

October 27, 2023

## June 30, 2023 Statement of Actuarial Opinion

### *State of Washington – Industrial Insurance Fund*

#### 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 Industrial Insurance Fund's ("the Fund") carried 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 Fund is comprised of three Workers' Compensation Program Accounts: the Accident Account, the Medical Aid Account, and the Pension Reserve Account. The Fund is currently administered by the 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's 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 reserves listed in Exhibit A, as shown in the Fund's Statutory Financial Information Report, as of June 30, 2023. The loss and loss adjustment expense reserves ("reserves") specified in Exhibit A, where applicable, include provisions for disclosure items (Disclosures 8 thru 12) in Exhibit B. I have reviewed the June 30, 2023 loss and loss adjustment expense reserves recorded under U.S. Statutory Accounting Principles. 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 items listed in Exhibit A, and did not include an analysis of any other balance sheet items. I have not examined the Fund's assets and I have formed no opinion as to the validity or value of these assets.

## Opinion

In my opinion, the amounts carried in Exhibit A on account of the items identified:

- (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 in the aggregate, both net of ceded reinsurance and direct and assumed, for all unpaid loss and loss adjustment expense obligations of the Fund 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 reserve amounts listed in Exhibit A.

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 Fund'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 Fund'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 Fund'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 2.90%. 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 15.6 years) was 3.95% as of June 30, 2023, 3.20% as of June 30, 2022, 1.76% as of June 30, 2021, and 0.95% as of June 30, 2020.

The Fund defines its “Contingency Reserve” as the difference between its assets and liabilities. Other insurance companies typically refer to this Contingency Reserve as Statutory Surplus. Due to the size of the Fund’s Contingency Reserve, \$4.699 billion, relative to the size of its loss and loss adjustment expense reserve, \$16.223 billion, any small changes in reserves will have a material impact on the Contingency Reserve. The current reserve leverage ratio (reserve / contingency reserve) is significantly higher than the majority of workers’ compensation carriers in the industry and workers’ compensation funds in other states.

An implicit assumption in the Department’s actuarial review is 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 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 reserves, especially for the Pension Reserve Account.

#### **B. Risk of Material Adverse Deviation**

With respect to this Statement of Actuarial Opinion, the amount of adverse deviation that I consider to be material is \$940 million. My basis for determining this amount is 20% of the Contingency Reserve. This amount represents a reasonable upward fluctuation in reserves from those carried by the Fund that would be material to the Contingency Reserve. My materiality standard was selected based on the context in which this opinion letter will be used. It is prepared solely to assess the reasonableness of the Fund’s loss and loss adjustment expense reserves. Other measures of materiality might be used for reserves that are being evaluated in a different context.

I believe there are significant risks and uncertainties with the Fund’s net loss and loss adjustment expenses that could result in material adverse deviation. I have identified those risk factors as the lack of diversity of exposure by line of business and by state, future medical trend, the discounting of the reserves, reserve leverage, and future cost of living adjustments. These risk factors are described in greater detail in the preceding paragraph and in the report supporting this opinion. The absence of other risk factors from this commentary is not meant to imply that additional factors cannot be identified in the future as having had a significant influence on the Fund’s reserves.

## C. Other Disclosures in Exhibit B

### 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 fund 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%.

The average combined interest rate for the Program is approximately 2.90% with a total discount amount of \$7.549 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 was 3.95% as of June 30, 2023, 3.20% as of June 30, 2022, 1.76% as of June 30, 2021, and 0.95% 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 and Medical Aid Account payments changed from 1.0% last year to 1.5% this year. The effect of the change in the interest rate assumptions this year was a decrease in the discounted reserve of \$414.6 million.

### Underwriting Pools or Associations

The Fund 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 Fund 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 Fund has not booked a reserve to account for any unpaid claims related to WARP.

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

### **Asbestos Exposures and Environmental Exposures**

I have reviewed the Fund'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 Fund 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 Fund 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 Fund 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 Fund 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).

### **Other items on which the Appointed Actuary is providing Relevant Comments disclosed in Exhibit B**

## **D. Reinsurance**

### **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 Fund'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.

## **E. Methods and Assumptions**

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.

#### **F. 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.

#### **G. 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 Fund's historical database or which are not yet quantifiable.

## **Actuarial Report**

An actuarial report and underlying actuarial workpapers supporting the findings expressed in this Statement of Actuarial Opinion will be provided to the Department to be retained for a period of seven years in the administrative offices of the Department and available for regulatory examination.

