Board of Governors
Future Calendar of Events
Revised October 14, 2010

BOG 2010 Meeting Schedule

Committees Meetings at OSB Center	Board Meeting Various Locations	BOG Meeting Locations	Special Events in Conjunction w/Meetings
	November11-13	*Timberline Lodge*	*Board Retreat, Board Mtg., Local Bar Social*

BOG 2011 Meeting Schedule

Committees Meetings at OSB Center	Board Meeting Various Locations	BOG Meeting Locations	Special Events in Conjunction w/Meetings
January 7	*February 17-19*	*Phoenix Grand, Salem*	*President's Reception, Lunch w/Supreme Court, Dinner w/ONLD, Leadership College*
March 18- 50-yr Lunch	*April 14-16*	*TBD*	*Board Meeting, Regional Bar Social*
May 20	*June 23-25*	*Tigard*	*Board Meeting, Past BOG Dinner, PLF Joint Mtg.*
July 29	*August 25-27*	*Pendleton*	*Board Meeting, Regional Bar Social*
September 23	*November 4*	*Tigard*	*HOD Annual Meeting (10:00 a.m.)*
	November 17-19	*The Allison, Newberg*	*BOG Planning Retreat, Regional Bar Social*

Upcoming Events
BOG members are encouraged to attend

Lawyer Referral Fair and CLE	*November 19*	*Convocation on Equality*	*November 4, 2011*

Upcoming Events/Meetings of Interest

SPRB

November 13	2010	Tigard
December 17	Conference Call	

Professional Liability Fund Board

Dec. 10	2010	Tigard

National/Regional Meetings

Feb. 9-15 *Midyear Mtg.*	2011	NABE/NCBP/ABA Atlanta, GA
March 10-11	2011	BLI Chicago, IL
March 30- April 2	2011	WSBC Maui, Hawaii
April 12-14	2011	ABA Day in Washington Washington, DC
Aug. 4-9 *Annual Meeting*	2011	NABE/NCBP/ABA Toronto, Canada
Feb. 1-7 *Midyear Meeting*	2012	NABE/NCBP/ABA New Orleans, LA
April 17-19	2012	ABA Day in Washington Washington, DC
Aug. 2-7 *Annual Meeting*	2012	NABE/NCBP/ABA Chicago, IL
Feb. 6-12 *Midyear Meeting*	2013	NABE/NCBP/ABA Dallas, TX
Aug. 8-13 *Annual Meeting*	2013	NABE/NCBP/ABA San Francisco, CA
Aug. 7-12 *Annual Meeting*	2014	NABE/NCBP/ABA Boston, MA
July 30-Aug. 4 *Annual Meeting*	2015	NABE/NCBP/ABA Chicago, IL

OREGON STATE BAR
MEETING OF THE BOARD OF GOVERNORS
Schedule of Events
October 29, 2010
10/15/2010 12:02 PM

Meeting Place	OSB Center 16037 SW Upper Boones Ferry Rd. Tigard, OR 97281-1935	**Phone:**	503-620-0222

<u>Friday, October 29, 2010</u>

8:00 a.m. – 9:00 a.m.	**BOG Meeting** McKenzie
8:30 a.m. – 9:30 a.m.	**CLE –** ***Professional Strategies for Dealing with Unprofessional Conduct*** Columbia A & B
10:00 a.m. – 2:00 p.m.	**HOD Meeting** Columbia A & B

Oregon State Bar
Meeting of the Board of Governors

October 29, 2010

Special Meeting Open Session

Draft

The Open Session Meeting of the Oregon State Bar Board of Governors will begin at 8:00 a.m. on October 29, 2010.

Friday, October 29, 2010 8:00 a.m.

1. Ratification of BOG Action of September 24, 2010 Meeting

A.	Ratify Approval of HOD Agenda	3
B.	Ratify Approval of Executive Director Contract	4
C.	Ratify Appointment to Council on Court Procedures	4

2. Approval of PFL 2011 Assessment

A.	2011 Excess Rates	5-6
B.	2011 Primary Program Assessment and 2011 Budget	7-46

3. Public Affairs Committee

A. Update

4. Good of the Order (Non-action comments, information and notice of need for possible future board action)

OREGON STATE BAR
Board of Governors Agenda

Meeting Date: October 29, 2010
Memo Date: October 5, 2010
From: Teresa Wenzel, Ext. 386
Re: Ratify Action of BOG September 24, 2010 Meeting

Action Recommended

A. Approve HOD Agenda

1. The board voted unanimously to approve the preliminary HOD Agenda. Due to its late arrival and *Keller* issues, the board voted unanimously to oppose inclusion of the Resolution to Encourage the Effective and Efficient Administration of Justice.

