

SENATE COMMITTEE ON LABOR

April 15, 1991 Hearing Room 50 03:00 p.m. Tapes 61- 63
MEMBERS PRESENT: SEN. GRATTAN KERANS, CHAIR SEN. LARRY HILL,
VICE-CHAIR SEN. PETER BROCKMAN SEN. BOB KINIIGH SEN. BOB SHOEMAKER

STAFF PRESENT: ANNETTE TALBOTT, COMMITTEE COUNSEL ROBERTA WHITE,
COMMITTEE ASSISTANT MEASURES HEARD: SB 868 - MODIFIES PROVISION
REGARDING DUTIES AND POWERS OF STATE ACCIDENT INSURANCE FUND CORPORATION
- PUBLIC HEARING

These minutes contain materials which paraphrase and/or summarize
statements made during this session. Only text enclosed in quotation
marks report a speaker's exact words. For complete contents of the
proceedings, please refer to the tapes. -

TAPE 60, SIDE A

001 CHAIR KERANS calls the meeting to order at 3:20 p.m.

SB 868 - MODIFIES PROVISION REGARDING DUTIES AND POWERS OF STATE
ACCIDENT INSURANCE FUND CORPORATION - PUBLIC HEARING WITNESSES: STAN
LONG, PRESIDENT AND CEO, STATE ACCIDENT INSURANCE FUND CORPORATION JIM
MANNA, VICE PRESIDENT AND CHIEF CORPORATE OFFICER, SAIF CORPORATION
KATHY KEENE, EXECUTIVE VICE PRESIDENT, SAIF CORPORATION

047 STAN LONG, PRESIDENT AND CEO, STATE ACCIDENT INSURANCE FUND
CORPORATION > SAIF is a separate entity from the Industrial Accident
Fund. The Industrial Accident Fund is a trust fund created by statute,
exclusively for purposes of workers' compensation insurance, and SAIF
Corporation is a statutory corporation created for the purpose of
administering the Fund. > SAIF governed by a Board of governors
appointed by the Governor with the confirmation of the Senate. > At this
time, SAIF maintains a staff of actuaries and financial people. The
Chief Financial Office of SAIF Corporation is Jim Ross. In addition,
they employ consulting actuaries, Milliman Senate Committee on Labor
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and Roberts in Los Angeles. Their financial reports are currently filed
with the Senate. > In addition to that, there are audits performed by
the Secretary of State. Its authority is to be the auditor of public
accounts. The Industrial Accident Fund qualifies as a public account,
therefore, the auditing of the Fund is often considered to be the
exclusive province of the Secretary of State. It does audit SAIF's books
and records on an annual basis. > The Secretary of State's office also
hires consulting actuaries to do the reserve examination. Those audits
are public. > Also, the Department of Insurance and Finance also audits
SAIF for various and sundry different circumstances. > This additional
requirement seems to be redundant to him. It duplicates work that is
already done. If the Committee decides that an external CPA's audit is
appropriate, they would like to be consulted on who performs the audit.

089 SENATOR SHOEMAKER: Do you have any problem substituting the DIF
audit with your own audit? LONG: Yes. As I read this bill, they are
talking about the review of financial statements by an accountant. What
we contract for outside the firm is actuarial services by consulting
actuaries. I couldn't do away with that. We use those people sometimes
on a month basis, certainly every quarter.

SENATOR SHOEMAKER: You don't provide a certified financial statement?

LONG: Not under this section. They are provided under a different section of the law.

SENATOR SHOEMAKER: I trust you are providing to the state an independent certified financial statement.

LONG: Through the Secretary of State's office. Providing certified accounting or financial statements - he has historically taken the position that that's their exclusive province. We don't duplicate that. The Secretary of State is the Deputy Attorney General and elsewhere that he is the auditor of public accounts and he provides that, and we simply pay the bill.

164 CHAIR KERANS: This is a smaller point of the bill. It's a matter of finding an arms-length out-of-house CPA firm to do a financial statement, just as it's done to other private carriers. The reason is that in the Ernst & Young report, they say that "because changes in discounting have changes the reserves, care is needed in interpreting income statements. I think that is what invites the idea of getting someone other than their own firm that they're paying \$40,000 to accept their reserving assumptions, and somebody other than the Secretary of State. This is the smaller part of the bill. SENATOR SHOEMAKER: Whether this is a smaller part of the bill or not, I think it's important that we have it straight. Is this proposing that we change the current practice of the Secretary of State's audit and have Department of Insurance and Finance arrange for that independent outside audit in or would this be an additional audit?

CHAIR KERANS: It appears to be additional, so there is no point in paying for it twice. .

These minutes contain materials which paraphrase and/or summarize the remarks made during this session. Only text enclosed in quotation marks report a speaker's exact words. For complete contents of the proceedings, please refer to the tapes. Senate Comm; - e on Labor April 15, 1991- Page 3 200 LONG: > There are some years where we pay three times or four times. The Secretary of State's Office, the Department of Insurance and Finance, and the independent audit. This seems like one more too many. > There are two sections of this bill which he wants to address? · Tiered-rates - What this refers to is that within a given category of employment or activity, and there is a price difference for those rates. · Each one of those rates is filed with the Commissioner's office, subject to the Commissioner's approval or disapproval is appropriate which involves the concept that rates can't be inadequate or excessive or discriminatory. How you construct these rates is a matter of business judgment, strategy, discretion, approach. · There was a time when SAIF was not allowed to use tiered rates. · One of the factors that influenced the loss of the best business for SAIF during the years of its market share losses, which undermined the financial integrity of the Fund of the Industrial Accident Fund, was the fact that competitors could directly offer tiered rates. This proposal has the effect of taking us back to those days, where I am concerned about the consequences of the Industrial Accident Fund. This does not affect other insurance companies, only SAIF. > SAIF requested to employ tiered rates. The Commissioner in the Atiyeh administration declined to grant that request on two grounds: · She didn't want to; and · she felt her legal authority to do so was questionable. > As a consequence, SAIF took an action, which continues today to be part of the perception problem that

