Washington State Auditor
Brian Sonntag

January 31, 2010

Ms. Judy Schurke
Director
Department of Labor and Industries
PO Box 44000
Olympia WA 98504-4000

We have learned that some misinterpretation exists from our recent summary report on the legislative-mandated actuarial review of the Department of Labor and Industries' Workers' Compensation Funds. As you know, we contracted with the independent actuarial firm of Towers-Perrin, which conducted the actuarial review. Permit me to explain some of the report's conclusions in hopes it will clarify what the report reflects.

Certainly, we stand by the conclusions in our summary report and in Towers-Perrin's detailed reports. We are aware some interested parties have interpreted the reports to conclude the Workers' Compensation Funds are on the verge of collapse. I want to assure you that, in our opinion, the funds currently are financially strong. The Workers' Compensation System is able to pay claims and should be able to do so for many years. However, our audit report serves as an early warning that given the current economic climate, incurred investment losses, reasonable assumptions regarding projected investment yield, and projected future claims, the rates adopted in 2010 for both the Accident Fund and Medical Aid Fund are significantly lower than they should be.

State law (RCW 51.44.115) requires our Office to assess the financial impact of the proposed rate level on actuarial solvency in the Accident, Medical Aid and Pension Reserve Funds. If fund liabilities exceed assets, it creates a condition known as an "actuarial insolvency". Our summary report indicates a high probability of actuarial insolvency in the Accident Fund in the years ahead, based in part, on the premium rate levels adopted by the Department for 2010. But let me clarify that this statement simply reflects that the Fund's liabilities may exceed its assets, resulting in a draw down and elimination of the contingency reserve. But as stated in our summary report, the funds would continue to have sufficient assets to pay claims and to support the day-to-day services provided to workers and employers by your agency. Again, our report is a warning that if this condition continues, the future liabilities may exceed assets within a few years, creating a financial hole difficult to recover from.

There has also been some confusion about whether the Department's estimated "break-even" rate is reasonable. Our audit report states that the actuarial firm believes the Department's actuarial break-even rate increase of 23.3 percent is "outside a range of reasonable estimates" using an investment yield estimate of 4.2 percent. The Department's investment yield assumption is 5.37 percent. Given an assumption of a 5.37 percent investment yield, Towers Perrin stated that the Department's estimated "break-even" rate is reasonable. However, Towers Perrin believes a projected yield of 4.2 percent is more appropriate based on the Department's mix of invested assets and the firm's view of future investment performance.

Insurance Building, PO Box 40021 • Olympia, Washington 98504-0021 • (360) 902-0370 • TDD Relay (800) 833-6388
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The Department of Labor and Industries has adopted rates for 2010 that are below the "break-even" level in order to help mitigate the financial burden on businesses and workers during these difficult economic times. Our report points out that whether the projected investment yield is 4.2 percent or 5.37 percent, the 2010 rate increase of 4.5 percent for the Accident Fund is significantly below the "break-even" level; and using Towers Perrin's best estimate for an investment yield, the Medical Aid Fund rate 8.4 percent is also significantly below the "break-even" level.

As always, I appreciate the opportunity to work with you. If you have any questions, please let me know.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

cc: The Honorable Governor Chris Gregoire
The Honorable Senator Jeanne Kohl-Welles
The Honorable Representative Steve Conway