	–
Total non-operating revenues, net	351,891	24,641	5,217	184	134	401	516	382,984
Increase (decrease) in Net Assets (deficit)	200,493	25,067	5,077	93	(68)	432	7,179	238,273
Net Assets (deficit) Beginning of Period	2,080,045	800,185	171,741	18,295	13,802	6,208	(784,730)	2,305,546
Net Assets (deficit) End of Period	$2,280,538	$ 825,252	$ 176,818	$ 18,388	$ 13,734	$ 6,640	$ (777,551)	$ 2,543,819

Statement of **Net Assets**

As of August 31, 2007

(in millions)	Actual	Projected	Variance	Prior Yr. Actual	Increase (Decrease)
Assets					
Total Cash and Investments	$ 17,563	$ 17,189	$ 374	$ 16,796	$ 767
Accrued Premiums	4,416	4,197	219	2,801	1,615
Other Accounts Receivable	218	363	(145)	189	29
Investment Receivables	168	183	(15)	142	26
Other Assets	121	120	1	127	(6)
Total Assets	$ 22,486	$ 22,052	$ 434	$ 20,055	$ 2,431
Liabilities					
Reserve for Compensation and Compensation Adj. Expense	$ 19,447	$ 19,331	$ (116)	$ 19,064	$ 383
Accounts Payable	83	94	11	77	6
Investment Payable	173	–	(173)	–	173
Other Liabilities	239	251	12	688	(449)
Total Liabilities	19,942	19,676	(266)	19,829	113
Net Assets	$ 2,544	$ 2,376	$ 168	$ 226	$ 2,318

Statement of **Cash Flows**

Fiscal year to date August 31, 2007

(in millions)	Actual	Projected	Variance	Prior Yr. Actual	Increase (Decrease)
Cash flows from operating activities:					
Cash receipts from premiums	$ 757	$ 805	$ (48)	$ 707	$ 50
Cash receipts – other	4	3	1	6	(2)
Cash disbursements for claims	(368)	(388)	20	(353)	(15)
Cash disbursements for other	(83)	(81)	(2)	(103)	20
Net cash provided (used) by operating activities	310	339	(29)	257	53
Net cash flows from capital and related financing activities	(1)	–	(1)	(1)	–
Net cash provided (used) by investing activities	201	(64)	265	9	192
Net increase (decrease) in cash and cash equivalents	510	275	235	265	245
Cash and cash equivalents, beginning of period	328	328	–	194	134
Cash and cash equivalents, end of period	$ 838	$ 603	$ 235	$ 459	$ 379

Statement of **Investment Income**

Fiscal year to date August 31, 2007

	Actual	Projected	Variance	Prior Yr. Actual	Increase (Decrease)
Interest Income					
Bond Interest	$ 115,803,585	$ 122,800,000	$ (6,996,415)	$ 140,255,092	$ (24,451,507)
Dividend Income (Dom & Int'l)	7,403,116	9,600,000	(2,196,884)	(6,903)	7,410,019
Money Market/ Commercial Paper Income	3,242,691	2,080,000	1,162,691	1,597,386	1,645,305
Misc. Income (Corp actions, etc.)	1,469,344	600,000	869,344	1,254,450	214,894
Private Equity	3,248,841	600,000	2,648,841	3,618,667	(369,826)
Net Securities Lending Income	–	–	–	1,079,623	(1,079,623)
Total Interest Income	131,167,577	135,680,000	(4,512,423)	147,798,315	(16,630,738)
Realized & Unrealized Capital Gains and (Losses)					
Net realized gain (loss) - Stocks (Dom & Int'l)	38,521,142	–	38,521,142	866,798	37,654,344
Net realized gain (loss) - Bonds	(18,272,140)	–	(18,272,140)	(371,762)	(17,900,378)
Net gain (loss) - PE	9,567,412	–	9,567,412	1,894,035	7,673,377
Unrealized gain (loss) - Stocks (Dom & Int'l)	(85,826,336)	35,760,000	(121,586,336)	(758,990)	(85,067,346)
Unrealized gain (loss) - Bonds	308,977,725	–	308,977,725	310,449,821	(1,472,096)
Change in Portfolio Value	252,967,803	35,760,000	217,207,803	312,079,902	(59,112,099)
Investment Expenses-Manager & Operational Fees	(1,150,949)	(2,224,000)	1,073,051	(2,510,617)	(1,359,668)
Total Investment Income	$ 382,984,431	$ 169,216,000	$ 213,768,431	$ 457,367,600	$ (74,383,169)

