

HEALTHCARE WORKERS' COMPENSATION FUND

HWCF

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Presentation by:

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Opening

Good Morning, Mr. Chairman, Board Members, Fund Members, Staff and Guest - it is my privilege to have this opportunity to report to you on the status of the Healthcare Workers' Compensation Self Insurance Fund (hereinafter I will call it the Fund). Your interest, shown by your attendance at this meeting, is the heart of what has made the Fund successful. I thank you for your support and involvement.

2006 Results

As you have already heard from our Certified Public Accountants, the bottom line is that the Fund operated at a profit for the year 2006. This is the fourth consecutive year that I have had the privilege of making the statement that the Fund has had a profitable year.

During 2006, the Fund took in \$12.2 million of "Gross Contributions" and \$656 thousand of "Net Investment Income". After subtracting operating expenses and the cost of all years claims activity that occurred during 2006 the "Income Before Tax Expense" for 2006 was \$1.45 million. The Fund paid \$500 thousand of "Income Taxes Expense" leaving a "Net Income" of \$948 thousand. That is a profit.

Transparency

This is a good point to address a subject that is getting a lot of attention in the news media. That subject is "Transparency". "Transparency" is the term which describes the ability of owners, investors, general employees and the public to clearly see what is happening in a corporation. What is the real financial condition of the corporation? Is the corporation making its customers fully aware of the current pros and cons of doing business with the corporation? How truthful are the statements made by executives of the corporation? In other words, is the true condition of the corporation easy to see through clear windows of information? Or, is the view hindered by cloudy or opaque windows to the information; thus, giving those trying to review the condition of

the company, a distorted image of the actual situation. Or, worst of all – is the view of the actual condition totally blocked and replaced by false images. Enron is a well known example of this situation.

The Board of Trustees has set a clear and definitive standard for the Fund. Management is to be open and fully transparent. We are to present sufficient and unaltered information to the Members and the Board so that you know the true condition of your Fund. We sincerely hope that this is apparent to you our Members and Owners. To give a couple of examples:

1. Our Accountants are at this meeting presenting the findings of their 2006 audit. You, the Members, can ask them questions without any restraints or hindrances.
2. In our loss reports, you are shown the full incurred cost of each claim including the loss reserves. Additionally, we encourage you to call our claims staff if you would like additional information on any claim.

Financial Strength

Each of these examples includes information that is very important to the financial reports. In talking about the financial condition of the Fund, we often tell you that the Fund is “Financially Strong”. What does this mean? How is it measured?

The dominant expense of an insurance company is the cost of claims. Of the \$10 million of Total Expenses in the 2006 financials, \$8.6 million was “Losses and Loss Adjustment Expenses”. That is 86% of all of the Funds’ expenses. Even though this is a large figure, the question should be asked – Is it enough? In studying the cause of financial failure or weakening of insurance companies, almost every time, the cause will be inadequate reserves to pay the claims. Adding reserve amounts to past year claims is treated as a current year financial cost; the adding of these cost causes the subject insurance company to take major hits to its financial position. This was painfully the situation in the case of the Reciprocal of America. “Strength” means that there are sufficient reserves to pay claims with the financial capability to add to those reserves without significantly changing the financial condition of the company.

Let us look at this in more detail. And, contrast the Funds’ current situation to the causes of the Reciprocal of America’s failure. The first line of protection to having sufficient money to pay all claims is “Case Reserves”. A case reserve is the amount of money that the insurance company sets aside to settle a specific claim. Each time that a new claim is reported, the claims staff reviews the claim. Based on their past experience and the facts of the claim, they set a reserve amount which they feel will be sufficient to settle that claim. If the claim stays open for months or years, the claims staff periodically reviews the reserve for adequacy. If they feel that the reserve is too low or too high they will adjust the amount of the reserve as needed. In the case of large reserves, there are levels of authority or approval. In claims where the reserve gets to \$10,000 or \$25,000 or higher; additional levels of management or the Board must approve the claim reserve before it can be changed. In the Fund, management keeps a close eye on significant reserve changes, looking for patterns of repeated reserve increases or reductions. Either pattern indicates the potential for difficulties with a larger segment of the case reserves.

At ROA, management was intentionally and artificially lowering case reserves to increase the profit image. In the end, their large claim case reserves had no resemblance to the actual value of those claims.

A second line of protection is provided by IBNR – Incurred But Not Reported – reserves. These reserves are developed by the coordinated efforts of management and actuaries. The actuaries use sophisticated, mathematical trending models to predict the ultimate claim cost of all the claims of each year. As an example, the actuaries analyzed the 2004 claims as of December 31, 2006 in determining how much they felt it would ultimately cost to settle all of the 2004 claims. Management then works with the actuaries in selecting a projected ultimate cost of claims for each year. The ultimate claim cost minus the sum of what has already been paid plus the case reserves equals the Funds' IBNR reserve. This amount provides financial protection for the adverse development of a few special claims. We cannot accurately identify which claims will adversely develop. But, based on many years of data and experience the actuaries can predict the ultimate cost of all claims as a group.