the company suffers from. It decided that it would set up a subsidiary. It set up SAIF of Oregon for the purpose of at least having two rates: the one that SAIF could have, and the one the subsidiary could have. That action was roundly denounced or hailed, depending on who you talked to and depending on where you stood. The point of it all is that it is administratively inconvenient and expensive, and an unnecessary triumph of form over substance. > SAIF again requested to file tiered rates, if it could do it directly instead of through a subsidiary. The Commissioner approved the filing in 1987-88. When he became director, he reviewed the expenses for maintaining SAIF of Oregon, he had them shut down. It was easier and cheaper to do it directly.

314 CHAIR KERANS: Point out where it says you cannot do that any more.

LONG: I rely to a certain extent on the testimony or explanation of the proponents of the bill that I heard, because I wouldn't do it this way if I wanted to, but if the intention of the sponsor, if I understand it correctly, by saying that insurance coverage should be provided all Oregonian employers at rates which vary only as a result of work classifications employed by the employer, the individual experience and payroll and shall be uniformly and consistently applied on an objective basis, that does away with tiered rates as they exist in the market place today for the following reasons: · Everybody employs underwriters, they don't just look at formulas, they exercise judgment about a business. · Under today's rules, an insurance company can tell an employer to change a practice or they will be down rated or canceled because the insurance company wants to avoid the claim. · This bill makes SAIF do everything based on what has already happened. Today we

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can exercise judgment about the quality and intention and efficacy of management and safety programs. > Tiered system is very objective. Rely heavily on objective indicators like experience mods, but they also put into the calculation what they believe to be the likely success of the safety program.

378 SENATOR SHOEMAKER: Are you going to be talking about Section 3 of the bill which would subject SAIF to ORS Chapter 737 in connection with this part of your testimony, or separately.

LONG: I was not going to because I feel it depends on what you do with the remainder of the bill. SENATOR SHOEMAKER: I was told at the last hearing that the reference to 737 was really 737.310, which requires that rates charged by domestic insurers, shall be adequate, not excessive nor unfairly discriminatory. Apparently the other insurance companies are subject to that chapter and SAIF is not. LONG: I didn't understand that testimony. I can tell you that I believed and have operated that bill applied to us, that those requirements applied to us, and I believed they did and our rates have been argued out and brokered out on the basis that they did. It was news to me that we were not subject to those requirements.

410 SENATOR SHOEMAKER: If my understanding is correct, then you would have no objection to that.

LONG: I have no objection, and I think it is appropriate that we be subject to those standards that everybody else is, and I thought we were.

CHAIR KERANS: Counsel reminds me that you are, but only specifically. > When DIF was here, Mr. Weeks indicated that the corporation could still use tiered rating if they were purely objective and had objective parameters that were demonstrated to be objected.

TAPE 61, SIDE A 012 CHAIR KERANS: When you go out and objectively observe problems, you could make a decision to move a person to another rate tier. Or in the case of a takeover, you told us last year that would be a new business, and in fact, we brought you many cases where they said they were in business forever. You don't need a rate tier to do that you would do that under your other powers as you have done in other cases. LONG: First of all, I personally wouldn't do anything, and neither would SAIF. It is the regulatory scheme of Oregon that makes new business a "1", not SAIF. That's true for everybody. And we might even cancel them mid-term if we felt they did not care enough about their workers to employ safe practices. 033 CHAIR KERANS: So we need to provide some language here so you can get to that, so that you could objectively demonstrate that this is a person with a sorry record in other activities and

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we're going to hammer you here, too.

LONG: On the issue of tiered rates, I would need to know in a more clear specific fashion what the problem was that some proponent was trying to solve before I could craft something that didn't do mischief. I'd certainly be willing to do that. I listened carefully to the testimony, but it did not tell me what it was they were trying to fix. I viewed it as some confusion about tiered rates in the first instance and frankly, when I've seen proposals like this before, they were coming from competitors who wished to go back to the situation where they could write on the same basis and SAIF could not. Let's make the language the same for everybody.

CHAIR KERANS: What we need to do is that whatever we do continues your ability to do that. Isn't that correct? In the same method as any other carrier that competes with you. Isn't that what we want to do?

LONG: If you're going to regulate the voluntary insurance market, my strong recommendation to this Committee and this legislature is, that with respect to those market place activities, that there be uniformity. If that is not done, adverse selection sets in and the public fund - the Industrial Accident Fund - suffers over time, as it did when SAIF made an unusual market decision some years ago to penetrate the assigned risk pool. It inflicted on itself a rather horrendous financial liability and at the same time it enriched its competitors. We don't want a duplication of that.

076 CHAIR KERANS: If the legislature were to come to the conclusion that there were confusion, uncertainty, or feeling that there was subjective, inconsistent, discriminatory or other kinds of applications

of rate tiers out there in the market place, by you and/or other carriers, and we wanted to set some uniform standard for the creation of those rates which were fair to all, and discriminated against none, would you have an objection?

LONG: > If the legislature came to that conclusion, I respectfully say to the legislators that they had made an error which causes me to have difficulty in answering your question. The Commissioner's office does not approve rate filings whimsically. The issue is whether companies adhere to their rate filings. > We are complying with our filings.

