

BWC Promotional Brochure

Plaintiffs' Exhibit 20

From the outset, the group rating program had 2 unsound features as noted by multiple actuaries since 1991. The program allows group rated employers to receive overly generous discounts that are unique to Ohio's workers' compensation system. Participating employers receive up to a 90% discount while similar employers who are not group rated must pay full price.

In addition to large discounts, groups are permitted to change their member employers each year. This undermines the notion that a group of smaller employers joined together to look like larger employers should be afforded discounts. Groups, unlike large employers, are permitted to kick out employers with claims to avoid higher pricing for the whole group. **Group rating causes pricing inequity between group employers and non-group employers. Group employers overall do not pay enough premiums to cover their total claims costs, forcing non-group employers to pay the difference because the BWC is revenue neutral. Non-group employers, as a result, subsidize group employers by approximately \$200 million annually.**

The Law Requires the Use of Actuarial Principles

- ORC § 4123.34(C): The administrator may apply that form of rating system that the administrator finds is best calculated to merit rate or **individually rate the risk more equitably**, predicated upon the basis of its individual industrial accident and occupational disease experience, and may encourage and stimulate accident prevention. The administrator shall develop fixed and equitable rules controlling the rating system, which rules shall conserve to each risk the basic principles of workers' compensation insurance.
- Principle 4: A rate is reasonable and **not** excessive, inadequate, or **unfairly discriminatory** if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer.

Setting fair rates

- **A rate:**
 - is an estimate of the expected value of future costs.
 - provides for all costs associated with the transfer of risk, which includes medical, wage replacement, compensatory costs and administration costs.
 - should provide for the costs of an individual risk transfer so that equity among insureds is maintained.
 - is reasonable and not excessive, inadequate, or unfairly discriminatory.

Group Experience Rating

- Under the current group experience rating plan, group sponsors form unique groups for each successive policy year by hand picking group members to maximize discount**
 - Group sponsors have the ability to exclude employers from group membership from year to year**
 - Group members' claims experience and payroll are added up and then the individual experience rating formula is applied as if the group were a single large employer**
 - All of the group members receive the experience modifier that is assigned to the group.**
 - Group discounts are enjoyed without risk for the rating year. The groups retain no portion of their risk, which is fully transferred to the State Fund.**
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Plan Options and Comparisons

Why is Controllability a Group Rating Issue?

- Participants in group plans today can predetermine a key rating component, the experience modification [EM], before the actual group is formed. This allows for the creation of groups that minimize incurred losses and, thus, the EM for the next policy year. This process is repeated as each new year of experience develops.
- One can think of this system using an analogy to the fantasy sports leagues that are popular among fans today. Fantasy league participants “draft” team members at the beginning of the season with their team results based on the individual performance of the players they select. The team results are based only on what the players do in the future, with no recognition of past statistics.
- Group insurers also select employers who can participate in their respective group rating plan with the overall loss results based on the performance of each group member. However, unlike the fantasy league example, future results do not matter, as only individual past results feed the rating modifications. In essence, because they already know the loss results of the members they are choosing, it is more like having a fantasy league where the players are chosen after the season has ended.