2. The BOG took the following position on HOD resolutions:

   a. No action taken on HOD Resolution No. 1.

   b. The board voted unanimously to oppose Resolution for Repeal of ORS 419B.010 and 9.114 – House of Delegates Resolution No. 2 and Mr. Piucci will present for the board.

   c. The board voted unanimously to oppose Resolution to Amend ORPC 7.1 – 7.3 – House of Delegates Resolution No. 3 and Ms. DiIaconi will present for the board.

   d. The board voted unanimously to oppose Resolution to Amend Bar Rule 8.2 – House of Delegates Resolution No. 4 and Mr. Haglund will present for the board

   e. The board voted unanimously to oppose Resolution to Amend ORS 133.060 – House of Delegates Resolution No. 5 and Mr. Knight will present for the board.

   f. The board voted unanimously to oppose Pricing of Oregon State Bar Products and Services – House of Delegates Resolution No. 6 and Mr. Kent will present for the board.

B. The board unanimously voted to approve the committee motion to accept the contract with Sylvia Stevens for the position of Executive Director.

C. For information only: The Nominating Committee recommended Mitzi Naucler to the board as its 2011 President-elect. The board will be asked to approve the committee recommendation at its November meeting. No action was taken at the September 24, 2010 meeting.

D. The board unanimously voted to approve appointment of Jennifer Gates to the Council on Court Procedures.

OREGON STATE BAR
Board of Governors Agenda

Meeting Date: October 29, 2010
Memo Date: October 11, 2010
From: Ira Zarov – CEO Professional Liability Fund
Re: 2011 Excess Rates

Action Recommended

The PLF BOD requests that the current rates for Excess Coverage be approved as set out in the accompanying attachment.

Background

In addition to its primary coverage, the PLF provides optional excess coverage to Oregon attorneys. The excess coverage is completely reinsured. Rates are determined through negotiations between the PLF and the excess reinsurers, usually Lloyds of London syndicates. Each year's rates are based on the ongoing PLF experience and predicted future trends, as well as in-person discussions between representatives of the PLF and reinsurers.

As a result of those discussions and an analysis of relevant factors, the Excess Rates for in-state lawyers will remain the same as 2010. The rates for out-of-state lawyers incorporate the proposed increase in the primary assessment to $3500. The rates are attached.

Attachment

Proposed 2011 PLF Excess Program Rates

Coverage Level	Class 1 Rates	Class 2 Rates	Non-Oregon Class1 Rates	Non-Oregon Class 2 Rates
$700,000	$882	$1,589	$4,382	$5,089
$1,700,000	$1,644	$2,827	$5,144	$6,327
$2,700,000	$2,391	$4,040	$5,891	$7,240
$3,700,000	$2,749	$4,622	$6,249	$8,122
$4,700,000	$2,978	$4,994	$6,478	$8,491
$9,700,000	$5,006	$8,288	$8,506	$11,788

OREGON STATE BAR
Board of Governors Agenda

Meeting Date: October 29, 2010
Memo Date: October 11, 2010

From: Ira Zarov – CEO PLF
Re: Assessment and Budget

Action Recommended

Approve the 2011 Budget and Assessment.

Background

On an annual basis the BOG approves the PLF budget and the assessment for the coming year. This year, the recommendation is to raise the assessment from $3200 to $3500. The assessment is set based on the actuary report and budget. The attached materials contain the proposed budget and recommendations concerning the assessment. (Included in the materials is a September 20, 2010 memo to the PLF Board relating to claim liabilities and the recent actuarial report. The BOG does not approve claim liabilities.)

This is the first assessment increase since 2007. As the accompanying memo indicates, the increase is driven by claims experience. The PLF has experienced three successive years of very high claims frequency with well over 900 claims in each. In addition, previous claim years have also developed at higher than expected amounts and we are concerned with the recent trends. There also has been a concomitant increase in projected severity for 2011.

