



2004 Casualty Loss Reserve Seminar

SOP 97-3

Department of Labor Special Fund Assessments

September 13, 2004

Bill Stanfield, ACAS, MAAA

Agenda

- Overview of SOP 97-3
- The DOL Special Fund
- Assessment Projection Methods

Overview of SOP 97-3

- Statement of Position 97-3: “Accounting by Insurance and Other Enterprises for Insurance-Related Assessments”
- Released in 1997, effective for financial statements for fiscal years beginning after December 15, 1998
- Provides
 - Guidance for determining when an entity should recognize a liability for assessments
 - Guidance on measuring the liability – discounting permitted if the amount and timing of the payments are fixed or reliably determinable
 - Requirements for disclosure of certain information

Overview of SOP 97-3

- Applicability
 - General: all entities including non-insurance companies that are subject to guaranty fund or *other insurance related assessments*
 - Specific: requires accrual for future assessments that result from claims which have already occurred that will be paid in the future
- Recognition of Liabilities
 - Assessment has been imposed, or information available prior to issuance of financial statements indicates it is probable that an assessment will occur, and
 - The obligating event (loss incurred) has occurred on or before the date of the financial statements, and
 - The amount of the assessment can be reasonably estimated

The DOL Special Fund

- A federal second-injury fund administered by the Secretary of the Treasury, created in 1972
- Only those employees covered under the USL&H Act
- Also called the Section 8(f) Special Fund
 - Determination of second-injury payments falls under § 8(f) of the USL&H Act
- Purpose: “...established to give effect to a congressional policy determination that, under certain circumstances, the employer of a particular employee should not be required to bear the entire burden of paying for the compensation benefits due that employee under the Act. Instead, a substantial portion of such burden should be borne by the industry generally.”

The DOL Special Fund

- Established to encourage employers to hire employees with previous or existing injuries
- Compensates injured employees when a current work-related injury combines with a prior disability to create an increased combined disability
- After 104 weeks of receiving lost time or medical payments from the employer, an individual is eligible to be “placed” into the Special Fund, and then receives indemnity payments directly from the Fund

The DOL Special Fund

- To qualify for Special Fund relief, an employer must show
 - The employee had a pre-existing partial disability
 - The employer was aware of the partial disability
 - The disability rendered the second injury more serious than it otherwise would have been
- The Fund generates revenue to pay these claims by assessing employers based on the employer's retained compensation (indemnity) payments and the employer's usage of the Fund

The DOL Special Fund

- DOL determines annual assessments based on the average of two ratios:
 1.
$$\frac{\text{Company Paid Indemnity Loss}}{\text{Industry Paid Indemnity Loss}}$$
 2.
$$\frac{\text{Special Fund 8(f) Indemnity Payments Made on Behalf of the Company}}{\text{Special Fund Industry 8(f) Payments}}$$

multiplied by the Fund's estimated expenses for the current year, currently \$137 million

Assessment Projection Methods

- Duration Approach
- Cash Flow Approach
- Ratio Approach

Assessment Projection Methods

Sample DOL Assessment Bill

Bill For Collection

Bill No.
July 14, 2004

U.S. Department of Labor

Employment Standards Administration
Office of Workers' Compensation Programs
Division of Longshore and Harbor Workers' Compensation

2004 Final Assessment Due: \$4,272,426

*This bill should be returned by
the payer with this remittance.
See instructions below.*

WORKER'S COMPENSATION PAYMENT	AMOUNT
2003 Company Compensation Payments	14,088,367
2003 Total Compensation Payments	368,769,923
SPECIAL FUND DATA	AMOUNT
2003 Company 8(f) Participation	9,064,202
2003 Total 8(f) Participation	107,564,601
2004 Special Fund Estimated Expenses	137,000,000

FORMULA FOR ASSESSMENT
*(2003 Company Compensation Payments / 2003 Total Compensation Payments) +
 (2003 Company 8(f) Participation / 2003 Total 8(f) Participation)
 DIVIDED BY 2 X 2004 Special Fund Estimated Expenses = ASSESSMENT*
 OR
 $(14,088,367 / 368,769,923) + (9,064,202 / 107,564,601) / 2 \times 137,000,000 = 8389277$

CALCULATION	AMOUNT
2004 Final Assessment	8,389,277
2004 Less Assessment Paid	4,116,851
Less Credit	0
Plus Interest (*)	0
2004 Final Assessment Due	\$4,272,426