Projected Statement of **Operations**

July 1, 2007 – June 30,2008

(in millions)	**Actual** July 31, 2007	**Actual** Aug.31, 2007	**Projected** Sept. 30, 2007	**Projected Quarter** Sept. 30, 2007
Total Operating Revenues	$ 198	$ 230	$ 193	$ 621
Total Operating Expenses	217	356	214	787
Net Operating Gain (Loss)	(19)	(126)	(21)	(166)
Net Investment Income	124	259	80	463
Increase (Decrease) In Net Assets	105	133	59	297
Net Assets Beginning of Period	2,306	2,411	2,544	2,306
Net Assets End of Period	$ 2,411	$ 2,544	$ 2,603	$ 2,603

(in millions)	**Projected Quarter** Dec. 31, 2007	**Projected Quarter** March 31, 2008	**Projected Quarter** June 30, 2008	**Projected Fiscal Year** June 30, 2008
Total Operating Revenues	$ 572	$ 587	$ 555	$ 2,335
Total Operating Expenses	724	710	744	2,965
Net Operating Gain (Loss)	(152)	(123)	(189)	(630)
Net Investment Income	90	107	143	803
Increase (Decrease) In Net Assets	(62)	(16)	(46)	173
Net Assets Beginning of Period	2,603	2,541	2,525	2,306
Net Assets End of Period	$ 2,541	$ 2,525	$ 2,479	$ 2,479

Projected Statement of **Cash Flows**

July 1, 2007 – June 30, 2008

(in millions)	Actual July 31, 2007	Actual Aug.31, 2007	Projected Sept. 30, 2007	Projected Quarter Sept. 30, 2007
Cash flows from operating activities:				
Cash receipts from premiums	$ 203	$ 554	$ 137	$ 894
Cash receipts – other	2	2	1	5
Cash disbursements for claims	(173)	(195)	(165)	(533)
Cash disbursements for other	(43)	(40)	(28)	(111)
Net cash provided (used) by operating activities	(11)	321	(55)	255
Net cash flows from capital and related financing activities	–	–	(3)	(3)
Net cash provided (used) by investing activities	71	129	–	200
Net increase (decrease) in cash and cash equivalents	60	450	(58)	452
Cash and cash equivalents, beginning of period	328	388	838	328
Cash and cash equivalents, end of period	$ 388	$ 838	$ 780	$ 780

(in millions)	Projected Quarter Dec. 31, 2007	Projected Quarter March 31, 2008	Projected Quarter June 30, 2008	Projected Fiscal Year June 30, 2008
Cash flows from operating activities:				
Cash receipts from premiums	$ 244	$ 952	$ 439	$ 2,529
Cash receipts – other	5	5	5	20
Cash disbursements for claims	(564)	(548)	(576)	(2,221)
Cash disbursements for other	(91)	(103)	(98)	(403)
Net cash provided (used) by operating activities	(406)	306	(230)	(75)
Net cash flows from capital and related financing activities	–	(17)	–	(20)
Net cash provided (used) by investing activities	–	–	–	200
Net increase (decrease) in cash and cash equivalents	(406)	289	(230)	105
Cash and cash equivalents, beginning of period	780	374	663	328
Cash and cash equivalents, end of period	$ 374	$ 663	$ 433	$ 433