Another factor supporting the increased assessment is the absence of retained earnings. Retained earnings are reserves above the expected outstanding claim liabilities. On advice of the actuaries, the Board has set a goal of $12 million for retained earnings. Retained earnings are important because they allow the Board flexibility when deciding whether to increase the assessment in a particular year. A final reason to set the assessment at $3500 is to increase the likelihood of maintaining the assessment at a stable level for a period of years. Predictability is important to covered parties.

Setting the assessment at the requested $3500 will allow the PLF to remain financially sound, stabilize the assessment absent a significant increase in severity or frequency, and make progress towards building retained earnings.

The accompanying memo provides a more in-depth description of the budget and recent claims experience.

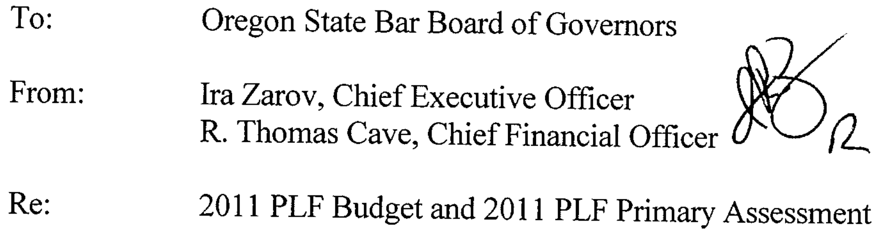
Attachment

Professional Liability Fund

Oregon State Bar

Ira R. Zarov
Chief Executive Officer

October 11, 2010



To: Oregon State Bar Board of Governors

From: Ira Zarov, Chief Executive Officer
R. Thomas Cave, Chief Financial Officer

Re: 2011 PLF Budget and 2011 PLF Primary Assessment

I. Recommended Action

At the October 8, 2010 meeting of the Professional Liability Fund Board of Directors adopted the following recommendations to the Board of Governors:

1. Approve the 2011 PLF budget as attached. This budget uses a 2011 salary pool recommendation of 3.0 percent. This recommendation has been made after consultation with Sylvia Stevens.

2. Setting the PLF Primary Assessment for 2011 assessment at $3,500, which is an increase of $300 from the 2010 assessment. (The last time the assessment was increased was 2007.)

II. Executive Summary

1. The reason for the increase in the assessment is poor claim results. The frequency of new claims has been up significantly for three years in a row. We project 960 claims for 2010. We had only 780 claims in 2006 and 2007. The recent actuarial rate study increases the frequency factor for projected 2011 claim costs.

   In addition, pending claims have developed worse than expected. The latest actuarial calculation of claim liabilities increased the liability for pending claims by more than $1 million; primarily because of poor results for the 2008 and 2009 claim years. This report also indicated that the severity of claims is increasing particularly on the expense side (e.g. defense costs). The actuaries raised the recommended average cost for new claims by $500 because of the trends pointing toward increased expense severity.

503.639.6911 I Oregon Toll Free: 1.800.452.1639 I Fax: 503.684.7250 I www.osbplf.org
Street Address: 16037 SW Upper Boones Ferry Rd. I Suite 300 I Tigard, OR 97224
Mailing Address: PO Box 231600 I Tigard, OR 97281-1600

2. There are increases to the operating budget. This budget adds an IT position but overall employee FTE will be about the same as 2010. This budget includes a salary pool of 3.0 percent. We anticipate an increase in the employer cost of PERS of about six percent of salaries for the second half of 2011 (and for all of 2012). This budget includes a $300,000 PLF contribution for the OSB Bar Books. Even with theses increases, operating expenses continue to be a small fraction of claim costs. Increases in operating expenses are not the reason for the assessment increase.

3. This $300 increase should allow the PLF to have a stable assessment of $3,500 for several years. We are concerned that an additional assessment increase will be necessary in 2012 if the assessment increase is less than $300 for 2011.

III. 2011 PLF Budget

Number of Covered Attorneys

We have provided the number of covered attorneys by period for both the Primary and Excess Programs. (The figures are found on pages 1 and 8 of the budget document.) These statistics illustrate the growth in the number of lawyers covered by each program and facilitate period-to-period comparisons.

