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June 30, 2023 Statement of Actuarial Opinion Regarding GAAP Reserves

State of Washington – Workers' Compensation Program

Identification

I, Rod Morris, am a Specialist Leader with the firm of Deloitte Consulting LLP. I am Fellow of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. I was appointed by the Washington State Auditors' Office to provide a Statement of Actuarial Opinion regarding the reasonableness of the State of Washington Workers' Compensation Program's ("the Program") carried Generally Accepted Accounting Principles ("GAAP") loss and loss adjustment expense reserves as of June 30, 2023. I meet the qualification standards promulgated by the American Academy of Actuaries and am appropriately qualified to perform these procedures and issue Statements of Actuarial Opinion. I have attested compliance with the Casualty Actuarial Society Continuing Education Policy as of December 31, 2022 to perform actuarial services in 2023.

The Program is comprised of four Workers' Compensation Program Accounts: the Accident Account, the Medical Aid Account, the Pension Reserve Account, and the Supplemental Pension Account. The Program is currently administered by State of Washington Department of Labor & Industries ("the Department").

The intended purpose of this opinion is to provide an opinion on the carried loss and loss adjustment expense reserves as of June 30, 2023. The intended users of this opinion are the Department and the State Auditor' Office. The loss and loss adjustment expense reserves are the responsibility of Department. My responsibility is to express an opinion on those reserves based on my review.

Scope

I have examined the loss and loss adjustment expense reserves as shown in the Program's Annual Comprehensive Financial Report as of June 30, 2023. I have reviewed the June 30, 2023 loss and loss adjustment expense reserves recorded under U.S. Governmental Accounting Standard GAAP. My review considered data evaluated as of June 30, 2023 and additional information provided to me through the date of this opinion.

In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by Mr. William Vasek, the Department's Chief Actuary, and his actuarial staff. I evaluated that data for reasonableness and consistency. In performing this evaluation, I have assumed that the Department (a) used its best efforts to supply accurate and complete data and (b) did not knowingly provide any inaccurate data. In other respects, my examination included the use of such actuarial assumptions and methods and such tests of the calculations as I considered necessary.

My review was limited to the loss and loss adjustment expense reserves listed below and did not include an analysis of any other balance sheet items. I have not examined the Program's assets and I have formed no opinion as to the validity or value of these assets.

Opinion

A summary of the Program's recorded loss and loss adjustment expense reserves by account in its Annual Comprehensive Financial Report as of June 30, 2023 is as follows:

Accident Account	$ 5,998,751,000
Medical Aid Account	4,282,003,000
Pension Reserve Account	5,930,706,000
Total Basic Plan Loss and LAE Reserves	$16,211,460,000
Supplemental Pension Account	23,460,000,000
Total Program Loss and LAE Reserves	$39,671,460,000

In my opinion, the loss and loss adjustment expense reserves listed above and displayed in the Program's Annual Comprehensive Financial Report as of June 30, 2023:

(A) meet the requirements of the insurance laws of the State of Washington;

(B) are consistent with reserves computed in accordance with accepted actuarial standards;

(C) make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Program under the terms of its contracts and agreements.

Relevant Comments

A. Company-Specific Risk Factors

Actuarial estimates of property and casualty loss and loss adjustment expense unpaid claims are inherently uncertain because they are dependent on future contingent events. Also, these unpaid claim estimates are generally derived from analyses of historical data, and future events or conditions may differ from the past. The actual amount necessary to settle the unpaid claims may therefore be significantly different from the reserves recorded in the Annual Comprehensive Financial Report.

The major factors and/or particular conditions underlying the risk and uncertainties that I consider relevant to the Department's estimates of unpaid losses and loss adjustment expenses as of June 30, 2023 are described in the sections below. These include but are not necessarily limited to the following items.

By statute, the Program's direct exposure is limited to one line of business (workers' compensation) in one state (Washington). Therefore, any adverse trends affecting this line of business and/or state could have a material effect on the Program's loss and loss adjustment expense reserves. Such trends would include legislative benefit level changes and adverse decisions or interpretations of law that may have an effect on all open workers' compensation claims.

A major assumption in the analysis of the medical component of the workers' compensation reserves is the selection of a long-term medical trend factor to apply to future calendar year medical payments. Estimating medical trend is difficult because it is highly variable. In my opinion, there is a higher than normal degree of variability associated with the Program's medical loss reserves due to the uncertainty surrounding future medical trends and the expected length of medical payments.