CHAIR KERANS: You would recommend that we not do it, even though it would rain equally on the just and the unjust.

LONG: > I would for this reason, now is not the time to try new things in Oregon. When I'm right we're successful, and when I'm wrong we fail. > There is no problem unless it's a problem of compliance, and SAIF does not have a problem with compliance. You can come and look at SAIF, I'm not worried about it.

140 CHAIR KERANS: Can you put your figure on the language in this bill which makes you the insurer of last resort. Please highlight those.

LONG: I'd be glad to share with you my thought process. I assumed the bill was crafted to

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accomplish some purpose, whether I agreed with that purpose or not. In trying to discern what that purpose is, and have some idea of who'd be interested in supporting this bill, I went back and reviewed the circumstances when SAIF was at a competitive disadvantage. One of those areas is, when the assigned risk pool in Oregon was very low, the majority of the business which produces losses was generally in one place: SAIF. CHAIR KERANS: Can you find in Section 2, § 1, show me the words that make you the insurer of last resort, and thus put you in such a competitive disadvantage as to depopulate the assigned risk pool and put them on your book of business as you are about to relate to the Committee. 171 LONG: In Oregon today there is no entitlement to insurance in statute. It is a voluntary market. This bill at a minimum creates, in my judgment, an entitlement to insurance unless certain conditions exist. > Line 21 "to make available workers' compensation insurance to all Oregon employers" sounds to me like the creation of an entitlement in all employers to insurance, followed by the proviso, which says "unless the employer's individual experience demonstrates that they're a high risk employers and would constitute a burden to the other Oregon employers insured with the State Accident Insurance Fund Corporation. CHAIR KERANS: That sounds to me like what you just said you want to avoid. That guarantees that we would avoid that - we would get rid of the high risk cases, put them in the high risk pool, and take the ones that would not cause you economic disadvantage. LONG: No, I think you misunderstood me. > Today there is no entitlement, Section 21 creates one. > If you say we have to write everybody unless their individual experience demonstrates they're high risk employers, that means that I'll have to write to somebody that we knew was engaging in conduct today that was going to cause a future problem, even though it

had not occurred yet. You would make us subsidize those coming claims. > We will be told, in effect, that people have a right to insurance, and we are the source, unless we can disprove it. That tips the system on its head. > Consequences: · The assigned risk pool volume will go down, and they will insure more people. · Saif will begin to experience excessive losses, loss of its better business, and the share of the market and the influence of the private carriers will go up.

294 SENATOR HILL: 10,000 businesses were terminated last year because they had an unsafe record and therefore represented an unfair burden to the balance of your insured clients, or somehow or other were justified for termination based on an evaluation of their individual characteristics and experience. Is that correct? LONG: No, I don't think I'd say that. The circumstances of late 1989 - 1990 were so complicated and there were so many different aspects. SENATOR HILL: Is it correct or incorrect that you checked out each of those

businesses prior to termination to determine if they represented an unfair burden on the balance of your clients? -

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LONG: > No, that's the standard of this bill, and that was done in some instances and not in others for valid reasons. SAIF created a non-standard tier for businesses which wrote \$16 million worth of premiums for 1,000 businesses. The losses from those 1,000 businesses totaled \$32 million. I recommended to the board in August 1989 that we discontinue that entire category of substandard business, that we cancel or discontinue all of those 1,000 accounts as a class - I felt it was appropriate and necessary to do that. I would suspect that the majority of those businesses went back to the assigned risk pool by category. It was an unusual action, it was necessary, but it was not based on a current review of individual businesses, but it was based on the underwriting that had been done on those businesses at the time the policy was written, when they were written non-standard insurance. So there was underwriting review as they came on the book in that category, and then the board of directors in its 1990 plan authorized and directed the cancellation of that category of business. > We withdraw from the assigned risk market place because we couldn't afford it. > The change to our mission statement was a prudent change which has changed the business practices. It makes more insurance available to as many as possible at the same time the fund's integrity has been preserved. These changes take us in a different direction from those passed in May 1990.

CHAIR KERANS: Are they complementary? Can one stand on the other? Can they work in concert?

384 LONG: No sir, I don't think so. In 1990 we expanded the number of people we insure by \$23 million, even though premiums are down. SENATOR SHOEMAKER: One of the objectives behind lines 21 through 24, is to stimulate Oregon's economy by providing a workers' compensation insurance market to new and emerging businesses so that they will not have to endure the high cost of the assigned risk pool. We could require that all domestic insurers make available workers' compensation insurance unless their experience proves them unworthy of it. How would you react to a change in that regard?

LONG: When a new business comes into existence, they are assigned a " 1" rating, or the average rating, and so you charge premiums on the basis of that " 1". Absolutely, undeniable facts are that as a class, when you look at all new businesses, they don't live up to the " 1 " rating, so it's a built in loss-leader. > We can change that artificial "1" to some other price that more closely parallels the experience. It's not a question of discriminating against new business, it's being required to write insurance at less than cost.

SENATOR SHOEMAKER: When they are in the pool, do they have to suffer the experience as those who are in the pool because of bad experience?

045 LONG: I don't run the pool. We spend a lot of time trying to find someone whose business is getting better.

SENATOR SHOEMAKER: That really doesn't answer the problem.