For the Primary Program, new attorneys paying reduced primary assessments and lawyers covered for portions of the year have been combined into "full pay" units. We currently project 6,902 full-pay attorneys for 2010. Our estimate for 2011 assumes growth of 1.5 percent from our 2010 projection which translates to 7,006 full-pay attorneys.

Although the Excess Program covers firms, the budget lists the total number of attorneys covered by the Excess Program. Participation in the Excess Program did not grow significantly during 2008 and 2009. Because of competition from commercial insurance companies, participation declined for 2010. We currently project 2010 excess program participation at 2,400 lawyers which is about 240 fewer than was expected. We project 2011 participation to remain at 2010 levels (no growth). If you include the other providers of excess insurance, more than 50% of the practicing lawyers in Oregon have excess insurance.

Full-time Employee Statistics (Staff Positions)

We have included "full-time equivalent" or FTE statistics to show PLF staffing levels from year to year. FTE statistics are given for each department on their operating expense schedule. The following table shows positions by department:

	2010 Projections	2011 Budget
Administration	9.10 FTE	8.90 FTE
Claims	18.60 FTE	18.00 FTE
Loss Prevention (includes OAAP)	11.83 FTE	11.83 FTE
Accounting	4.90 FTE	5.90 FTE
Excess	1.00 FTE	1.00 FTE
Total	**45.43 FTE**	**45.63 FTE**

We continue to have some permanent positions staffed at less than full-time levels for both 2010 and 2011. Some staff members work from 33 to 36 hours per week. These part-time arrangements fit the needs of both the employee and the PLF. Part-time and staff changes are the reason for the fractional FTE's.

The 2011 budget includes a new information technology position. The PLF has used outside contractors for data processing support for many years. The PLF's use of technology has grown significantly in recent years and user training and necessary software changes have often been delayed. It is no longer economical to use outside parties. We feel that training and system support will be better provided by a full-time in-house position. While some of the costs of this position will be offset by reductions in professional service expense, the primary purpose of this position is to provide support and training that is not currently being done.

This budget drops one claims secretary position and a partial clerical position in the administration department. The overall FTE in the 2011 proposed budget is slightly more than 2010 projections but it is less than that the FTE in the adopted 2010 budget.

Allocation of Costs between the Excess and Primary Programs

In 1991, the PLF established an optional underwritten plan to provide excess coverage above the existing mandatory plan. There is separate accounting for Excess Program assets, liabilities, revenues and expenses. The Excess Program reimburses the Primary Program for services so that the Primary Program does not subsidize the cost of the Excess Program. A portion of Primary Program salary, benefits, and other operating costs are allocated to the Excess Program. These allocations are reviewed and adjusted each year. The Excess Program also pays for some direct costs, including printing and reinsurance travel.

Salary and benefit allocations are based on an annual review of the time PLF staff spends on Excess Program activities. The current allocation includes percentages of salaries and benefits for individuals specifically working on the Excess Program. The duties of each individual are reviewed and the allocations are modified with each budget cycle.

Besides specific individual allocations, fourteen percent of the costs of general claims personnel and twelve percent of all loss prevention personnel are allocated to the Excess Program. The total 2011 allocation of salary, benefits and overhead is about 18.86 percent of total administrative operating expense. (The 2010 allocation was 18.66 percent.)

Primary Program Revenue

Projected assessment revenue for 2010 is based upon the $3,200 basic assessment paid by an estimated 6,902 attorneys. The budget for assessment revenue for 2011 is based upon a $3,500 assessment and 7,006 full-pay attorneys. Primary Program revenue also includes our forecast for SUA collections of $183,000 for 2010 and $185,000 for 2011. This budget assumes that there is no change in the current SUA policies.

The investment environment was very poor for the first six months of 2010. There was an investment loss of about $534,000 compared to the gain of $1.049 million that was expected in the budget. Although there was strong recovery for investments during July, there was a large decline in August. Our investment return projections for the remainder of 2010 and for 2011 began with the (low) June 30, 2010 market value of all current investments. Investment revenue was calculated from June forward using the rates of return for the different asset categories recommended by R. V. Kuhns & Associates, Inc. (3% for the short-term cash flow bond fund, 5% for intermediate bonds, 8.15% for domestic equities, 8.60% for foreign equities, 7.75% for hedge fund of funds, 7% for real estate, and 6.75% for absolute return). These rates of return are lower than historical figures but reflect the current reduced expectations of our investment consultants. The overall combined expected rate of return for 2011 is about 7.21 percent.