Group Experience Rating is Actuarially Unsound

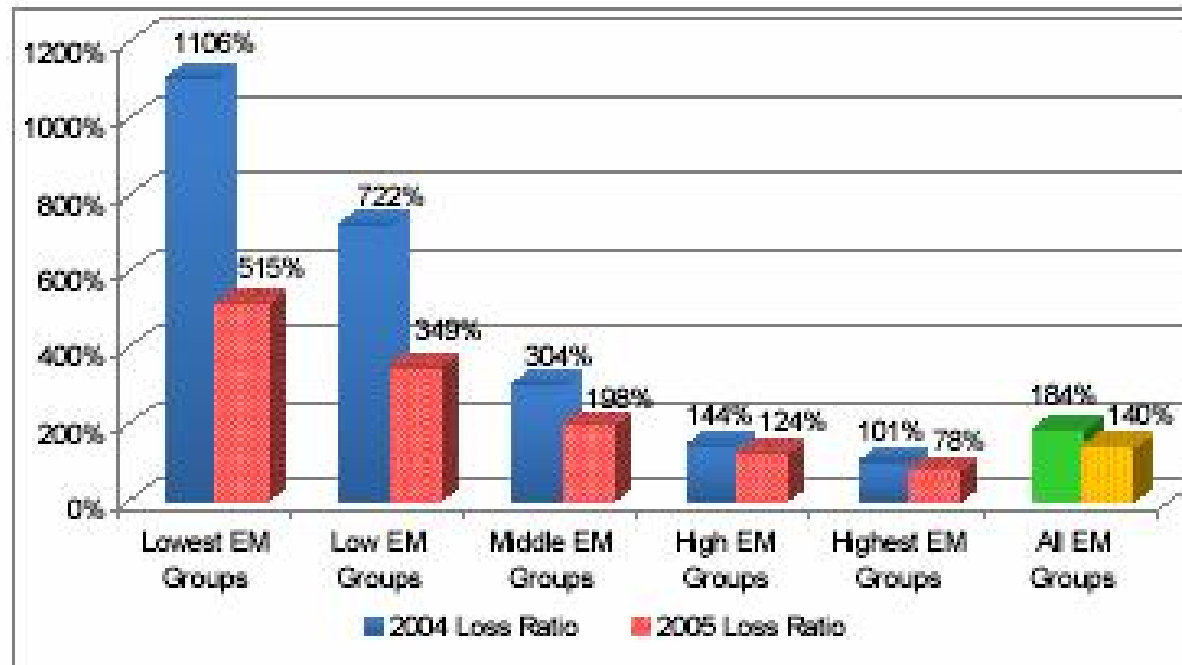
- ❑ **An individual experience rating formula applied to a group is not generally predictive of future losses for that group, regardless of similarities in type of business and prior loss experience of the group members [Deloitte Consulting]**
 - ❑ **Unlike large individual employers, employer groups can re-arrange their experience every year and can maintain large discounts by excluding employers who suffer claims**
 - ❑ **Studies of the BWC's group experience rating program have consistently demonstrated that applying the individual experience rating formula to group experience has resulted in significant under-prediction of losses for groups [Deloitte Consulting]**
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Group Experience Rating is Actuarially Unsound

- ❑ Loss ratio analysis in an actuarial and insurance industry standard measure of premium adequacy and rate equity
 - ❑ Loss ratio relativities – comparing the loss ratios of classes of the insured population – indicate whether rates charged are equitable, or whether there is cross-subsidization between classes (*i.e.*, one class is charged inadequate premium relative to its losses, while another class is charged excessive premium relative to its losses)
 - ❑ The loss ratios of employer classes should be within five percent (5%), and their relationship (*i.e.*, which one is larger or smaller) should vary over time
 - ❑ The current Ohio group experience rating plan does not effectively align premiums with an employer's costs
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Deloitte Consulting LLP Comprehensive Study June, 2008

- Graph shows Group Loss Ratio Patterns by Low to High Group EM.
- Loss Ratios should be roughly equal if EMs are equitable.
- Such large dispersions indicate that group rating needs to be discontinued in its present form.