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LONG: > Higher reserves means higher premiums. > Our purpose is non-profit. We are to use ability to sell insurance so that the fund wouldn't be depleted. We reserve because you tell us to. > Our reserving practice, unlike any other carrier, is determined by statute. Other carriers have a choice of how they reserve subject to approval by the Commissioner. We have one method, and the legislature gave it to us in 1961. We don't have any choices unless the legislature gives them to us. > The idea that the fund discounts its future obligations is not new. It used to be that the number was in the statute. It used to be 4%, it was 2%, 2 1/2 % . The legislature made changes as they tried to directly manage the idea of how much money you needed. > The legislature decided to put the time value of money into the rate by adopting this reserving statute. We don't have the profit purpose. > The goal for SAIF and the goal for private carriers is the same - they are all required to insure to the ultimate liability. Insurance companies have discretion as to how they do that. > SAIF determines rates by history trended by actuaries. > Up to now, the legislature has wanted SAIF to drive down rates with interest earnings.

247 CHAIR KERANS: > The Executive Summary of the Ernst and Young report dated February 1990, states that the "loss reserves based on our analysis reserve recommendations are deemed adequate in accordance with adequacy described in the report. However, those reserve recommendations would not be adequate under more stringent discounting requirements. Indeed, more stringent discounting requirements could cause SAIF Corporation into negative retained earnings and be deemed technically insolvent. The current reserve recommendations correspond to greater financial risk, weaken reserves, etc. Because changes in discounting have weakened reserves, care is needed in interpreting income statements and changes in retained earnings in recent years. Greater discounting means that income is recognized earlier, consequently future earnings will be depressed as discounted reserves unwind. Separation of losses due to discount unwinding and losses due to current operations might be crucial to evaluation of recent changes in SAIF operations." I don't know if the caution flag went up in all of that, but it probably should

have to someone, but it raises the question of how are we doing this, what is the outcome, and what do we, ultimately, as the board of directors of another corporation - the corporation of the State of Oregon - of which your corporation is a subsidiary, have when we start thinking about these things and their impact. > You have also said in your letters to people about this bill that it will "immediately create multi-million dollar debt for the industrial accident fund", and it would be possible for the bill to make SAIF insolvent and that we would immediately disadvantage you if you were required to care for your reserves under Section 4 in the same manner as a domestic insurer in ORS Chapter 733. You also said it might cost the general fund some money, and the taxpayers, and a whole bunch of other things that might occur. Can you tell us how that would happen and how that follows? companies do. 318 LONG: I have read the Ernst and Young report, and the bottom line judgment of that report is that SAIF's reserves are adequate. Adequate means we're all right. Actuarial principles usually operate on a range. Our financial statements are correct and conservative. We have adequate funds. The reason why I'm concerned about this change is that extra money will be needed. I don't want to see the legislature take \$600 million out of rate, or find some other source for the

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\$600 million, because I don't think it's necessary. I don't think there's any credible evidence, any caution flags or anything else when you make the question ultimate liability. 391 CHAIR KERANS: In your letters to people raising questions about this bill and why it was here and motivations, etc., you put the figure at \$639,338,000 as of December 31, 1990. That's the difference between your approach to reserving under the treatment given to the corporation, and your best estimate as of December 31, 1990, where you would be if you were treated like other domestic insurers. Is that correct? LONG: No, that's not what I said. TALBOTT: That's the value of your discount rate. CHAIR KERANS: So you said you would need over \$600 million immediately. Is that the difference between your reserves today, and what they would have been had you been treated over the years as any other domestic insurer? LONG: No. CHAIR KERANS: What is it? TAPE 61, SIDE B. 001 LONG: If you leave the statute the way it is and simply tell us to use a different discount rate or none, the value of that change is \$600 million today. If you tell us to go to some other reserving system, you've got to tell me what it is, and when we're going to implement it, and how long we have to get to it. The point is that if you ignore the different paths by which you get the ultimate liability, you are taking \$600 million out of the economy for no reason. > If it's some other point, then you've got to tell me what the other point is. CHAIR KERANS: Let's say the legislature came to the conclusion that the discounting was, by virtue of the fact it was one of the largest discounts to any reserve in the United States of America for a state fund, if not the largest discount, and represented a significant amount of money that we decided we needed to be more prudent and get you into the same parameters as domestic insurers instead of the language in Section 4 did as you just said, have you go to a reserving standard no less than that of a domestic insurer covered by ORS Chapter 733, and said you've got to do it over a period of 15 or 20 years. And then at the end of that time the same as whatever the minimum was, and we took that as our new standard of prudence regarding your reserve, because we are a member of a board of directors

which does, in fact, stand behind the Industrial Accident Fund by virtue of the fact that your corporation is a creation of our company. Would that be possible? LONG: It would be possible for me to answer that after I had a chance to do some work. CHAIR KERANS: Would it be possible for us to do that? LONG: You can do anything you want. You can tell us right now to go do it like a domestic insurer. We don't know what that means. If it means rolling back the discount of \$600 million

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of unnecessary money and huge additions to rates, if we've got to do it in one year, or two years, or five years. If you want us to change the discount rate to some other number, but continue with the statute, it's just a question of the difference between what you think is prudent - in other words you can go back to the way it was before 1961 and put a rate in the statute.

041 CHAIR KERANS: What we might do is ask the Insurance Commissioner to publish the discount rates without even naming the companies. Then say, you shall have the lowest one, you shall have no greater than that allowed by the Commissioner for any other domestic insurer. How would that be? LONG: What that tells me is that I haven't made my point clear. We follow a statutory system that includes discounting. The other people don't do it that way. We start out with different numbers. Hopefully, we end up in the same place. The other carriers should be here telling you that they have enough money to pay their ultimate liabilities, and how they got there is between them and the Commissioner. I'm telling you SAIF Corporation today has more than enough to pay its ultimate liabilities. You could turn this around and say we have too much money. If you wanted to make that argument out of the numbers you probably could. We think we have enough money. What I'm saying is that these numbers are open to argument, depending on what your purposes are. We make our best judgment about what to do. My concerns are these: if you make a change, please understand what all the consequences are, and number 2, when you say you are going to take a series of actions that will cause rates to go up, I have to tell you that it's unnecessary. There is no risk that I'm aware of. We're so conservative with respect to the manner in which we determine our reserves, leaving out discounting, our total amount reserved is conservative. It's adequate.