INSTRUCTIONS
 Payment is due within 30 days from the date of the bill.
 DO NOT combine any payments.
 Please send your check with a copy of this bill to:
 Department of Labor, P.O.Box 371088M, Pittsburgh, PA 15251

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Assessment Projection Methods

Relevant Portion of DOL Bill

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OR	
$(14,088,367 / 368,769,923) + (9,064,202 / 107,564,601) / 2 \times 137,000,000 = 8389277$	

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Assessment Projection Methods

- Duration Approach
 - Average annual assessment times factor (duration)
 - Useful when
 - Historical assessment data is not available or is limited
 - Need a quick estimate
 - Need for caution
 - Examples of durations (discounted)
 - Low: 5
 - Average: 8
 - High: 12

Assessment Projection Methods

- Cash Flow Approach
 - Project future cash flows for each data element used in the assessment formula
 - Assessment formula (prior calendar year statistics): average of
 1. $\frac{\text{Company Paid Indemnity Loss}}{\text{Industry Paid Indemnity Loss}}$
 2. $\frac{\text{Special Fund 8(f) Indemnity Payments Made on Behalf of the Company}}{\text{Special Fund Industry 8(f) Payments}}$

times the Fund's estimated annual expenses for the current year
 - Useful when cash flows can be reasonably estimated
 - Many assumptions
 - Example

Assessment Projection Methods

Cash Flow Example

- Historical data from DOL bills

Calendar Year	Entity Paid Indemnity Loss	Industry Paid Indemnity Loss	Entity-to Industry Ratio	Entity 8(f) Indemnity Payments	Industry 8(f) Indemnity Payments	Usage Ratio	Average Ratio	Special Fund Estimated Expenses	Entity Assessment
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
1994	\$14,207,229	\$360,565,582	0.0394	\$5,035,177	\$86,603,583	0.0581	0.0488	\$116,000,000	
1995	13,221,978	347,127,157	0.0381	5,710,306	92,247,718	0.0619	0.0500	118,000,000	\$5,755,045
1996	13,660,360	350,710,876	0.0390	6,383,495	98,481,434	0.0648	0.0519	113,000,000	5,649,525
1997	13,464,634	334,319,947	0.0403	6,667,174	98,396,527	0.0678	0.0540	110,000,000	5,707,337
1998	12,231,351	342,503,543	0.0357	7,580,010	98,809,028	0.0767	0.0562	111,000,000	5,995,827
1999	14,273,733	353,071,178	0.0404	8,834,844	103,318,103	0.0855	0.0630	130,000,000	7,307,647
2000	14,263,714	358,603,454	0.0398	8,394,372	107,790,409	0.0779	0.0588	130,000,000	8,185,999
2001	14,438,700	373,930,223	0.0386	9,130,513	107,631,824	0.0848	0.0617	133,000,000	7,823,893
2002	13,734,927	362,392,867	0.0379	8,682,756	105,579,082	0.0822	0.0601	125,000,000	7,715,271
2003	14,088,367	368,769,923	0.0382	9,064,202	107,564,601	0.0843	0.0612	125,000,000	7,508,751
2004	14,100,000	369,000,000	0.0382	9,100,000	108,000,000	0.0843	0.0612	137,000,000	8,389,277
Total	\$151,684,993	\$3,920,994,750	0.0387	\$84,582,849	\$1,114,422,309	0.0759	0.0573	\$1,348,000,000	\$61,649,295

