Final Product Definition –
Deductible Program

Implementing Operational Reform Program
New Products Project
December 17, 2008

Objective
The Ohio Bureau of Workers' Compensation (BWC) is engaged in an intensive reform effort to increase the stability, consistency, and competitiveness of workers' compensation insurance for Ohio's injured workers and employers. One aspect of this reform is to improve BWC's overall experience-rating methodology, create new performance-based incentive programs and strengthen Ohio's group-rating program.

Making meaningful improvements to Ohio's workers' compensation system requires the application of actuarially sound insurance-rating principles, industry best practices and appropriate performance incentives and measures. This includes better aligning premiums with the claims costs of individual employers. It also involves ensuring these discounts correspond with a measurable reduction in risk.

BWC believes an actuarially appropriate deductible program would benefit Ohio employers. Virtually all lines of insurance, including workers' compensation providers in other states, offer employers the option of paying lower premiums in exchange for paying the costs of a claim up to a chosen deductible level.

Such an approach would give employers an option to control their costs and an incentive to promote workplace safety programs and services. In addition, it would encourage businesses to report all costs to the system, which would allow BWC to set rates more accurately and to understand better what is going on with safety efforts.

The basic premise would be to provide a premium reduction proportional to the amount of risk (deductible) an individual employer would be willing to take on for each claim occurrence. Employers who want to lower premium payments would have to agree to take on more risk in the form of a higher deductible. Those employers who experience little to no claims occurrences, or excel at limiting costs, would benefit from reduced premiums.

This document details the preliminary definition of a deductible program that would meet the goals as defined by BWC. The content is a result of researching effective workers' compensation in both competitive and exclusive markets. The proposed program will be reviewed by interested stakeholders and built out further per the feedback. Implementation of the deductible program and the schedule for doing so, will be dependent upon the approval of the Board of Directors.

Overview of Best Practices Research

Entities Researched and High Level Structure

Private Workers' Compensation Insurers

Small (under $10,000 per claim) and high (over $100,000 per claim) deductible plans are very common in the workers' comp private sector. All private deductible plans researched had the insurer pay first dollar on a claim and bill the balance back to the employer. Plans almost exclusively provided a discount to premium based on the level of deductible chosen. State rules may restrict the structure of insurers' deductible plans. Small deductible plans are highly standardized and are typically based upon NCCI's "Small Deductible Plan".

Some examples of private deductible plans are as follows:

- Liberty Mutual
    - Small Deductibles vary according to state rules but typically follow NCCI's plan
    - Offer an Intermediate deductible level only in Florida which ranges from $10,000 to $25,000 per claim
    - Large Deductibles are over $25,000 per claim and further information on their structure is proprietary
    - Typically utilize letters of credit to secure the possible high receivables created by a deductible plan, sometimes draw accounts are established for funding the deductible.
- General – Wells Fargo
    - Small Deductibles vary according to state rules but typically follow NCCI's plan
    - High Deductible plans are over $300,000 and have more complex rules as compared to the low deductible plans
    - Utilize letters of credit and draw accounts (loss fund established by financial institution) to draw weekly or monthly
- Compsource (Oklahoma)
    - Only offer a small deductible plan with the following pricing structure:
        - A 2.7 % Premium Reduction for a $500 deductible, a 3.4% reduction for a $1000 deductible, 4.0% for a $1500 deductible. 4.7% for a $2000 deductible, and 5.4% for a $2500 per claim.
    - The deductible is a medical only deductible

Below is a summary of state rules for all NCCI states which offer deductible programs:

#	State	Mandatory (M) or Optional (O) Program	Deductible Type Available Medical (M) or Indemnity (I)	Range of Deductible Amount Available	Premium Varies by Hazard Group (HG)	Experience Rating Gross (G) or Net (N)
1	Alabama	M	M & I	100 - 2,500	Yes	N
2	Arkansas	M	M & I	1,000 - 5,000	Yes	G
3	Colorado	M	M & I	500 - 5,000	Yes	N
4	Connecticut	O	M & I	1,000 10,000	Yes	G
5	Florida	See State Pages	See State Pages	See State Pages	See State Pages	G & N
6	Georgia	M	M & I	100 - 2,500	Yes	N
7	Hawaii	See State Pages	See State Pages	See State Pages	See State Pages	N
8	Illinois	M	M	1,000 Only	Yes	G
9	Indiana	O	M & I	500 - 5,000	Yes	G
10	Iowa	O	M	100 - 2,500	Yes	N
11	Kansas	O	M & I	100 - 10,000	Yes	N
12	Kentucky	M	M & I	100 - 10,000	Yes	N
13	Maine	See State Pages	M & I	See State Pages	Yes	G & N
14	Maryland	O	M & I	500 - 2,500	Yes	G
15	Minnesota	M	M & I	1,000 - 10,000	Yes	G
16	Missouri	O	M & I	100 - 20,000	Yes	G & N
17	Montana	See State Pages	See State Pages	See State Pages	Yes	G
18	Nebraska	M	M	500 - 2,500	Yes	G
19	Nevada	O	M & I	100 - 5,000	Yes	G
20	New Hampshire	M	M & I	500 - 2,500	Yes	G
21	New Mexico	M	M & I	500 - 10,000	Yes	N
22	North Carolina	O	M & I	100 - 5,000	Yes	G
23	Oklahoma	M	M	500 - 2,500	Yes	N
24	Rhode Island	O	M & I	250 - 5,000	Yes	N
25	South Carolina	M	M & I	100 - 5,000	Yes	G & N
26	South Dakota	O	M & I	500 - 2,500	Yes	G & N
27	Tennessee	O	M & I	100 - 2,500	Yes	G
28	Utah	O	M & I	500 - 5,000	Yes	G
29	Virginia	O	M & I	100 - 10,000	Yes	G
30	West Virginia	O	M & I	100 - 10,000	Yes	G

<u>State Workers' Compensation Insurance Funds</u>

Our research indicates that all exclusive state funds other than Ohio currently offer deductible plans as a method for employers to reduce premiums and as an incentive to lower losses. Deductibles offered by these funds ranged from $500 to $100,000 per claim. The insurer always paid first dollar in all funds researched.

Some examples of state fund deductible plans are as follows:

- North Dakota (WSI)
  - Deductible levels ranged up to $100,000 per claim
  - An employer is able to reduce premiums in exchange for agreeing to reimburse WSI for all losses up to a specified deductible amount.
  - Eligibility for participation in the Deductible Program is based on the financial stability and resources of the employer.
  - WSI may require an employer to provide a Surety Bond or letter of credit guaranteeing payment of losses.
  - An initial deposit to offset claims costs may be required.
  - The insured is periodically billed for a reimbursement of payments until the per claim deductible is met.
  - If desired, WSI can provide aggregate stop-loss coverage for additional premium.
  - An irrevocable deductible contract must be signed by both parties.
  - Employers are required to file claims within 24 hours of their occurrence.
- Wyoming
  - Deductible levels offered are $1,000, $5,000, $10,000, $50,000, $75,000, or $100,000
  - The Division may require applying employers to undergo a financial audit to ensure financial stability. The audit may include a credit check and review of company financial reports.
  - The employer shall reimburse the Division for all costs paid by the Division on individual claims up to the amount of the contractually agreed deductible.
  - The maximum deductible level offered to an employer by the Division shall not be more than 50% of the employer's standard premium.

Conclusions of Research

From the research gathered, our group found that small deductible plans are offered by the vast majority of exclusive and competitive workers' comp insurers. Nearly a third of NCCI states make it mandatory ofr insurers to offer a deductible program. The plans usually offer between 5 and 10 deductible levels; typically ranging from $500 to $10,000.   The plans offer a discount to premium based on a combination of hazard group (usually NCCI defined) and deductible level chosen. Almost all state rules for private small deductible plans are modeled off of the NCCI Small Deductible Plan.

The vast majority of insurers included both medical and indemnity costs as part of the deductible program. A few examples only had the deductible apply to medical costs but that approach is not considered best practice by NCCI.

Nearly all deductible plans in the exclusive and competitive state markets had the insurer paying first dollar on each claim. This allowed the insurer to track the claim adequately for billing purposes, provided the insurer the opportunity to apply loss mitigation practices, and aided in accurately tracking loss history for each employer.