069 CHAIR KERANS: The question that's behind this is to nail down those questions and not be able to move back and forth between those two arguments and be able to treat you like other domestic insurers. If the sponsors of the bill have got it wrong, then we need to find out how to make it right. LONG: The reason why our numbers change is because our performance has changed like any dynamic company. > The State of Oregon was in the business of providing this insurance since 1910 to 1965. It isn't that we're permitted to compete with the privates, it's that the legislature permitted them to compete with us. There has never been the suggestion that we ought to do everything like them, because our purposes are different. If you want to make us act like them, fine. There are some other changes you ought to make along with them, and I can give you a list if you'd like, but the real question is workers' compensation is mandatory insurance. The state's been in the business since day one. The constitutionality went to the Supreme Court in 1914.

In 1965, you decided somebody else should come in. These practices were in place then. ~ If the goal of the workers' comp system is to compete with everybody else, fine. I didn't understand that that was what we were doing. I understood that using these resources that were given to us over time were out there trying to drive the price down.

132 SENATOR SHOEMAKER: If you were to conform to the reserve requirements of the privates, that would increase your reserves substantially. LONG: It depends on what that means. I could probably pick a private sector formula to do

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reserving if I thought about it that might not. The only thing that produces the \$600 million is this sort of approach where you just go after discounting and take that out of the statute, and leave us with what we've done historically. I think we have the right amount of money, and I could probably come up with a reserve system that produced it. > Really what underlies this is what do you want the state to do with its \$100+ million a year in interest income? Do you want us to put it back into rates, or do you want us to do something else with it? That's the policy question. Right now, we're putting it into policy rates, if you don't like that, tell us to do something else with it and we'll do that with it. SENATOR SHOEMAKER: If you have to increase your reserve requirements substantially because of a change, where would you get the resources to increase it? LONG: From rates. The only source of income SAIF has, other than investments, which is reserves paying back interest, is if you told us to add \$100 million to reserves, I'd say how long do I have to raise it? When I knew that, I'd go out and figure out what the rates would be, plus start adding until I made up the \$100 million. SENATOR SHOEMAKER: There is no other source for the funds that are put into reserves.

LONG: None.

162 SENATOR HILL: In looking at the actuarial report, I gather that report is based on the fiscal year that concluded July 1, 1989. > I'd like to understand, when SAIF was losing money in 1989, where was the loss reflected? How was that loss applied. Where was that loss occurring? Where did the blood flow. Was the shortage in the reserve account? LONG: IN 1988, for the calendar year '88, my opinion of where the losses came from that amounted to \$50 million, came from the need to put into reserve more money than we had in the rate because the development, the loss development, of ongoing cases as handled by the claim system was producing bigger net final payments than predicted the year earlier. > The main problem with SAIF that I operated on when I came in was our claims system was consistently generating more expense than had been predicted. I felt the reasons for that were that SAIF had too big a share of the assigned risk pool, that its claims performance and system had been allowed to deteriorate over time, medical inflation was rampant, but worse, the rate of awards of partial permanent disability cases was outstripping anything in the country. The changes that I made were designed at getting at those things that were causing you to have to dump \$50 million more which would show as a loss, and the next year you would raise rates. I started out by centralizing claims. I then asked the legislature to make certain changes. In August 1989, the Board adopted the 1990 plan, which included the controversial elements

that in part spawned some of these discussions today. The reason why SAIF's finances turn as quickly as they do is very simple: when you change one of the elements of the system, your financial statement changes. We put in a new claims system that works very well. We did not experience negative loss development after May or June of 1989, we began to experience the opposite. 229 SENATOR HILL: How was that deficiency that you identified reflected in your actuarial statements. Where did it show.

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LONG: When you close out the books for a year, the principle way is that the surplus goes down. It basically is just like a private business in that respect, not others. You've got this operating loss of \$50 million, you've got to get it someplace, your net worth goes down. SENATOR HILL: I know you're pointing to an operating loss there somewhere. I want to see that on a sheet of paper. Can you bring that sheet of paper for fiscal year 1988-1989, showing where that \$50 million loss occurred. Can you briefly summarize - did that occur in insufficient reserves? Is that where it was reflected? LONG: Yes. It doesn't show those kind of results. You've got an income statement or an operating statement that shows a loss, and you've got some others, maybe from the market place, and then you've got what your surplus was at the end of 1987, what your surplus is at the end of 1988, and then you've got to go through the financial statements and figure out why the change. It could have come from the market. My operating assumption as the new president was that it was from loss development.

SENATOR HILL: Where was this loss showing. Where was the problem. JIM MANNA, VICE PRESIDENT, CHIEF CORPORATE OFFICER, SAIF CORPORATION: > It was my understanding that the \$49 million loss for the year was a calendar year underwriting loss. That is, net income for the calendar year 1988. The exhibits you're referring to right now are from the Secretary of State's audit report, which is done on a fiscal year which ends 6/30/89. The \$49 million would show up in the annual statement report that we file with DIF, it would not be shown on the Secretary of State's report.

269 SENATOR HILL: Would it be insufficient reserves for expected claims? Is that where the hole is, or was at that time?

MANNA: We would have to take a look. The \$49 million is a by-product of comparing premium income less expenses and incurred losses, and then adding in investment income. You have to go into those various components of each of those factors to determine where it is coming from.