The Department discounts the loss and loss adjustment expense reserves to reflect the time value of money using an average annual interest rate of 1.97%. Changes to the interest rate used for discounting could result in material changes to the reserves. I note that the current risk free interest rate matching the duration of these liabilities (approximately 17.1 years) was 3.99% as of June 30, 2023, 3.26% as of June 30, 2022, 1.84% as of June 30, 2021, and 1.03% as of June 30, 2020.

A major assumption in the analysis of the Supplemental Pension Account and Pension Reserve Account is future cost of living adjustments and the implicit assumption that the State of Washington cost of living adjustments will be similar to cost of living adjustments approved by the Federal Government for Social Security retirement benefits. Future State of Washington cost of living adjustments different from those anticipated or that vary significantly from those approved by the Federal Government for Social Security retirement benefits could result in a material change in future costs and the adequacy of the loss and loss adjustment expense reserves.

B. Other Disclosures

Non-Workers' Compensation Pension Liabilities for State Employees

Statutory Accounting Principles ("SAP") do not require the Program to record a separate liability for the unfunded State employee non-workers' compensation pensions. However, the Program under SAP recognizes a portion of the unfunded state employee non-workers' compensation pension in the claims administrative expense ("CAE") liability for the portion pertaining to its claims administration.

GAAP requires the Program to record a liability for the total unfunded state employee pensions in its Annual Comprehensive Financial Report as of June 30, 2023. The CAE liability in the Annual Comprehensive Financial Report does not include any of the unfunded State employee pensions so as to not double count the liability. This difference in accounting results in a GAAP CAE liability that is approximately $11.7 million less than the SAP CAE liability.

Therefore, the GAAP reserve shown above upon which I am expressing an opinion excludes the liabilities for the unfunded State employee pensions for staff administering claims. The amounts excluded total $11.7 million ($3,704,000 for the Accident Account and $8,009,000 for the Medical Aid Account).

Discounting

The Department discounts the loss and loss adjustment expense reserves to reflect the time value of money. The amount of discount is based on an actuarially derived projected payment pattern and selected annual interest rates as follows.

- For the Medical Aid Account, the Department's selected interest rate is 1.5%.
- For "state Program pensions" within the Pension Reserve Account, the Department's selected interest rate is 4.0%.
- For "self-insured pre-funded pensions" within the Pension Reserve Account, the Department's selected interest rate is 5.6% consistent with the Washington administrative code rule WAC 296-14-8810. The rates selected for self-insured pre-funded pensions is allowed to be different from the rate selected for state fund pensions according to SB6393.
- For the Accident Account, combinations of interest rates are used to discount the reserves. The future total permanent disability and fatal transfers made to the Pension Reserve Account assume interest discounts based on an annual rate of 4.0%. The actual transfer payments and all other payments are discounted using a Department selected rate of 1.5%.
- For the Supplemental Pension Account, the Department's selected interest rate is 1.0%.

The average combined interest rate for the Program is approximately 1.97% with a total discount amount of $14.127 billion. The interest rates were selected by the Department, and I make no opinion regarding the appropriateness of the selected rates. I note that the current risk free interest rate matching the duration of these liabilities (approximately 17.1 years) was 3.99% as of June 30, 2023, 3.26% as of June 30, 2022, 1.84% as of June 30, 2021, and 1.03% as of June 30, 2020.

The interest rates used for the self-insured pre-funded pensions within the Pension Reserve Account changed from 5.7% last year to 5.6% this year. The interest rates used for the "state fund pensions" within the Pension Reserve Account remained the same at 4.0% this year. The interest rates used for the actual transfer payments and all other Accident Account, Medical Aid Account, and Supplemental Pension Account payments changed from 1.0% to 1.5% this year. The effect of changing these interest rate assumptions this year was an increase in the discounted reserve of $2.334 billion.

Underwriting Pools or Associations

The Program participates in the Washington United States Longshore and Harbor Workers' Compensation Act Assigned Risk Plan ("WARP") which was established to provide USL&H workers' compensation insurance coverage for employers unable to purchase it through the normal private insurance market. The Program pays assessments to WARP and participates in any underwriting losses or surpluses incurred by WARP. Based on discussions with the Department, I understand that WARP is not currently in a deficit position. Therefore, the Program has not booked a reserve to account for any unpaid claims related to WARP.