* Losses valued as of 12/07; 2005 Loss Ratios are 1 year less mature than 2004 Loss Ratios

Group Experience Rating is Actuarially Unsound

- ❑ Group rated employers do not pay enough premium to cover their claims costs, and this forces non-group employers to pay the difference
 - ❑ Non-group employers subsidize group rated employers by approximately **\$200 million** annually, according to the BWC's estimate
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Deloitte Consulting LLP

Comprehensive Study June, 2008

GROUP RATING USING AN INDIVIDUAL EXPERIENCE RATING FORMULA

- Differences in the loss experience of individual employers are largely driven by the differences in the behavior of the management and employees of each employer, in terms of employee selection and training, safety programs, operating procedures, accident prevention, risk controls, etc.
 - Such behaviors directly affect the frequency and severity of work injuries.
 - Experience rating is a good predictor of future losses for an employer, because prior loss experience reflects an employer's oversight of such behaviors.
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Deloitte Consulting LLP

Comprehensive Study June, 2008

GROUP RATING USING AN INDIVIDUAL EXPERIENCE RATING FORMULA

- A group of employers will not have the same management influencing such behavior, and therefore an individual experience rating formula applied to a group is not generally predictive of future losses for that group, regardless of similarities in type of business and prior loss experience of the group members.
 - Studies of BWC's group rating program have consistently demonstrated that applying the individual experience rating formula to group experience has resulted in significant under-prediction of losses for groups.
 - The poor performance of the individual experience rating formula when applied to groups is evidence of the flaws in the current approach to group rating, and indicates a need for a different approach to group rating.
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Oliver Wyman Actuarial Consulting Presentation May 28, 2008

A confluence of credibility issues

- The past and present credibility tables give too much weight to the loss history of large risks, with large defined as expected losses of roughly 250k and higher
- The OBWC has not had regular updates to the credibility table to recognize inflation indexing
- Effective July 2008 the credibility is 85% for expected losses of \$1M; other states with comparable benefit levels have a credibility of roughly 50% at \$1M
- The maximum credibility level also defines the maximum experience rating credit: a large risk or large group with minimal losses can receive an experience mod of 0.15, or an 85% credit
- Experience rating is revenue neutral, meaning no additional dollars should be gained or lost after all debits and credits are applied (in practice there is always a slight impact)

Large Employer	Group
Constancy—has a risk profile that does not change much over time	Risk profile changes can be significant as members are dropped and added
Homogeneity-Represented by a few manual classes, typically having one large primary class	Heterogeneous—risks may come from the same industry group, but represent many different classes
All loss experience stays with the employer over time for experience rating purposes	Loss experience stays with the risk, but not with the group, allowing for adverse selection
Qualifies for higher credibility and therefore higher credits or debits from experience rating	Qualifies for the same level of credibility as a large employer, even though a group does not statistically resemble a large employer

The BWC Continues to Ignore The Fundamental Underlying Problem

□ BWC Proposes Split Experience Rating Plan

Deloitte Consulting already rejected split plan as a solution:

CONVERSION TO NCCI-TYPE SPLIT PLAN

- A split experience rating plan, with lower credibility assigned to group experience compared to the current plan, will mitigate some of the inequity currently produced by group rating.
- However, a split plan shares the same basic flaw as the current plan in that it applies a formula designed for an individual employer to a group of employers.
- The opportunity to manipulate the composition of a group in order to maximize discount will still be present under such a structure, and inequity will persist.

The BWC Continues to Ignore The Fundamental Underlying Problem

❑ BWC Proposes Split Experience Rating Plan

Oliver Wyman Consulting already rejected split plan as a solution:

“A rate imbalance would likely still result under a 10k split plan with the current group rules that allow for annual changes in membership. The premiums calculated are estimates, with the assumption of static group membership.”

The BWC Continues to Ignore The Fundamental Underlying Problem

- ❑ Propose lowering maximum discount

Ignores the fact that applying individual experience rating formula to groups does not work [Deloitte Consulting]

Penalizes individual employers who deserve higher discount – individual experience rating is not broken, yet BWC intends to modify it in another attempt to fix group experience rating

Current situation

	Carpenter A	Carpenter B
Status:	New employer	Max discount group employer (90 percent)
Total payroll:	\$500,000	\$500,000
Total claims:	0	0
Rates at \$9.61 per \$100 of payroll	\$48,050	\$4,805

What has gone wrong?

