

April 13, 2004

Circular 2004-03

To: All Members of the Indiana Compensation Rating Bureau
Re: Mail Vote of All Members - Proposed Creation of the Indiana Workers
Compensation Reinsurance Pool (IRP)

By a vote of eleven to one, the Governing Board of the Indiana Compensation Rating Bureau has recommended approval of a proposal to create a state-specific pooling mechanism to replace our current affiliation with the National Workers Compensation Reinsurance Pool. Although the Governing Board has the authority to make this decision, they decided to place it before all Member Carriers for consideration.

An overview of the current and proposed reinsurance mechanisms is provided on the following pages. Complete details can be obtained from our website at www.icrb.net. Click on the Assigned Risk tab at the top of the page, and then on the white sticky note in the left hand column. The password to gain access to the White Paper document is xxxxx.

ITEM

PROPOSED EFFECTIVE DATE

Establishment of the Indiana Workers
Compensation Reinsurance Pool

January 1, 2005

Please complete the mail vote information on the attached duplicate copy and return it in the enclosed stamped envelope by May 5, 2004.

Unless we hear to the contrary by that date, we will assume you are voting in the affirmative and will proceed with the filing process.

Ronald W. Cooper
President

To the President:

Date _____

I vote in the affirmative _____

I vote in the negative _____

Signature _____

Printed _____

Company _____

INDIANA WORKERS COMPENSATION REINSURANCE POOL (IRP)

INTRODUCTION

The Workers Compensation Rating Bureau of Indiana ("ICRB") is a statutorily created independent rating bureau. Ind. Code §27-7-2-5. The ICRB is comprised of all insurance companies that hold a certificate to make workers compensation insurance in the State of Indiana. The ICRB is organized as an unincorporated association. A Governing Board comprised of twelve members directs and oversees the operations of the ICRB.

The ICRB performs numerous services, many of which are required by statute. The ICRB works closely with the Indiana Department of Insurance ("IDOI"), and in many cases the ICRB's activities are closely monitored and approved by IDOI.

One of the ICRB's important functions is to serve as the Plan Administrator of Indiana's Assigned Risk Plan (the "Plan"). The Plan is a statutorily created reinsurance mechanism whereby employers who are unable to self-insure or procure insurance in the voluntary market, may apply to the ICRB for their mandatory workers compensation insurance coverage.

The most significant feature of the Plan is the method by which claims and losses are ultimately paid. While a Servicing Carrier provides normal insurance services for an employer in the Plan, the Servicing Carrier is not primarily liable for the losses and claims. All members of the ICRB as statutory reinsurers proportionately share all losses and claims incurred in the Plan. Ind. Code §27-7-2-29. An ICRB member's share of these losses and claims are calculated based upon the member's gross premiums written in the State of Indiana.

CURRENT REINSURANCE MECHANISM

The ICRB Governing Board is the Plan/Pool Administrator in Indiana and in 1970 elected to meet the statutory requirement through participation in the National Workers Compensation Reinsurance Pool (NWCRP).

The NWCRP is a pooling or "sharing" arrangement. It is not an entity or company. There are no employees to do any work. The Pool is an "arrangement" or reinsurance mechanism that insurance companies join and agree on how they will share in the losses, state-by-state. Each state's financial results are kept separate. Once an insurance company signs the Articles of Agreement, it becomes a member of the National Pool.

The handling of insurance premiums is a unique feature of the NWCRP. While the Servicing Carrier collects the premium, it retains only a small percentage to compensate the Servicing Carrier for its administrative services. The percentage is determined by the ICRB with review and approval by IDOI.



INDIANA WORKERS COMPENSATION REINSURANCE POOL (IRP)

The balance of the premium is then collected by the NCCI, as administrator of the NWCRP, and redistributed quarterly to ICRB members. ICRB members hold those premiums and utilize the monies to pay their share of the losses and claims incurred by the Plan until they are subsequently assessed, or *called back*. Sometimes, losses, claims and expenses incurred in the Plan exceed premiums collected. As statutory reinsurers, ICRB members must fund any shortfall, including amounts owed by companies that have become insolvent. No public dollars are involved in this process.