I understand that the Program does not participate in any other voluntary or involuntary pools.

Asbestos Exposures and Environmental Exposures

I have reviewed the Program's exposure to asbestos and environmental claims. There has been no reported claim activity. In my opinion, the chance of material liability related to asbestos and environmental claims is remote. The Program has not provided coverage that could reasonably be expected to produce material levels of asbestos and/or environmental liability claims activity.

Disclosure of Total Claims Made Extended Loss and Loss Expense Reserves

Department management has informed me that the Program does not provide extended reporting coverage at no additional charge in the event of death, disability, or retirement of the insured.

Disclosure of Accident and Health (A&H) Long Duration Contracts

Department management has informed me that the Program does not write A&H policies with contract terms of thirteen months or greater and for which contract reserves are required.

Disclosure of Unearned Premium Reserves for Property and Casualty (P&C) Long Duration Contracts

Department management has informed me that the Program does not write single or fixed premium policies with coverage periods of thirteen months or greater which are non-cancelable and not subject to premium increase (excluding financial guaranty contracts, mortgage guaranty policies, and surety contracts).

Reinsurance Collectability

Use of ceded reinsurance is minimal and is limited to catastrophic events and terrorism coverage at high limits in older years and once again purchased effective February 1, 2019 and subsequent. The current reinsurance program consists of two excess of loss contracts. The first excess of loss contract covers catastrophic or terrorism events that exceed $200 million up to $500 million per occurrence. The second excess of loss contract covers catastrophic or terrorism events that exceed $500 million up to $1.0 billion per occurrence. All reinsurers are rated A or better by AM Best. As of June 30, 2023, Fund management has informed me that it is not aware of any catastrophic events that would trigger a reinsurance recovery. Therefore, there are currently no ceded reserves recorded as of June 30, 2023 and no reinsurance collectability problems. With respect to loss and loss adjustment expense reserves net of ceded reinsurance, I have not anticipated any contingent liability which could arise if any of the reinsurers prove unable to meet their loss and loss adjustment expense obligations under the terms and conditions of their contracts with the Fund.

Retroactive Reinsurance, Financial Reinsurance

Based on discussions with Department management and its description of the Program's ceded reinsurance, I am not aware of any reinsurance contract that either has been or should have been accounted for as retroactive reinsurance or financial reinsurance.

Major Assumption Changes and Other Comments

The Supplemental Pension Account COLA adjustment for fiscal year 2024 of 2.01% was obtained from the Employment Security Department's State Average Annual Wage data and represents the change in calendar year 2022 wages. By statute, the COLAs are based on the annual calendar year change to the states' average wages and are somewhat lagged (e.g. the annual COLA change for fiscal year 2024 is based on the change in calendar year 2022 wages). This year, the Department used the Washington Economic Forecast Council's estimates for calendar years 2023 through 2025 as a proxy for COLA adjustments for fiscal years 2025 through 2027. The COLA adjustments for fiscal years 2028 through 2037 are projected by using a linear interpolation between the fiscal year 2027 COLA adjustment of 4.40% and a long-term constant COLA adjustment assumption of 1.5%. For projected COLA adjustments subsequent to fiscal year 2037, the Department uses the long-term assumption of 1.5% per year. I note that due to the current economic environment and the increase in the expected average wages in the state for the next few years, the effect of updating the future COLA assumptions from those used last year was an increase of $2.407 billion in the Supplemental Pension Account discounted liability at 1.5%.

During my review, I considered the Department's selection of future COLA adjustments. The Department's selections are lower than the most recent or long-term historical average of COLA adjustments. For example, the simple average of the most recent 15 years of COLA adjustments is 4.31% with annual changes varying between 2.79% (at the 30th percentile) and 4.93% (at the 70th percentile). These COLA adjustments have been at this level while interest rate and/or inflation rate changes have been declining during this same time period. The materiality of this assumption is significant given that selecting the most recent 15-year historical average COLA adjustment of 4.31% would increase the Supplemental Pension Account discounted liability by $11.997 billion (keeping the discount rate at 1.5%). The Department has assumed that there will be a significant correlation between changes in the future COLA adjustments and changes in the interest rates in the future even though the correlation between the two has been weak at best in the past.