An aggregate stop-loss limit is an optional coverage offered by some but is not common. The inclusion of an aggregate stop-loss results in a reduction of the discount offered by the deductible so makes the plan less attractive. The pricing of a deductible discount also becomes more difficult in that an aggregate stop-loss is more beneficial for an employer with higher claim frequency (in that they will more often hit the stop-loss limit and reach it more quickly.) Therefore, the stop-loss option must be priced with the expected losses and nature of those losses in mind.

State rules seem to be split on whether the gross or net of amount of deductibles is included in the employer's experience. "Net" would mean that payments by the employer towards the deductible would not be used when calculating their experience. A study by NCCI indicated that calculating experience net of deductibles creates inequity across market segments. The net approach creates a subsidy from those not in the deductible program to those whose who do participate. It also favors large policyholders and creates a subsidy from smaller ones. They recommend using gross as a best practice.

High and intermediate range deductibles are also common tools utilized by larger companies to take on partial self-insurance. It should be noted though, that no exclusive state funds offer deductibles over $100,000, the typical minimal amount for a program to be defined as "high deductible". NCCI does not yet define as formal of rules around high deductibles as they do for small. States perform some regulation of the high deductible market, but the rules tend to be less stringent. High and Intermediate deductible plans involve significant credit risk resulting in the necessity for employers to obtain letters of credit or surety bonds.

Proposed Deductible Structure

Overview

BWC would offer a small deductible program to any private employer or public employing taxing district that insures their workers' compensation insurance obligations with BWC. BWC would pay first dollar on all claims and bill the deductible amounts back to the insured on a periodic basis. Qualification criteria would be established to verify that the employer is in good financial standing with BWC and is an acceptable credit risk. Per best practices as defined by NCCI, the amount under the deductible will be applied to the employer's loss experience.

Deductible Levels

The following deductible levels would be offered to Employers:

- $500 per claim
- $1,000 per claim
- $2,500 per claim
- $5,000 per claim
- $10,000 per claim

Target Customer

Both group and non-group employers would be eligible to participate in the deductible program as long as they meet the qualification criteria. Individual employers within a group would have the opportunity to make their own election as to the adoption and level of a deductible plan.

PA and PEC employers would both be eligible for the deductible plans and rules would apply equally across both segments.

It is anticipated (and verified in our research) that deductible plans will be unattractive to the very small employers. The premium reduction they receive would be a percentage of total premiums, such a small return for the additional risk of deductible charges would discourage small employers from adopting the plan.

With a minimum deductible option of $500, initial analysis has concluded that employers with annual premium less than $20,000 would not be likely to adopt the deductible plan. Approximately 15,000 Ohio employers have an annual premium above this threshold. Group employers may initially not be as accepting of a deductible since the discount will be applied after the group discount is applied.

The likely target audience (of Non-Group employers with premium over $20,000) for the deductible program would be approximately 10,000 employers; a subset of these employers is expected to adopt the program. This target market may shift dependent upon final pricing from Oliver Wyman.

Qualification Criteria

Any private employer or public employing taxing district that insures their workers' compensation insurance obligations with BWC may apply for the deductible program. PA and PEC employers will be allowed to enroll once per year and will commit to participate for the full duration of the policy year. A re-enrollment process will also need to be defined that will be minimal work for the employer but still allow BWC to re-verify that the employer is an acceptable credit risk and has paid their deductible payments on time. Emphasis will be put upon simplicity so that overhead related to the deductible program will not be a deterrent to adoption of the plan.

An employer must be in good financial standing with BWC (no pending balance and a history of timely payments) and be considered an acceptable credit risk to participate in the Deductible Program. Detailed rules will be built to define "good financial standing" and a process will be put in place to efficiently evaluate credit worthiness. A further check of account standing will be made before the first discount is given. (Example: An employer enrolls at 7/1, has claims, is billed, but doesn't pay. Before the payroll report goes out in December with the discounted rate, BWC will verify both status and billing) If an employer the employer does not pass the eligibility requirements at that point, they will be removed from the program mid-coverage period.

An employer will not be allowed to choose a deductible limit larger than 25% of the premium for the last full policy year (or expected premium for newer employers.) This will minimize the credit risk of employers choosing disproportionately large deductible levels.