This Opinion is solely for the use of assessing the reasonableness of the loss and loss adjustment expense reserves and is only to be relied upon by the Fund and the State.

A handwritten signature in black ink that reads "Rod Morris". The signature is written in a cursive style with a large, sweeping initial "R".

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*October 27, 2023*

Statement of Actuarial Opinion – Year Ended June 30, 2023

*State of Washington Industrial Insurance Fund*

Exhibit A: SCOPE

<b><u>Loss and Loss Adjustment Expense Reserves:</u></b>	
1. Unpaid Losses (Liabilities, Surplus and Other Funds page, Col 1, Line 1)	\$15,267,934,000
2. Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Col 1, Line 3)	<u>\$955,239,000</u>
<b>Total Net Loss and Loss Adjustment Expense Reserves</b>	<b>\$16,223,173,000</b>
3. Unpaid Losses – Direct and Assumed (Schedule P, Part 1, Summary, Totals from Cols. 13 and 15, Line 12 * 1,000)	\$15,267,934,000
4. Unpaid Loss Adjustment Expenses – Direct and Assumed (Schedule P, Part 1, Summary, Totals from Cols. 17, 19 and 21, Line 12 * 1,000)	<u>\$955,239,000</u>
<b>Total Direct and Assumed Loss and Loss Adjustment Expense Reserves</b>	<b>\$16,223,173,000</b>
5. The Page 3 write-in item reserve, “Retroactive Reinsurance Reserve Assumed”	\$
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately, adding additional lines as needed)	\$
<b><u>Premium Reserves:</u></b>	
7. Reserve for Direct and Assumed Unearned Premiums for P&C Long Duration Contracts	\$
8. Reserve for Net Unearned Premiums for P&C Long Duration Contracts	\$
9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately, adding additional lines as needed)	\$

**Statement of Actuarial Opinion – Year Ended June 30, 2023**

***State of Washington Industrial Insurance Fund***

**Exhibit B: DISCLOSURES**

<b><u>Item:</u></b>			
1. Name of the Appointed Actuary	<b>Last</b>	<b>First</b>	<b>Middle</b>
	Rodney	Scott	Morris
2. The Appointed Actuary's Relationship to the Fund. Enter E or C based upon the following: E if an Employee of the Fund or Group C if a Consultant	C		
3. The Appointed Actuary's Accepted Actuarial Designation (indicated by the letter code): F if a Fellow of the Casualty Actuarial Society (FCAS) A if an Associate of the Casualty Actuarial Society (ACAS) S if a Fellow of the Society of Actuaries (FSA) through the General Insurance track M if the actuary does not have an Accepted Actuarial Designation but is approved by the Academy's Casualty Practice Council. O for Other	F		
4. Type of Opinion, as identified in the OPINION paragraph. Enter R, I, E, Q, or N based upon the following: R if Reasonable I if Inadequate or Deficient Provision E if Excessive or Redundant Provision Q if Qualified. Use Q when part of the OPINION is Qualified. N if No Opinion	R		
5. Materiality Standard expressed in U.S. dollars (Used to answer Question #6.)	\$939,738,000		
6. Are there significant risks that result in Material Adverse Deviation?	YES <input checked="" type="checkbox"/> [X] NO <input type="checkbox"/> [ ] N/A <input type="checkbox"/> [ ]		
7. Statutory Surplus (Contingency Reserve)	\$4,698,690,000		

Statement of Actuarial Opinion – Year Ended June 30, 2023

*State of Washington Industrial Insurance Fund*

**Exhibit B: DISCLOSURES**

<b><u>Item:</u></b>	<b><u>Amount</u></b>
8. Discount included as a reduction to loss reserves and loss adjustment expense reserves	
8.1 Non-tabular Discount	\$1,738,966,000
8.2 Tabular Discount	\$5,810,234,000
9. The net reserves for losses and loss adjustment expenses for the Fund's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and loss adjustment expenses	N/A
10. The net reserves for losses and loss adjustment expenses that the Fund carries for the following liabilities	
10.1 Asbestos	\$0
10.2 Environmental	\$0
11. The total claims made extended loss and loss adjustment expense reserve	
11.1 Amount reported as loss and loss adjustment reserves	\$0
11.2 Amount reported as unearned premium reserves	\$0
12. The net reserves for A&H Long Duration Contracts that the Fund carries	
12.1 Losses	\$0
12.2 Loss Adjustment Expenses	\$0
12.3 Unearned Premium	\$0