Primary Program Claims Expense

For any given year, claim expense includes two factors – (1) the cost of new claims and (2) any additional upward (or downward) adjustments to the estimate of costs for claims pending at the beginning of the year. Factor 1 (new claims) is much larger and much more important than factor 2. However, problems would develop the effects of factor 2 were never considered, particularly if there were consistent patterns of adjustments. The "indicated average claim cost" in the actuarial report calculates an amount for factor 1. The report also discusses the possibility of adding a margin to the indicated costs. Adding a margin could cover additional claims costs from adverse development of pending claims (factor 2) or other possible negative economic events such as poor investment returns. We have included margins in the past several years to good effect.

The PLF experienced an increase in the frequency of new claims during 2008 and 2009. This frequency level has continued during 2010. (Other NABRICO companies have reported a similar increase in claims frequency.) We currently project 960 new claims for 2010 at a cost of $19,500 per claim.

The 2010 budget included $690,000 (approximately $100 per covered party) for adverse development or actuarial increases to estimates in liabilities for claims pending at the start of the year. The adjustment recommended in the June 30, 2010 actuarial review of claim liabilities was greater than this budget amount ($1 million). Most of the adjustment came from adverse development of pending claims from recent claim years. In particular, the expense severity increased for the 2008 and 2009 claims years. In their review, the actuaries recommended increasing the average cost figure for expense. (Claims expense is defined as payments made to individuals other than the claimant; e.g., defense costs.) We do not know if pending claims will continue to develop adversely. It is very possible that the December 31, 2010 actuarial adjustment will be positive rather than negative. However, we continue to have concerns about the effects of the ongoing poor economy on claims and we feel it is prudent to project an additional adverse adjustment of $500,000 for the second half of 2010.

Primary Program new claims expense for 2011 was calculated using figures from the actuarial rate study. The study assumed a frequency rate of 14 percent, 7,006 covered attorneys and an average claim cost of $19,500. Multiplying these three numbers together gets a 2011 budget for claims expense of $19,126,380. This would also translate to about 981 claims for 2011.

We have added a margin of $200 per covered lawyer to cover adverse development of claims pending at the start of 2011. If pending claims do not develop adversely, this margin could offset even greater 2011 claims frequency or cover other negative economic events. This pending claims budget for adverse development is equal to $1,401,200 ($200 times the estimated 7,006 covered attorneys). The concept of using a margin will be discussed again in the staff recommendation section regarding the 2011 assessment.

Salary Pool for 2011

The total dollar amount that is available for staff salary increases in a given year is calculated by multiplying the salary pool percentage increase by the current employee salary levels. The salary pool is the only source available for cost of living *and* merit increases. Although there is no policy requiring them, the PLF and OSB historically provide increases to staff that are generally consistent with cost-of-living adjustments.

After consultation with Sylvia Stevens, a three percent salary pool increase is recommended for 2011. The salary pool is used to adjust salaries for inflation, to allow normal changes in classifications, and when appropriate to provide a management tool to reward exceptional work. As a point of reference, one percent in the salary pool represents $37,328 in PLF salary expense and $10,865 in PLF benefit costs.

In the past, PLF budgets have often also included additional funds for potential salary reclassification. For example, the 2010 budget included $26,000 for potential salary reclassification. Salary reclassifications generally occur in two circumstances, when a person hired at a lower salary classification achieves the higher competency required for the new classification, or when there is a necessity to change job requirements. The 2011 budget does not include any additional funds for reclassification. All salary adjustments, including reclassification, will be done with the three percent salary pool.

The salary for the PLF's CEO position was reviewed during the closing months of 2009. The 2010 budget had already been prepared and did not include any amounts for CEO salary adjustments other than the normal salary pool that was applied to all PLF positions. After various salary studies, the CEO's was adjusted to be consistent with comparable positions. Since the budget did not anticipate this adjustment, the amount above the salary percentage was charged to the contingency item on page 1 of the budget. The costs of salary consultants and retroactive salary adjustments were charged to the 2009 contingency item.