Assessment Projection Methods

Cash Flow Example

- Project the required payment streams

Calendar Year	Entity	Industry	Entity-to-Industry Ratio	Expected SIF	Expected SIF	Usage Ratio	Average Ratio	Projected	Undiscounted
	Expected Paid Indemnity Losses	Expected Paid Indemnity Losses		Payments to Entity 8(f) Claimants	Industry 8(f) Indemnity Payments			Special Fund Estimated Expenses	
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
2005	\$14,151,670	\$370,110,000	0.0382	\$8,824,437	\$108,320,000	0.0815	0.0599	\$139,000,000	\$8,511,710
2006	12,202,498	371,220,000	0.0329	9,043,445	108,640,000	0.0832	0.0581	141,000,000	8,439,044
2007	10,704,241	372,330,000	0.0287	9,263,998	108,970,000	0.0850	0.0569	143,000,000	8,302,126
2008	9,552,116	373,450,000	0.0256	9,445,885	109,300,000	0.0864	0.0560	145,000,000	8,247,857
2009	8,662,216	374,570,000	0.0231	9,525,714	109,630,000	0.0869	0.0550	147,000,000	8,231,976
2010	7,988,098	375,690,000	0.0213	9,464,984	109,960,000	0.0861	0.0537	148,000,000	8,141,141
2011	7,428,214	376,820,000	0.0197	9,295,430	110,290,000	0.0843	0.0520	149,000,000	7,996,761
2012	7,027,898	377,950,000	0.0186	9,075,783	110,620,000	0.0820	0.0503	150,000,000	7,799,595
2013	6,606,907	379,080,000	0.0174	8,797,011	110,950,000	0.0793	0.0484	151,000,000	7,598,280
2014	6,145,348	380,220,000	0.0162	8,607,715	111,280,000	0.0774	0.0468	152,000,000	7,350,481
2015	5,800,354	381,360,000	0.0152	8,277,578	111,610,000	0.0742	0.0447	153,000,000	7,153,857

Assessment Projection Methods

- Ratio Methods
 1. Assessment-to-indemnity ratio method (total)
 2. Assessment-to-indemnity ratio method (component)
 - Apply ratio to liabilities
 - Easy to use
 - Assumptions
 - Examples

Assessment Projection Methods

Ratio Methods

- Data based on DOL bills

Calendar Year	Assessment Breakdown		Indemnity Assessment as % of Entity Indemnity Payments	Usage Assessment as % of Entity 8(f) Payments	Ratio of Total Assessment to Total Paid Indemnity
	Due to Paid Indemnity Experience	Due to 8(f) Usage			
	[1]	[2]	[3]	[4]	[5]
1994					
1995	\$2,324,755	\$3,430,290	0.164	0.681	0.299
1996	2,152,069	3,497,456	0.163	0.612	0.298
1997	2,142,277	3,565,060	0.157	0.558	0.285
1998	2,235,246	3,760,581	0.166	0.564	0.298
1999	2,321,254	4,986,393	0.190	0.658	0.369
2000	2,627,778	5,558,221	0.184	0.629	0.354
2001	2,645,086	5,178,807	0.185	0.617	0.345
2002	2,413,335	5,301,936	0.167	0.581	0.327
2003	2,368,791	5,139,960	0.172	0.592	0.335
2004	2,616,952	5,772,325	0.186	0.637	0.362
Total	\$23,847,542	\$46,191,030	0.173	0.612	0.329

Assessment Projection Methods

Assessment-to-indemnity ratio method (total)

- Ratio times total indemnity reserve base
 - Ratio =
$$\frac{\text{total assessment}}{\text{paid on indemnity claims} + \text{paid on 8(f) claims}}$$
 - Reserve base = USL&H indemnity reserves + 8(f) indemnity reserves
- Tends to understate the accrual
 - Based on loss - does not reflect upward trend in Fund expenses over time
- Does not differentiate between trends in compensation and participation

Assessment Projection Methods

Assessment-to-indemnity ratio method (component)

- Component 1 – Compensation assessment
 - Ratio times indemnity USL&H reserves
 - Ratio = $\frac{\text{indemnity portion of assessment}}{\text{paid indemnity loss}}$
- Component 2 – Participation assessment
 - Ratio times 8(f) indemnity reserve
 - Ratio = $\frac{\text{8(f) usage portion of assessment}}{\text{paid 8(f) indemnity loss}}$
- Differentiates between trends in compensation and participation
- Also tends to understate the accrual, but to a lesser extent than Method 1

Assessment Projection Methods

How large are the Special Fund assessment liabilities?

- Ratio of Special Fund Assessment Liability to USL&H Liability, discounted

	All Entities	Excluding High/Low
Low	15%	17%
Average	44%	39%
High	107%	65%

- Special Fund assessments can be material to financials

Summary

- SOP 97-3 requires the accrual of liabilities for future assessments from the Special Fund resulting from incurred claims that will be paid in the future
- Special Fund assessments are separate from, and in addition to, state second-injury fund assessments
- Methods are available to estimate the accrual
- Accruals are likely to be material to the financial statements

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Presenter's contact details
Bill Stanfield, ACAS, MAAA
KPMG LLP
(404) 222 7642
wgstanfield@kpmg.com