There are several bodies that carefully analyze these ultimate claim cost for adequacy. The Fund uses an outside actuary – PricewaterhouseCoopers – to assist in the preparation of these figures for all years of operation, on an annual basis. An actuary's reputation is dependent on the quality and accuracy of their work. Additionally, the Certified Public Accountants are required by their audit standards to independently review the adequacy of the ultimate claim cost figures as part of their audit. Then, in addition to all the above, reports are submitted to the State of Alabama, Department of Industrial Relations, Workers' Compensation Self Insurance Department for their review. They also determine if the ultimate claims cost figures are adequate to pay all claims. Just a side, the IRS is also looking at these figures, but for a different reason. They do not want the Fund to be hiding profits from taxation. Therefore, they are looking to see if the amounts are overstated.

In the case of ROA, IBNR was being intentionally and artificially kept at a low, inadequate level. And, none of the reviewing bodies were reporting these inadequacies; until the end. At that point, they all did.

A third line of protection is reinsurance. The Fund purchases reinsurance for claims that exceed \$500,000 in cost. In other words, once a claims' cost reaches a total of \$500,000 the reinsurance program starts to reimburse the Fund for the cost above the \$500,000. Therefore, no one claim should cause the Fund a significantly adverse financial hit.

In the case of ROA, they had several layers of reinsurance programs. The first layer was inter-company between companies within the ROA organization. When one company got in trouble, it added to the troubles and downfall of the other companies. The second layer of reinsurance was with an outside reinsurance company. However, as the receiver has taken steps to recover claim cost, anticipated to be covered by reinsurance, they have discovered that there are conditions added to the reinsurance agreements not made available to the ROA Board or regulators. These conditions severely erode the amount of reinsurance recovery actually available.

Finally, above and beyond all the other lines of protection is a sum of money within the Fund that is not committed to any other liability. This is the "Member Equity" figure shown on the financial balance sheet report. In your 2006 report, this amount is

\$2.7 million. All of us can take some comfort that this amount is there to give us additional protection – Just In Case.

The Fund continues to maintain adequate case reserves and IBNR reserves. We have reinsurance with financially sound reinsurance companies. And, the Funds' "Member Equity" continues to increase at the direction of the Board. These are the reasons that we can tell you confidently that the financial position of the Fund has grown stronger each year.

Activity Report

During last years Members' Meeting, I talked about 3 projects which were underway. I would like to update you on those projects.

1. Warehousing Project. This computer project is now on line. Basic reports are being produced utilizing the data stored in the computer warehouse. However, the project is still ongoing and more reports are being designed or implemented.
2. Development of Third Party Administrator (TPA) Claim Services. During 2006, the Workers' Compensation Claims' Department continued to manage old ROA Workers' Compensation claims under TPA contracts. Marketing efforts have been initiated to add new contract clients.
3. Listening. Management has made staff aware that it is important to listen to our clients and to report ideas and suggestions for improvement to their managers. I hope that each of you could give us an example of where the Funds' staff has listened to you or someone from your organization.

Plans For The Coming Year

For the coming year, the following projects are underway to improve the Fund.

1. Member Claim Reports. The first of the new claim/loss reports was sent to the Members' recently. This new report is an improvement over past reports. And, provides information which should assist you in managing your claims experience and improving your risk management programs.
2. Profit Return Program. The Fund has reached a financial position which will allow it to start returning some of the profits to the Members. A profit return program is being developed which will continue to build "Member Equity", while taking a portion of projected profits and returning them to the Members. As this program is being developed, we are working closely with outside legal counsel and our auditors to ensure that the program is in compliance with applicable laws and financial reporting standards. The completed program will be presented to the Board for their review and approval in time to be effective this year.
3. Board of Trustee Transition. For the third year in a row, the Board of Trustees has replaced a Trustee. Two of these changes have occurred because of retirements. This is the case this year. Bob Chapman retired from Eastern

Health System and, due to Fund By-Law requirements left the Board. The Members have just elected Russ Tynner of Baptist Health, here in Montgomery, to fill that position. These transitions are positive as the new Board Members gain knowledge and understanding of the Funds' operations they present new ideas and ask questions not asked before.

Closing

In summary, it is a pleasure to tell you that your Fund is healthy and financially secure. With this, it can be proudly stated that the future for the Fund is bright and positive.

Mr. Chairman that concludes my comments.