SENATOR HILL: Now the earned income and investment income is pretty much frosting on the cake, isn't it? Isn't your reserving supposed to be adequate to carry current risk? With or without a discount, it's supposed to be adequate to carry current risk, is that correct?

MANNA: The reserves that we establish at any given point in time should be sufficient to handle all liabilities that we have given whatever discount that we are using. Under statutory accounting practices we're required to reserve to the ultimate value of a claim, and then discount

the appropriate amount.

293 LONG: The whole process of reserving involves creating a snapshot of a moving picture and saying what would happen if you shut the business down today. So what you do at a given point in time when you get to the end of the year, we're making the assumption that we stopped everything, sold everything, and paid everything we owed, what would we have left. That figure we have called "left" is the surplus. . These minutes contain materials which paraphrase and/or summarize staterasatc made during this session. Only text enclosed in quotation marks report a speaker'. exact words. For complete contents of the proceed ngs, please refer to the tapes. Senate Committee on Labor April 15, 1991 - Page 13

311 CHAIR KERANS: Your statement to the committee is that the loss is a loss to the financial profile of the corporation. LONG: Net worth. CHAIR KERANS: The question that Senator Hill asked is where did it go, it flowed out of the assets of the corporation into reserves to reflect the higher claims cost that you experienced. Is that correct? LONG: As we go along, we make an estimate of what we're going to need. When we get all done with that, we make an estimate of what we're going to need and what we have on hand. If it's short, we have a loss. 326 CHAIR KERANS: Did you add to the reserves as a result? Is that where the money went? LONG: The money came out of our diminished net worth. CHAIR KERANS: The higher claims experience was paid out of your operating capital and did not come out of reserves and it did not change and no additional money went in. 333 LONG: When an insurance company makes an estimate of future responsibility, moves it back to reality, sets it in reserves, then you come along a year later, make that same look back we've still got the money. We're holding it to pay it out over time. We're not out of cash. CHAIR KERANS: Oh I understand that. LONG: The losses are revisions in the estimates of future liabilities. SENATOR HILL: Future liability that you know you have incurred. Is that correct?

LONG: Including some incurred, but not reported. SENATOR MILL: You reserve against that liability - that's the purpose of the reserves and the reserves are actually assets against that potential loss which you expect to occur. Theoretically, if we took a snap shot today, your reserves should be adequate to pay off that obligation. LONG: The difference is our current liability is not yet ascertained because that case isn't done with yet. It has not turned into an obligation yet - it has turned into a liability, but not a liability like a bank. SENATOR HILL: You haven't quantified it. LONG: Exactly. SENATOR HILL: Most of your obligation has been established, and it is represented by investments and the reserves, right? You can't say that most of your obligation is currently in the pipeline at any one point in time.

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385 LONG: A big chunk of our reserve is for medical and those aren't paid yet. SENATOR HILL: Don't you reserve for future medical? LONG: Yes. SENATOR HILL: You do. So you don't know exactly what it is going to be but you reserve based on actuarial standards. My point is, in 1989, as of June 30, you said you were short \$50 million. LONG: When? SENATOR HILL: 1989. LONG: No. 1988. SENATOR HILL: You were not losing money in 1989. LONG: Well, I'm just telling you that the reports filed. SENATOR HILL: Were you or were you not? LONG: In the first quarter we lost money. In the second quarter we lost money. In the third quarter I

announced in a press conference that we were probably beginning to make money. Certainly by the fourth quarter of 1989 we were making money. 404

CHAIR KERANS: And in the first quarter of the next calendar year, there were a whole lot of people who were not insured by you. SENATOR HILL: This audit talked about both the reserves as discounted reserves and nondiscounted, and the adequacy of the reserves, depending on if you looked at them from a discounted view point or non-discounted view point. The report does say that as discounted reserves, they were adequate; as non-discounted reserves, if you use that standard, they were inadequate. In no point in this report does it mention you losing \$50 million. LONG: It's for a different time period. SENATOR HILL: It was for the fiscal year July 1, 1988- June 30, 1989, your period of greatest loss. Correct? LONG: No. SENATOR HILL: When was your period of greatest loss? LONG: When I went to SAIF Corporation in November 1988, the company had experienced losses throughout that year. The \$50 million figure was for December 31, 1988, on a statutory basis. The report you're looking at is on a different basis for a different time period.

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SENATOR HILL: Six months difference. So it overlaps half of the time period in which you lost \$50 million. TAPE 62, SIDE A 001 LONG: No, each quarter we take a look at what we think the future is going to hold for us, and we make estimates of liabilities in income and a lot of complicated stuff, and take a snapshot for our purposes, and file a copy with the Commissioner. In each quarter we have to make some reserving adjustments, to reflect what's going on under the system we use. I don't remember when in 1988 they took the loss - I wasn't there. So they probably lost enough in the first two quarters of 1988 to make the final one \$50 million down, and they may have made a little money or not in the second or third quarter. It's a cumulative thing, and the losses were probably in the first two quarters of 1988. 012 CHAIR KERANS: In May of 1989, in front of this committee, you repeatedly said, and your staff repeatedly said, that the losses were characterized in the order of \$1 million a week, or \$50 million a year. Horrendous bleeding was going on, hemorrhaging was current. SENATOR HILL: The term was "current bleeding". It was currently going on. CHAIR KERANS: It wasn't described as the two quarters a year ago. LONG: You're addressing the issue of what you know and when you know it. The financial report of 1988, I believe to be correct, and throughout 1989, until about the third quarter of 1989, we believed, and we were, experiencing losses. The first quarter of 1989 was pretty bad. The second quarter of 1989 was pretty bad. The third quarter was a little less than we projected it was going to be, and the fourth quarter was a little better than we thought it was going to be. KATHY KEENE, VICE PRESIDENT, SAIF CORPORATION: I think I understand the source of Senator Hill's confusion. Senator Hill is relying on a statement in the auditor's outside actuarial report about the adequacy of our reserves, with or without discounts. There was an additional item that this accompanied. This is simply a statement of whether our reserves are adequate. There was also a financial statement filed as part of that audit which shows that we lost money on a general accounting principles basis for the period that ended June 30, 1990, which was the span of that audit, so although the times were different and the bases of the audits were different, the accounting principles were different, the operating loss and underwriting loss was also shown in the Secretary of State's audit for that six months. LONG: I think the