Although the NWCRP never has secured an IRS ruling on its tax status, it has operated since its inception as a non-taxable pooling arrangement. NWCRP funds are taxed only at the carrier level.

The ICRB has no direct involvement in the management of the NWCRP, or authority over its operations. The NWCRP is governed by a group of 12 member carrier representatives writing workers compensation insurance in any of the 22 National Pool states.

PROPOSED REINSURANCE MECHANISM

The Indiana Workers Compensation Reinsurance Pool would hold and invest funds at the Pool level, and make distributions to and assessments from Pool member companies based on operating surplus and losses, not cash flow. Although carriers would lose the opportunity to directly invest the funds while losses are maturing, they would not forfeit investment income. Rather, the ICRB would invest the funds on the carriers' behalf, while virtually eliminating the financial burden associated with carrier insolvencies. Since the premiums for several policy years will be collected long before the losses of the first policy year are completely paid, the Pool will accumulate a substantial amount of investable funds. Investment of these funds provides a significant additional revenue source for the Plan, but perhaps more importantly, these funds are the security provided by the member companies to ensure their ability to meet their financial obligations to the Pool. It is anticipated that Funds would be invested solely in securities of the highest quality, U.S. government and agency bonds, under the direction of a proposed IRP Advisory Board.

There is a potential, believed to be remote, that the IRS could impose taxation on any surplus distributions at both the Pool and carrier levels. (The financial impact of the worst-case scenario on individual carriers would be minimal.) However, a 1956 IRS ruling confirmed the non-profit, tax-exempt status of the ICRB's operations at that time. ICRB's legal counsel advises that a tax ruling need not, and should not, be requested from the IRS, as the 1956 tax ruling would not be impacted by the creation of the IRP. This topic will be discussed further at the June 10, 2004 meeting of the Governing Board.



The Advisory Board would consist of five of the ICRB Governing Board representatives, who are elected to two-year terms by all Members present at the ICRB annual meeting.

Administration services would be provided by Compensation and Insurance Services (CIS), a Mississippi general partnership which has operated the Mississippi Workers Compensation Assigned Risk Pool since that State withdrew from the NWCRP in 1993. CIS would provide the ICRB all systems and processing protocols, and provide the training and assistance necessary for the ICRB to absorb all Pool administration functions in-house, at a later date, if the ICRB chooses to do so. Most of all outside professional services (legal, banking, audit, etc.) would be located in Indiana and the Board and other similar meetings would take place in Indianapolis.

CONCLUSION

A comprehensive White Paper on the creation of a stand-alone Indiana Pool is available to Member carriers at www.icrb.net/assigned_risk/. Except with regard to financial Pool reports, the proposed change would be transparent to Member carriers. All Plan services associated with Assigned Risk policies would stay the same.

The *Executive Overview* pages of the White Paper list advantages and disadvantages associated with the IRP. The Governing Board concluded the advantages of the proposed pooling mechanism far outweigh the disadvantages. The centerpiece of the proposed Pool is the cash flow arrangement that would virtually eliminate the risk of insolvency. (Carriers were required to contribute \$1.5 million for the three-year period 2001 – 2003 related to Indiana insolvencies under the National Pool model.) Certain Board members have been outspoken in favor of establishing localized control of the Indiana Pool, and the Indiana Department of Insurance would prefer such an arrangement.

A carrier needs to be mindful, however, of the loss of direct control over the investment of its portion of Pool funds, and the elimination of the cash flow associated with the NWCRP. There also is a potential, albeit remote, that the IRS could impose taxation on any surplus distributions at both the Pool and carrier levels.

If you have questions or comments, you may contact either:

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