Projected Statement of **Investment Income**

July 1, 2007 – June 30, 2008

	Actual July 31, 2007	Actual Aug. 31, 2007	Projected Sept. 30, 2007	Projected Quarter Sept. 30, 2007
Interest Income				
Bond Interest	$ 58,119,451	$ 57,684,133	$ 61,400,000	$ 177,203,584
Dividend Income (Dom & Int'l)	1,634,880	5,768,235	4,800,000	12,203,115
Money Market/ Commercial Paper Income	1,200,993	2,041,698	1,040,000	4,282,691
Misc. Income (Corp actions, etc.)	546,281	923,063	300,000	1,769,344
Private Equity	1,860,819	1,388,022	100,000	3,348,841
Net Securities Lending Income	–	–	–	–
Total Interest Income	63,362,424	67,805,151	67,640,000	198,807,575
Realized & Unrealized Capital Gains and (Losses)				
Net realized gain (loss) - Stocks (Dom & Int'l)	821,515	37,699,627	–	38,521,142
Net realized gain (loss) - Bonds	(17,680,511)	(591,629)	–	(18,272,140)
Net gain (loss) - PE	(7,071,565)	16,638,978	–	9,567,413
Unrealized gain (loss) - Stocks (Dom & Int'l)	(81,130,460)	(4,695,876)	17,880,000	(67,946,336)
Unrealized gain (loss) - Bonds	165,465,665	143,512,061	–	308,977,726
Change in Portfolio Value	60,404,644	192,563,161	17,880,000	270,847,805
Investment Expenses-Manager & Operational Fees	-	(1,150,949)	(5,350,000)	(6,500,949)
Total Investment Income	$ 123,767,068	$ 259,217,363	$ 80,170,000	$ 463,154,431

	Projected Quarter Dec. 31, 2007	Projected Quarter March 31, 2008	Projected Quarter June 30, 2008	Projected Fiscal Year June 30, 2008
Interest Income				
Bond Interest	$ 184,200,000	$ 186,100,000	$ 189,900,000	$ 737,403,584
Dividend Income (Dom & Int'l)	14,400,000	14,400,000	15,100,000	56,103,115
Money Market/ Commercial Paper Income	3,120,000	3,120,000	3,120,000	13,642,691
Misc. Income (Corp actions, etc.)	900,000	900,000	900,000	4,469,344
Private Equity	–	–	–	3,348,841
Net Securities Lending Income	–	–	–	–
Total Interest Income	202,620,000	204,520,000	209,020,000	814,967,575
Realized & Unrealized Capital Gains and (Losses)				
Net realized gain (loss) - Stocks (Dom & Int'l)	–	–	–	38,521,142
Net realized gain (loss) - Bonds	–	–	–	(18,272,140)
Net gain (loss) - PE	–	–	–	9,567,413
Unrealized gain (loss) - Stocks (Dom & Int'l)	53,640,000	53,640,000	54,780,000	94,113,664
Unrealized gain (loss) - Bonds	(165,000,000)	(149,500,000)	(118,500,000)	(124,022,274)
Change in Portfolio Value	(111,360,000)	(95,860,000)	(63,720,000)	(92,195)
Investment Expenses-Manager & Operational Fees	(1,656,000)	(1,645,000)	(1,909,000)	(11,710,949)
Total Investment Income	$ 89,604,000	$ 107,015,000	$ 143,391,000	$ 803,164,431

Insurance **Ratios**

August 31, 2007

	Actual FY08 Aug. 31, 2007	Projected FY08 Aug. 31, 2007	Actual FY07 Aug. 31, 2006
Loss Ratio	110.69%	87.23%	98.06%
LAE Ratio - MCO	8.28%	12.35%	9.57%
LAE Ratio - BWC	10.33%	19.26%	11.15%
Net Loss Ratio	129.30%	118.84%	118.78%
Expense Ratio	4.22%	4.38%	4.07%
Policyholder Dividend Ratio	0.00%	0.00%	0.00%
Combined Ratio	133.52%	123.22%	122.85%
Net Investment Income Ratio	30.34%	32.44%	34.12%
Operating Ratio (Trade Ratio)	103.18%	90.78%	88.73%