report to which Senator Hill is referring shows a \$28 million dollar loss for the fiscal year period. CHAIR KERANS: For fiscal year, but on the calendar year it came to \$10 million. 052 KEENE: I think the confusion is the notion that an outside auditor is saying that our reserves are adequate. Yes, they were, but they are also noting that we had an underwriting loss on a GAAP basis for that fiscal year. SENATOR MILL: The Ernst and Young report points out that SAIF's loss adjustment reserves

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are clearly inadequate on an undiscounted basis. A deficiency on the order of \$28 million is indicated. And this report also indicates "because changes in discounting have weakened reserves, care is needed in interpreting income statements and changes in retained earnings for recent years". Finally, the recommendations being implemented at the time would not be adequate under more stringent discounting requirements, indeed more stringent discounting requirements could cause SAIF Corporation to have a negative retained earnings and be deemed technically insolvent. > I think there may have been confusion in the way the reserves were viewed by the Secretary of State's and by this auditor, perhaps that \$28 million gap in the reserves was deemed as inadequate in viewing the reserves on an undiscounted basis. Looking at it on a discounted basis, one could say that it's adequate, but my concern stems from the interest in seeing that SAIF retains its financial liquidity and not become insolvent. > My second concern is to understand and hopefully come to the conclusion that SAIF has not been manipulated for some purpose - that is the definition of reserves, which could be adequate on the one hand and inadequate under the other, has not been juggled to achieve political ends and also to justify the expulsion of thousands of small businesses whose only sin was they're small, and therefore, not very profitable. So I have an interest in understanding where the numbers came from over the past several years, and who was defining what, because if the numbers have been defined differently at different times, with the net result that Mr. Gilliam's people have suffered, then I think we have to adjust the statute to prohibit such juggling of numbers in the future. 126 > We owe it to the people of the State of Oregon to determine if this legislature has been told the truth consistently, first, and second, if you believe that we have been told the truth, to understand how you arrived at the figures and the information you shared, so we can understand your interpretation of the truth. 194CHAIR KERANS: You're entering into some arrangement with the Associated Oregon Industries for some group deal. Can you tell us about that? LONG: The problem of insuring the very small account has perplexed everybody. One response to these perplexing problems of too little to pay accompanied by a sort of standard administrative expense and huge risk, is minimum insurance premiums. Writing small business is something most carriers don't do. Group insurance has seemed like something that you ought to try as a way of making insurance more accessible and maybe a little cheaper, you get some advantages out of numbers. The laws of Oregon prohibited grouping of small businesses unless they were in the same business. There's a reason for the law prohibiting unlike businesses from being grouped - it's because in order to make a group work, you have to have some sort of unity of program or unity of ownership. If you want small businesses to have the same kind of advantages of size that large businesses have,

you've simply got to group them. So the legislature passed a bill that removed the prohibition of grouping unlike businesses. The folks at AOI were watching that and came up with the idea, which we wholeheartedly support, that if you put enough small businesses together in a program that has some unity and structure to it. that maybe we could rate them as if they were one large employer paying \$8 million, instead of a bunch of little guys paying \$250 or \$500. It's a very elegant system that I think will put Oregon on the map, because I think we're going to solve a problem. > AOI is going to make available pre-employment drug testing at a very nominal fee for those employers who want to do it. ~ In addition, there are some safety measures imposed on the State by the bill.

Administering

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those safety programs together as part of one group provides efficiency and consistency where the results of that group insurance may pay back those safety considerations. SAIF Corporation under the authority you gave us in the change in our directions is in effect putting up the money to make it possible for there to be a comprehensive safety program, including drug testing, for a large well-run group of individual businesses rated together as if they're one, even though they are engaged in unlike activities. We're going to write them at \$500 for minimum premium. There is no membership fee, all they are going to get for being in AOI's group is more service for less cost. > We're going to offer to the 10,000-12,000 businesses that we have that fit the criteria of being non-experience rated, under \$2,500 in annual premium, to transfer them to that group so they can be part of those safety programs. AOI is going to insure them \$ the low rate. 275 CHAIR KERANS: You're going to suggest that part of your book of business goes over to this? LONG: Yes, just like the formation of any new group. CHAIR KERANS: Do you have a financial relationship with them in which they receive something from you for purposes of doing this? Is there a licensing fee for the use of their name, or the use of your name, what do they get? How does it work? LONG: Classic relationship, such as we have with other small groups. They perform for the insureds some of the safety obligations that we have under statute. We reimburse their administrative expenses for doing these things. Other than that, they don't get anything. LONG: They employ and we approve and appoint a managing general agent to do the work so the people get the right forms filled out. We pay a commission to that agent, which is not AOI, just like we pay a commission now to the agents who write the business now. There's been some front-end expense which we bear, which is out contribution so to speak, made possible by the bill, where we believe that this is an appropriate thing to do to try to solve this longstanding problem, and we'll put up the money for computer programs, and that sort of thing. 315 KERANS: Who is the target population again? LONG: Businesses that are too small to be experience rated, so they don't have a number. They are under \$2,500 a year in annual premium. This is the difficult market that usually can't find insurance except in assigned risk pools. 352 SENATOR MILL: I'd just like to know, did you have the opportunity to discuss this with other possible partners? LONG: Yes. I approached NFIB, they rejected it and endorsed Liberty's program. SENATOR HILL: So NFIB was in discussions at one point, and you didn't work out an agreement. 358 LONG: No, I proposed something like that to them, asked them what their ideas were and I didn't hear back

from them.