Pricing Structure

For opting to participate in the Deductible Program, the employer will receive a discount on their premium. The discount percentage will be applied to the Pure Premium (not inclusive of DWRF and Administrative Cost.) The amount of discount will be dependent upon the NCCI Hazard Group the employer falls within and the level of deductible chosen.

Oliver Wyman is in the process of developing a detailed pricing structure for deductibles. The discount levels will be set at a level that will adequately compensate employers for the additional risk but not generate additional premium slippage for BWC.

Based upon feedback from our TPA/Sponsor Workgroup, an aggregate stop-loss will also be an available option at some point in the future. The first year of the Deductible Program will not include this option to simplify the program rollout. By choosing this option, an employer guarantees that they will not pay more than a defined cap each year in deductible costs. The initial pricing efforts are placing the aggregate stop-loss amount at 7 times the deductible level chosen. An example would be if a level of $1,000 was chosen, an employer would never pay more than $7,000 in deductible costs for injuries that occurred during that policy year. When choosing this option, employers will receive a smaller discount to their premium than what they would have otherwise received. This option will probably not be included in the original release of the deductible product, but be added later as an option.

The mapping of Ohio manual classifications to NCCI Hazard Groups will be created by Oliver Wyman per Excess Loss Factors (a measure of loss severity) level. The seven NCCI Hazard Groups (A-G) will be utilized.

Billing Structure

BWC paying first dollar on each claim will necessitate additional billing to employers. Billing for deductibles will occur monthly so that BWC can decrease potential issues related to collections, cash flow, and transparency. Also, employers will be able to pay down their deductible costs with greater frequency instead of building up one large bill.

All recorded costs (of injuries occurring within the given coverage period) under the defined deductible level will be charged to the employer each month, even if the claim remains open. The employer may still be billed for deductible costs after the end of the coverage period if a claim remains open and has not yet hit the deductible level.

Preliminary Internal and External Impacts

<u>Internal Impacts</u>

Based on preliminary analysis multiple departments of BWC will be effected by the implementation of a deductible plan. A separate document has been created that details the resource impact for implementing and maintaining the program.

Estimated internal impacts include:

- Information Technology
  - Rates and Payments will need to be changed to account for the new deductible discount calculation.
  - The WCIS system will require changes to account for the new deductible option.
  - Detailed claim information will need to be included on deductible bills to the customer.
  - The Data Warehouse will be changed to account for the new deductible related fields.
  - Additional software may be required to assist in the additional credit risk analysis processes.
  - Possible additional infrastructure and/or software to allow for automatic withdrawal of deductible costs.
- Risk Analysis Department
  - Additional processes will be required to determine the credit worthiness of deductible program candidates.
  - An additional workload will result from the adoption of the deductible program including the application process and underwriting process.
- Account Receivable
  - New processes will need to be created to account for monthly billing of deductibles
  - An additional workload will result from the adoption of the deductible program; both in billing and collection efforts.
- Customer Service
  - Will require additional education regarding the structure of deductible programs and a means to access deductible information.
- Claims
  - Will require additional education regarding the structure of deductible programs and a means to access deductible information.
- Actuarial
  - Will need to build new processes to account for the implications of the new program.
- Claims/Employer Policy \

    - Will need to be educated on the program and its impacts on the claims process.
- Law
    - Assist in the drafting of rules.
- Training & Communication
    - Will need to create a means of educating internal staff and target Ohio Employers.

External Impacts

Based on the input of our TPA/Sponsor Workgroup and expertise of internal BWC employees, the implementation of a deductible plan would affect the following external entities:

- Ohio Employers
    - Additional options would be available for reducing Workers' Compensation premiums.
    - An employer would be able to accept the risk of possible deductible payments in exchange for a lower premium if they believe their experience rating does not adequately reflect their safety risk.
    - Education will be required
- TPA
    - Will need to determine employers that may benefit from a deductible program and market the program accordingly.
- Sponsors
    - Will need to be made aware that their constituents may be adopting the program and its implications.
- Injured Worker attorneys
    - Will need to be made aware of the program and its implications.
- Business accountants, CPA's
    - Will need to understand this from and accrual and financial statement perspective.