	Actual FY08 Aug. 31, 2007	Projected FY08 Aug. 31, 2007	Actual FY07 Aug. 31, 2006
Premiums to surplus	0.17	0.17	1.88
Assets to liabilities	1.13	1.12	1.01
Total reserves to surplus	7.64	8.14	84.35
Loss reserves to surplus	6.91	7.34	76.88
Investments to loss reserves	1.00	0.98	0.97
Cash + bonds to loss reserves	0.82	0.76	0.94
Cash % of total investments	5%	3%	3%
Bond % of total investments	78%	74%	95%
Equities % of total investments	15%	20%	0%
Equities as % of surplus	105%	145%	4%

Fiscal Year End Insurance **Ratios**

Fiscal years 2003 – 2008

	Projected FY08	Preliminary FY 07	Audited FY06	FY05	FY04	FY03
Loss Ratio	93.8%	46.9%	74.3%	106.7%	96.7%	128.9%
LAE Ratio - MCO	10.1%	3.8%	8.6%	7.1%	9.1%	8.8%
LAE Ratio - BWC	15.8%	10.9%	6.4%	14.7%	8.3%	12.9%
Net Loss Ratio	119.7%	61.6%	89.3%	128.5%	114.2%	150.6%
Expense Ratio	4.0%	2.3%	4.0%	4.0%	5.1%	4.1%
Policyholder Dividend Ratio	0.0%	0.0%	-0.4%	10.3%	18.6%	28.7%
Combined Ratio	123.7%	63.9%	92.9%	142.8%	137.9%	183.4%
Net Investment Income Ratio	33.5%	18.5%	30.4%	22.1%	20.5%	23.9%
Operating Ratio (Trade Ratio)	90.2%	45.4%	62.5%	120.7%	117.3%	159.5%

	FY08	FY 07	FY06	FY05	FY04	FY03
Premiums to surplus	0.97	1.88	-17.10	-2.29	2.59	4.04
Assets to liabilities	1.12	1.12	0.99	0.96	1.04	1.03
Total reserves to surplus	7.96	8.36	-149.48	-19.50	18.90	28.93
Loss reserves to surplus	7.16	7.55	-136.24	-17.68	16.98	25.90
Investments to loss reserves	0.99	0.96	0.94	0.96	1.12	1.13
Cash + bonds to loss reserves	0.79	0.78	0.91	0.54	0.65	0.75
Cash % of total investments	2%	2%	1%	8%	10%	13%
Bond % of total investments	78%	80%	96%	49%	48%	54%
Equities % of total investments	20%	16%	0%	38%	36%	30%
Equities as % of surplus	142%	114%	-9%	-641%	680%	869%

Issue
Briefing

Group Rating Program Issues

Original Program Design: Group rating was first implemented for the policy year beginning July 1, 1991 (House Bill 222, Ohio Revised Code section 4123.29(4).) The program allowed small employers to form a group. Once the group reached the appropriate size, the individual members would be able to take advantage of rating methods used for larger employers. The program was also intended to substantially improve accident prevention and claims handling for the employers in the group.

The BWC maintains the revenue neutrality of all group and non-group programs. This means that we collect the overall required premium for a policy period from the all programs -- not necessarily from each group and non-group program for that particular industry. That is, a group program that collects insufficient premium for the risks involved will be subsidized by non-group employers so that sufficient total premium is collected for that job classification.

Analyses of the Group Rating Program: Even before the group rating program went into effect, independent actuaries began to raise questions about its implementation and impact. The studies include:

- (Mercer) Oliver Wyman – 1990, 1991, 1993, 1994, 1995, 2001, 2004
- Pinnacle Actuarial Resources, Inc. – 2006
- AON Actuarial Analytics – 2007

All of these independent studies have demonstrated that the group program does not produce sufficient premiums for employers in groups, while non-group rated employers pay an additional "off balance" premium to produce sufficient total premium. In addition, when an employer leaves group rating, usually due to claim activity that will adversely impact the group's discount, that employer's non-group premium can rise by a factor of 2, 3, 5, or more.