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SENATOR HILL: Would you suggest that NFIB has a current agreement similar to yours with Liberty?

LONG: No, I don't think so. I don't think they get involved in insurance at all. They indicated to me early on that they weren't interested in such kinds of arrangements. I knew that essentially because they had had a prior bad experience, but the question was, who is that you're going to be in that business. There are only two business organizations around of sufficient size, NFIB and AOI. SENATOR SHOEMAKER: I understand the auditor for 1989-90 is due in a couple of weeks. I think it would be interesting for us to obtain that to see what the audit has to say about the adequacy of their reserves and see if any of the suggestions in the previous audit were followed up and that kind of thing.

TAPE 63, SIDE A

009 SENATOR HILL: If someone could put together a memo, just chronologically listing the changes in your discounting practices - that is there were changes that occurred based upon developing interpretation of the statute as it applied to your discounting practices. When did those changes occur. I'd like to know the month and year they occurred, and to which classes were they applied, or were they applied to all classes.

LONG: The change in the discount rate occurred in 1988 before I arrived at SAIF Corporation. I know of no other change in the rate. There have been none since then. It will be a very short list. SENATOR HILL: There have been no changes since then?

LONG: We have made no changes in the discount rates since I have been at SAIF.

022 SENATOR HILL: And it went into effect in June 1988? The opinion was in May of 1988. I'd be interested to see how that corresponds with performance with reserves, and to see if that discounting rate is linked with some change in the reserves. LONG: The change in the discount rate made an enormous change in the reserves sometime in March or April. When you increase the discount rate under our system, it makes a change. CHAIR KERANS: You got real healthy, real quick. 032 LONG: I don't think real healthy is accurate. > That change was made in the early part of 1988, and then a bunch of it was lost, which is what brought me to SAIF Corporation. ANNETTE TALBOTT, COMMITTEE COUNSEL: > I believe the value of the discount was \$171 million dollars. LONG: What's important about that is there is more than one opinion about what you do about that. My predecessor had a point of view on that subject, about what was causing it and what

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you do about it. When I came to SAIF I developed a point of view about what you do about those kind of occurrences. My response was to build a new different claims system. We produced different financial results in the cases in the pipeline so that we didn't experience those kinds of numbers. That pattern had been occurring at SAIF off and on since 1982 or 1983, and my job was to try to end that pattern, and thus far, the changes we've made have proven over time to be well considered. The difference between us and other insurance companies who have grappled with these issues is we felt an imperative to make several changes at once - we not only change the claims system, we went after some market changes, we went after a number of things all at once, because I felt the situation in November 1988 was very dangerous, and I felt that if we didn't reverse those trends and soon, the company would use up all of its cushion and then you would have to figure out what to do with an impaired state owned insurance company. It's that same urgency of concern that led me to make the recommendations I did in August 1989 to the Board that were accepted, that were implemented until about April 1990. In April 1990, we declared a moratorium, not on our claims development, but upon our underwriting changes. The legislature met in May, and since then our marketing underwriting results have been very good. > The changes they have experienced since 1988 come from hard work, not juggling books or other kinds of things.

078 SENATOR SHOEMAKER: What were the anticipated premiums - what was your book of business for that same period of time? MANNA: The earned premium for that year was \$210 million, and the \$50 million was the net loss after consideration of investment income with the premium income, plus incurred losses and expenses. SENATOR SHOEMAKER: So on \$210 million coming in, you essentially expected \$260 million going out, not just cash, but in terms of reserve reduction. What is the book of business that you have had in the year since that year?

088 MANNA: We finished 1990 with a net income of a positive \$46.5 million.

SENATOR SHOEMAKER: No, the book of business - the gross sales.

MANNA: Earned premiums shown in our annual report was \$185 million.

SENATOR SHOEMAKER: So that's less than the \$210 million.

MANNA: Yes.

SENATOR SHOEMAKER: If the \$185 leads to \$46.5 in income, take that off the \$185, and you're down to \$137 million in cost, as opposed to \$260 million in cost?

100 MANNA: That's basically the contrast we're looking at, but understand also, that when we talk about net income, it's premium income plus investment income.

LONG: The big change in our overall financial condition is a change in our pay outs, in what we're estimating we're going to pay out. This claims expense change is the big factor. > Part of the change in one year is as a result of legislative changes and our performance.

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145 MANNA: When you look at a financial statement for an insurance company, it reflects not only the current underwriting year, that is the premiums and losses generated by the business in effect during that year, but also the impact of pluses or minuses as a result of re-evaluation of prior year reserves. So when you have a reform that comes in and has an impact on older cases, that flows through the current year in terms of reduced and incurred losses. So the current year losses for 1990, where we show \$166 million on this consolidated statement of incurred losses, which \$100 million less than the prior year, it reflects the internal improvements, the quality of business we were able to retain and write new, plus any benefit we may have received by reform that flowed through the statement for that period of time.

176 Meeting was adjourned at 5:52 p.m.

Submitted by: Reviewed by:

Roberta White Annette Talbott Assistant Admmistrator

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