Areas Requiring Further Definition

The following areas will be further explored before implementation:

- Evaluation of the market acceptance for a deductible program. Research has indicated that although they are offered in almost all states, adoption levels are often low.
- Further evaluation of credit worthiness options.
- When in the claims adjudication process is it appropriate to bill (e.g. appeal, deny/appeals)
- Further evaluation needed to define when financial audits are required for employers enrolling or re-enrolling in a deductible program.

- Need to create detailed rules on deductible levels that will require credit risk analysis.

Oliver Wyman will also provide us with the following actuarial information:

- Detailed discount pricing based on NCCI Hazard Group and deductible levels as defined above
- The effect of an aggregate stop-loss limit option on the deductible discount
- Grouping of Ohio specific manual classifications into the NCCI Hazard Groups

Stakeholder Input Feedback

First workgroup meeting 9/9/08

- The group identified medium and large employers as the likely target market
- Small employers may be more interested if there was an aggregate stop loss option to reduce risk
- Group would like clarification on how the $15K medical to deductible transition will happen
- Net versus Gross deductible was discussed and BWC explained best practice
- How this will work with other changes implemented for the rating year

Second workgroup meeting 9/24/08

- Group verified that deductibles would be attractive to employers.
- Requested further investigation of an aggregate stop loss option although it is not common in the industry
- Continued clarification needed on how it will interact with other programs
- Clarified that the BWC medical fee schedule will apply for all claims cost in the deductible program
- Net versus Gross deductible was again covered and it was concluded that we will have Oliver Wyman model both scenarios.
- How this will work with other changes implemented for the rating year
- Request to study how a deductible program may be used to help an employer stay in group
- Suggested that we analyze the current retro program and see how it compares to a typical high deductible program

Third workgroup meeting 10/28/08

- Lower the industry hazard the lower the discount % for the deductibles
- If the deductible amount will be included in experience, then 15K & Salary Continuation are in conflict.
- If deductible amount is excluded from experience, continues to leverage the strength of SC and 15K.
- BWC will perform underwriting to protect risk in the system.

1) What type of employers would be most likely to participate in a deductible program? What types of industries would you think this should be marketed towards? Are there particular sizes or types of risks that you think would find this program more attractive?
• Higher risk
• 15K
• Salary Continuation
• Biz Owners with higher risk appetite
• Companies who have the financial wherewithal to fund the deductible (assumes underwriting)
• Companies with bad experience recently looking at deductibles as a way to handle resulting increased premiums for set period of time
2) Will these target markets change at all based on potential future changes to the credibility tables?
• Yes – group rejects
• Yes – higher premiums will make deductible credits more attractive
Underwriting critical– to ensure companies don't assume financial accountability they cannot fund

3) Do you think deductible levels ranging from $500 to $10,000 are sufficient enough for initial implementation?
• Offer minimums and maximums tied to premium, ex.
Minimum = 10% of premium–
Maximum = 50% of– premium
• Q: Should premium be capped at 1.5 or 2x if employer takes on the risk of a deductible?
• Q: Should there be a maximum "out of pocket" annually?
• Q: Should there be a tie between the deductible amount granted and the quality of an employer's safety efforts?
4) If employers are billed monthly for deductible costs and fall behind in payments, what consequences should they face?
• Eliminate monthly billing
• Include deductible dollars owed in semi-annual invoice from past six

months
• Apply today's non-pay rules
• Plus, employer becomes ineligible for deductible program for x time period
5) What factors would keep a deductible program from being successful in Ohio?
• Too complicated to understand
• Too vague or complicated underwriting
• Design permits too much financial risk
• Too little incentive for degree of risk assumed by the employer
• Lack of adequate underwriting resources
• Cost of administering the program limits the amount of deductible credits allowed
• Lack of employer understanding of how and when to take advantage of deductibles
6) How can this program be marketed most effectively?
• Communicate immediacy of deductible savings and the employers' ability to positively, proactively, control premiums
• Clearly communicate in language that speaks to target industries
• KISS – simple program, keep marketing simple
• Leverage TPA's and sponsors in communication effort
7) What other aspects should BWC consider as development of a deductible program continues?
• Q: Can we create a tax-advantaged way for employers to save for the potential deductible payment?
• Q: Could the deductible experience period match the current experience rating period?