It is difficult to determine the reasonableness of this future correlation considering it has not occurred in the past. Therefore, I have decided to consider the reasonableness of the Supplemental Pension Account liability assuming the historical average COLA adjustments. In doing so, I believe that the selection of the COLA adjustment should not be considered in isolation but in conjunction with the selection of the interest rate used to discount the liabilities.

I agree with the Department that wages long-term (and thus COLA Adjustments) will move in the same direction as inflation and the risk-free interest rates. In addition, I believe that there are alternative approaches to calculating the risk-free interest rate used to discount the liabilities that would be high enough to more than offset the low future COLA assumptions the Department is currently using. Therefore, I conclude that the Supplemental Pension Account liabilities are reasonable overall.

An implicit assumption in the Department's actuarial review is that the cost of living adjustments granted to the claimants in the State of Washington are going to be similar to the cost of living adjustments approved by the Federal Government for Social Security retirement benefit payments. The estimate of unpaid claims could be different, perhaps significantly, if these two cost of living adjustment rates were to diverge in the future.

Beginning in fiscal year 2020, the Department initiated a Workers' Compensation System Modernization (WCSM) project to update its policy, administration, and claim systems. It is estimated that a total of $30.4 million has already been spent as of June 30, 2023 of which none has been currently allocated to CAE payments. The anticipated future cost of WCSM is approximately $340.6 million over the next ten fiscal years. The Department assumes that approximately 2/3 of the cost will be claims related and will expense the allocated State Fund costs (i.e. excluding costs allocated to self-insureds) through its claims administration expense (CAE). The CAE related cost has been distributed to both future and historical fiscal accident years. The estimated amount allocated to fiscal-accident years 2023 and prior and included in the reserves as of June 30, 2023 totals $51.2 million on a discounted basis and $63.6 million on an undiscounted basis.

The assumed future medical growth rate was changed from 4.0% as of June 30, 2022 to 4.5% as of June 20, 2023. The effect of the change in the medical growth rate assumption this year was an increase in the discounted reserve in the Medical Aid Account of $265.0 million.

The Department has increased its assumption of the number of total permanent disability claims (TPD or pension claims) after claim administration staff identified several COVID-19 claims that indicated a strong potential to result in a TPD pension. To account for this, an adjustment was made to reflect the potential for more TPD COVID-19 pensions. The adjustment increased the number of TPD pension claims for the accident periods impacted by COVID-19 (beginning April 1, 2020 to present) by 6.58%. The adjustment resulted in an additional 212 TPD pensions and approximately $100 million.

C. COVID-19

The COVID-19 pandemic has impacted the number and severity of reported claims over the past 39 months. There has been a total of 11,312 compensable claims reported as of June 30, 2023. These claims represent 10.9% of the compensable claims for fiscal-accident year 2023, 21.2% of the compensable claims for fiscal-accident year 2022, 10.3% of the compensable claims for fiscal-accident year 2021 and 5.4% of the compensable claims for fiscal-accident year 2020. The total case incurred value of the COVID-19 claims as of June 30, 2023 is $62.2 million of which $50.8 million has been paid. The majority of these claims are very small in nature with only a handful of larger claims. However, there is some initial evidence that many of these claims may become TPD pension claims as discussed previously. The resultant shutdowns and economic downturn had an initial effect on the medical treatment, legal processes, and business operations but I believe that most of these indirect effects of the pandemic have stabilized as of June 30, 2023. In my analysis I have separated out the COVID-19 claims performing the analysis excluding these claims and then adding in a provision for unpaid COVID-19 claims. I have not incorporated estimated adjustments to the actuarial assumptions in consideration of the effects of the pandemic. However, I caution that the volatility and uncertainty of my projections related to the COVID-19 claim provision is high due to the potential number of TPD pensions in the future.

D. General Uncertainty

In evaluating whether the reserves make a reasonable provision for unpaid losses and loss adjustment expense, it is necessary to project future loss and loss adjustment expense payments. It is certain that actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. No warranty is expressed or implied that such variance will not occur. Further, my projections make no provision for the broadening of coverage by legislative action or judicial interpretation or for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Program's historical database or which are not yet quantifiable.

This Statement of Actuarial Opinion regarding GAAP loss and loss adjustment expense reserves is solely for the use of assessing the reasonableness of the GAAP loss and loss adjustment expense reserves and is only to be relied upon by the Program and the State of Washington.

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