- Currently, 85,000 non-group employers pay more than **\$200 million annually** to subsidize 98,000 group-rated employers.

Who's being hurt by group rating right now?

- Employers not in group rating
 - \$1,251 – average subsidy for non-group employers that pay more than \$100 in annual premium.
 - More than 8,400 employers pay a subsidy of at least \$4,500.
 - Nearly 4,500 employers pay a subsidy of at least \$12,500.
 - Nearly 1,500 employers pay a subsidy of at least \$25,000.

Industry	What employer expects to pay	What employer <u>actually</u> pays	Rate inflation
Carpentry	\$48,050	\$105,500	120 percent
Farming: Crops and drivers	\$22,450	\$68,900	206 percent
Trucking: Local drivers	\$57,600	\$106,600	85 percent
Painting	\$29,250	\$61,850	111 percent
Landscapers	\$35,550	\$73,300	106 percent
Cement workers	\$26,300	\$49,950	90 percent
Automotive service centers	\$15,450	\$28,300	71 percent

The expected base rate and the actual base rate per \$100 of payroll for each industry. The premium calculations use a payroll of \$500,000 to determine premiums for each industry.

The rate inflation demonstrates how much higher the actual premium is compared to the expected premium.

Balanced base rates

- Currently, BWC must mark-up its premium rates to ensure it collects enough premium.
- Manual class 5645 (carpentry):
 - Total premium needed: \$44.6 million
 - Total premium after discounts: \$21.4 million
 - Total mark-up in premiums: 120 percent

Premium comparison

Rating plan	Number of employers	Premiums at the manual base rate of \$9.61	Premiums at \$9.61 applying employer credits and debits	Premiums at \$21.10 and applying employer credits and debits
Base rated	17,397	3,164,114	3,164,114	6,859,993
Debit rated	603	4,436,864	5,418,523	11,897,069
Credit rated	493	4,594,113	3,478,726	7,637,995
Group rated	4,839	30,627,375	7,479,123	16,421,384
Not rated	8,517	1,850,417	1,850,417	1,850,417
Total	31,849	44,672,883	21,390,904	44,666,860

Impact on base rates

- Rate for 5645 (carpentry) with mark-up: \$21.10 per \$100 of payroll
- Employer with \$250,000 in payroll:
 - At base rate (\$9.61): \$24,025
 - With inflated rate (\$21.10): \$52,750

Who's being hurt by group rating right now?

- Average base rates for each state in 2006.

Indiana	1.24
Michigan	2.05
West Virginia	2.20
Pennsylvania	2.80
Ohio	3.00
Kentucky	3.78

Granted Injunction Will Serve the Public Interest

Finally, we point out that any overall subsidy of group-rated employers shows up as higher base-rates and thus higher Workers' Compensation costs to non group-rated employers. This will likely reduce Ohio's competitiveness in attracting and retaining employers to the state. Employers considering relocating to or from Ohio may be misled by comparing Ohio's Workers' Compensation base rates to those of surrounding states.

- Aon Risk Consultant's Report, June 14, 2007
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Injunctive Relief Will Serve the Public Interest

Today, group rating is not fulfilling its promise as an economic development tool.

Group rating:

Forces non-group **employers to pay more** than their fair share

Causes **financial hardship** for businesses that lose their group discount

Inflates premium rates costing Ohio business development opportunities

Injunctive Relief Will Serve the Public Interest

Third, Ohio's base rate is artificially higher making **Ohio uncompetitive and unattractive.**

- The \$200 million subsidy paid by non-group employers inflates Ohio's workers' compensation base rate.
- Ohio's base rates appear to be the 12th highest in the country (\$3 per \$100 of payroll) and one of the highest in the Midwest.

- BWC Report
 - Bottom Line: the current group rating plan is hurting Ohio's economy
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Ohio Inspector General, Report of Investigation dated August 21, 2007

“Finally, we believe that it is long past time for BWC to adopt the findings of its own actuarial consultant with regard to the huge premium discounts the Bureau has granted to employers in its group-rated programs.”