Three aspects of group rating are at the center of these problems:

1. The weight assigned to a group's experience, known as its credibility, is too high;
2. Group membership is established after the experience is known, rather then before; and
3. The cost of one or a few claims has too much impact on the experience modification applied to premium.

1. The weight assigned to a group's experience, known as its credibility, is too high (the credibility problem): Assigning too much weight (credibility) to the experience of groups has resulted in cross subsidies. Some small reductions have already been implemented, lowering the maximum credibility over three years from 100% to the current 90%, effective July 1, 2007. Before these changes were implemented, the subsidy was estimated at over $300 million. The changes reduced this figure to $200 million. Further reducing the maximum credibility to 60% would eliminate most of the subsidy.

Credibility	Premium Shift: Group to Non-group per Year	Cumulative Shift	Base Rate Reduction	Cumulative Base Rate Reduction
90%	Current Level			
80%	$75 million	$75 million	-4.9%	-4.9%
75%	$34 million	$109 million	-2.6%	-7.4%
60%	$89 million	$198 million	-6.1%	-13.0%

2. Membership is established after the experience is known, rather then before (Group Continuity): The oldest four of the last five years of claim activity is used in determining the experience modification. In the most recent of the five years, group memberships are established. This allows group sponsors to remove employers with significant claims from a group so the group can maintain a favorable experience modification (an adjustment of premiums based on claims). However, removing an employer with claims causes an understatement of the risk presented by the employers remaining with the group. That is, the accuracy of the group rate is impaired.

The following table from the 2006 Pinnacle study, illustrates that group rated employers have lower loss experience per premium dollar than those not in groups. However, after experience rating, it is clear that premium has been reduced too much. Ideally, experience rating should bring the loss ratios for all three categories much closer together.

Pinnacle Study: Policy Year 2004 – 2005

Evaluated as of 3/31/06

	Number of Employers	Loss Ratio Without Experience Rating	Loss Ratio Using Experience Rating
PA Group Experience Rated	87,960	22.7%	96.1%
PA Non-Group Exp. Rated	16,674	41.7%	37.9%
PA Base Rated	133,522	41.7%	41.7%
Total	238,156	30.3%	52.7%

Base Rates Affect All Employers

A key consideration in reducing the base rate is that all employers' rates use the base rate:

Rate = (Experience Modification) X (Base Rate)

Reducing credibility will increase experience modifiers, but will be tempered by the corresponding drop in base rates.

3. The cost of one or a few claims has too much impact on the experience modification applied to premium (the impact of a claim): The BWC's experience rating formula compares the total losses, subject to a maximum, to the losses that are expected for an employer or a group. This ratio is used, based on the credibility of the employer or group, to give a discount or surcharge. In addition to the credibility problem mentioned above, the formula makes no distinction between one very large claim and many smaller claims with the same total value. However, the frequency of claims is a more significant indicator of risk than just the value of those claims. There is a widely accepted methodology that utilizes the frequency of claims, while reducing the impact of the size of those claims. This is the methodology used by the National Council on Compensation Insurance (NCCI). Fully implementing this approach will also address the credibility problem.

Additional Information

Oregon Study: The state of Oregon studied 55 industry classifications and ranked states according to the average base rate. Ohio's base rate was the 12th highest in the country. Since our base rates include the off-balance that imposes the subsidy, reducing the subsidy will lower our base rates, which will increase our competitiveness for new business entries into Ohio. Achieving 60% credibility would reduce base rates for 50 of the 55 classifications studied. Ohio's rank could drop an average of six places (from 12th highest to 18th highest – almost the middle of the states).