

October 25, 2024

**June 30, 2024 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 a 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, 2024. 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, 2023 to perform actuarial services in 2024.

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 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, 2024. 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, 2024. I have reviewed the June 30, 2024 loss and loss adjustment expense reserves recorded under U.S. Governmental Accounting Standard GAAP. My review considered data evaluated as of June 30, 2024 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, 2024 is as follows:

| | |
|--|-----------------------|
| Accident Account | \$ 6,390,428,000 |
| Medical Aid Account | 4,082,266,000 |
| Pension Reserve Account | <u>6,003,556,000</u> |
| Total Basic Plan Loss and LAE Reserves | \$16,476,250,000 |
| Supplemental Pension Account | <u>27,177,000,000</u> |
| Total Program Loss and LAE Reserves | \$43,653,250,000 |

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, 2024:

- (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, 2024 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 1.96%. 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 17.8 years) was 4.59% as of June 30, 2024, 4.06% as of June 30, 2023, 3.52% as of June 30, 2022, and 2.10% as of June 30, 2021.

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. 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 \$6.548 billion. My basis for determining this amount is 15% of the Program's Loss and LAE Reserves. This amount represents a reasonable upward fluctuation in reserves from those carried by the Program that would be material to the "Total Net Position" of the Program. 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 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 net loss and loss adjustment expenses that could result in material adverse deviation. These risk factors are described in section A above 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 reserves. The Program's "Total Net Position" is in a deficit position which adds to the risk that small changes in reserves could have a material effect on the "Total Net Position". In addition, a "Total Net

Position" with a growing deficit position will increase the need for more premiums since the liabilities will have less and less investment income to cover the future payments of the liabilities.

C. 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, 2024. 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 \$12.3 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 \$12.3 million (\$3,971,000 for the Accident Account and \$8,281,000 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 5.5% 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 1.5%.

Actuarial Standard of Practice No. 20: "Discounting of Property/Casualty Claim Estimates" applies to actuaries when performing actuarial services that involve the discounting of claim estimates for property/casualty coverages to a present value. The standard also requires disclosure of certain information regarding the actuary's use of discounting. The intended purpose of the discounted

estimates is to provide perspective on the impact of the time value of money on the estimates at the annual interest rate provided and used for discounting. In the discount calculations, it is assumed that interest payments will be made in the middle of each successive development period and that the selected payment patterns will apply in the future. The paid development patterns used are based upon the patterns selected in the underlying analysis.

The average combined interest rate for the Program is approximately 1.97% with a total discount amount of \$16.132 billion. The interest rates were selected by the Department. The Department's selected interest rate for non-pension liabilities has been selected to equal a benchmark risk-free rate less a risk adjustment percentage. According to the Department,

"this rate is then rounded to the nearest half percentage point. The current benchmark rate is the five-year average of the 20-Year U. S. Treasury yield. The duration of the 20-Year US Treasury is closer to the duration of the liabilities than other benchmark U.S. Treasury bonds. This five-year average was 2.839% as of June 30, 2024. The five-year averaging provides a balance between stability of the selection and responsiveness to economic conditions. The Department uses daily data from the US Federal Reserve for this calculation. The risk adjustment for the non-pension liabilities is two percentage points when the benchmark rate is over 4.0% and half the benchmark rate when the benchmark rate is under 4.0%. The indicated rate for the June 30, 2024 liabilities in the Accident Account and Medical Aid Account is therefore 1.5% ($2.839\% - \frac{1}{2} \times 2.839\% = 1.419\% = 1.5\%$ after rounding to the nearest half percent.)"

I believe that the selected combined interest rate of 1.96% is reasonable based on the duration of the unpaid claim estimates of 17.8 years and the Treasury risk-free returns of 4.43% to 4.64% for 15-year and 20-year maturities as of the June 30, 2024. While the rate selected by the Department is lower than the referenced rates, an explicit risk margin beyond what is implicit in the referenced rates may be appropriate to consider the inherent uncertainty in the timing and amount of payments underlying the unpaid claim estimates.

The interest rates used for the self-insured pre-funded pensions within the Pension Reserve Account changed from 5.6% last year to 5.5% 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 remained the same at 1.5% this year. The effect of changing these interest rate assumptions this year was an increase in the discounted reserve of \$5.8 million.

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).

Deductible Recovery Collectability

Department management has informed me that it does not have material exposure to uncollectable deductibles that are unsecured. With respect to the loss and loss adjustment expense reserves, I have not anticipated any contingent liability for situations where the deductible recoveries are uncollectable and unsecured.

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 with companies rated A or better by a recognized rating agency. The Department 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, 2024 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 Program.

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 2025 of 5.91% was obtained from the Employment Security Department's State Average Annual Wage data and represents the change in calendar year 2023 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 2025 is based on the change in calendar year 2023 wages). This year, the Department used the Washington Economic Forecast Council's estimates for calendar years 2024 through 2026 as a proxy for COLA adjustments for fiscal years 2026 through 2028. The COLA adjustments for fiscal years 2029 through 2038 are projected by using a linear interpolation between the fiscal year 2028 COLA adjustment of 4.00% and a long-term constant COLA adjustment assumption of 2.3%. For projected COLA adjustments subsequent to fiscal year 2038, the Department uses the long-term assumption of 2.30% per year. We 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 \$2.789 billion in the Supplemental Pension Account discounted liability at 1.5%.

During our review, we 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 4.47% with annual changes varying between 2.79% (at the 30th percentile) and 5.41% (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 4.47% would increase the Supplemental Pension Account discounted liability by \$15.893 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, we have decided to consider the reasonableness of the Supplemental Pension Account liability assuming the historical average COLA adjustments. In doing so, we 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.

We do 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, we 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, we 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. The anticipated future cost of WCSM is approximately \$253.7 million over the next ten fiscal years, as of June 30, 2024. 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 2024 and prior and included in the reserves as of June 30, 2024 totals \$46.3 million on a discounted basis and \$50.2 million on an undiscounted basis.

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.

A handwritten signature in black ink that reads "Rod Morris". The signature is fluid and cursive, with a long horizontal line extending from the start of the name.

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