Mercer Consulting Recommendation March 18, 1990

Recommended Safeguards

There are several safeguards that the Bureau should adopt to improve the equity in the rating system and to protect those employers not joining groups. First, membership in the group should not be dependent upon actual claim experience. The dangers of this are explained above. Second, all members of the sponsoring organization should be given the opportunity to join the rating group. This will prevent the formation of groups whose claim experience is abnormally good. Third, members of the rating group should be compelled to keep the group's rating for at least three years. If the group is debit rated, most of the individual members will be better off to be rated on their own experience.

STILL BEING IGNORED

Report of William M. Mercer consulting dated August 28, 1991

Summary of Actuarial Problems Associated with Current Method of Group Rating

We think the current method of group rating significantly reduces the "actuarial" equity in workers' compensation rates for employers in the State of Ohio. Some problems with the current method are:

- The credibility assigned to an individual employer's experience is no longer actuarially correct. Rates are therefore less accurate. Some employers are paying more than their experience justifies, while others are receiving more credit than they deserve (by virtue of associating with a group).
 - Base rates will need to be "artificially" higher to offset the additional credits caused by group rating.
 - "Splinter groups" will cause additional inequities.
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Report of William M. Mercer consulting dated August 28, 1991

Suggestion -- Change Group Rating to be "Retrospective" and Use Current Loss Experience of Group to Determine Current Rates

We suggest that the current experience of a group be used to determine the group's current rating modification. Many private insurers offer so-called "safety group" rating plans which use this concept. These plans have proven to be effective in encouraging additional safety and loss control efforts. Using current experience of the group emphasizes current safety efforts, and is not subject to "artificial" manipulation.

STILL BEING IGNORED

Report of Aon Risk Consultants dated June 14, 2007

Given its current unfairness, the Group Rating Program should not continue in its current form. While the general concept of group rating has merit, the program as it currently exists does not produce rates that are actuarially sound (reasonable and not excessive, inadequate, or unfairly discriminatory). Group rated companies consistently produce loss ratios well in excess of non-group rated companies, indicating that non-group rated companies are subsidizing the group rated companies.

STILL BEING IGNORED

Deloitte Consulting Comprehensive Study Executive Summary June, 2008

- Studies of BWC's group rating program have consistently demonstrated that applying the individual experience rating formula to group experience has resulted in significant under-prediction of losses for groups.
- The poor performance of the individual experience rating formula when applied to groups is evidence of the flaws in the current approach to group rating, and indicates a need for a different approach to group rating.

STILL BEING IGNORED

Impact of Rates on Frequency, Severity, and Loss Ratios

Situation: Changes in an employer's premium can have an impact on employer behavior with respect to controlling workers compensation costs. As an example specific to the Ohio workers compensation system, employers who are part of groups have a strong incentive to control costs as a result of the significant cost savings available to group rated employers.

Methodology: We analyzed the extent to which frequency, severity, and loss ratios changed for employers that experienced significant premium changes between 2004 and 2005.

Conclusions: We found that employers with substantial decreases in premium from 2004 to 2005 had much worse loss ratios and worse claim frequency in the 2005 year relative to charged premium. Employers with substantial increases in premium displayed significant improvement in loss ratio and frequency relative to charged premium. The tables below display these results. Please note that losses are evaluated as of December 31, 2007. Therefore, the 2005 year is less mature than the 2004 year.

The results using base premium indicate that a slight decrease in claim frequency appears to be occurring, except for those employers with the largest decreases in premium. However, claim frequency has been trending downward slightly for workers compensation claims in general. The loss ratio differences using base premium indicate no real difference between employers who have had premium increases or decreases, regardless of the size of the change in charged premium. From this analysis, we conclude that there is no discernable impact of rates on frequency, severity or loss ratio.