The 2011 salary pool of three percent includes the CEO position.

Benefit Expense

The employer cost of PERS and Medical / Dental insurance are the two largest benefit costs for the PLF.

The specific employer contribution rate for PERS varies depending upon how long an employee has participated in PERS. The rates are changed periodically based upon actuarial studies of the PERS pension liability. Prior to July 1, 2009, the PLF paid between 12.49 percent and 13.98 percent of employee salary to PERS. As of July 1, 2009, the rates changed to 8.01 percent and 8.79 percent which was a drop of nearly 5 percent of salary. The rates are expected to increase as of July 1, 2011. After consultation with PERS, our best estimate is that the rates for the second half of 2011 will increase by a little more than six percent from currently levels. Since the change will come half way through the year, the 2011 budget will have an increase for the cost of PERS of about 3 percent of salaries. Assuming that the increase continues until July of 2013, the 2012 budget will have an additional increase of about 3 percent since the rate adjustment will apply to all of 2012.

Unlike many state employers, the PLF does not "pick up" the employee contribution to PERS. PLF employees have their six percent employee contribution to PERS deducted from their salaries.

PLF employees pay for a portion of the cost of providing medical and dental insurance to dependents. The cost of medical insurance continues to rise faster than salary levels. Although medical insurance rates are difficult to predict, we have included about a 10 percent increase for the cost of medical and dental insurance.

Capital Budget Items

The 2008 column of the capital budget schedule (page 8) shows the large one-time costs relating to moving into the new Bar Center.

The PLF continues to implement a document management system and the paperless office. The capital budget schedule includes the cost of copiers / scanners, hardware and software related to this project. Storing documents electronically has allowed the PLF to reduce or eliminate the amount of office space dedicated to storage and file rooms.

The 2010 budget anticipated continued replacement of aging personal computers and network servers. Personal computer changes include larger computer monitors to allow better viewing of documents in a paperless setting.

The 2011 budget allows for some additional expenditure for scanners and other equipment related to electronic document storage. Some aging personal computers and network servers are also expected to be replaced.

Other Primary Operating Expenses

The PLF has traditionally had defense panel meetings every other year. The last meeting was in 2009. The claims department is preparing a trial college for late 2010 specifically geared to defense panel members with limited trial experience. This trial college will be held at the Oregon State Bar Center. The costs of the trial college were not anticipated in the 2010 budget; however, expenses are expected to be much less than the normal defense panel.

The 2011 budget includes the costs of the planned defense panel meeting in Salishan. Defense panel members pay for their own lodging and meal expenses and some additional costs. The PLF does pay the cost of staff lodging and meals and a portion of supplies and speakers.

The 2011 budget includes the cost of the PLF's $300,000 contribution to the Oregon State Bar Bar Books. This contribution was made pursuant to a vote by the PLF Board of Directors at the request of the Oregon State Bar Board of Governors. The BOD believes there was substantial loss prevention value in access to Bar Books via the internet which has the potential to reduce future claims. The $300,000 contribution is part of an agreement which provides the PLF will contribute an additional $200,000 in 2012 and another $100,000 in 2013. At that time the Bar Books project is expected to be self-supporting.

For many years, the PLF Primary Program has included a contingency budget item. For 2011, we included a contingency budget of equal to 2 percent of operating costs ($143,391). As was discussed earlier, costs relating to adjustments to the CEO's salary were charged to that item for 2009 and 2010. At this time, we are unaware of any item that might be charged to contingency for 2011.

Total Operating Expenses and the Assessment Contribution to Operating Expenses

Page one of the budget shows projected 2010 Primary Program operating costs to be slightly lower than the budget amount.

The 2011 Primary Program operating budget is 9.23% higher than the 2010 budget and 9.77% greater than the 2010 projections. The main reasons for the increase from projections are the 3 percent salary increase, the higher costs of PERS and medical insurance, and the PLF contribution to Bar Books.

Excess Program Budget

The major focus of this process is on the Primary Program and the effects of the budget on the 2011 Primary Program assessment. We do include a budget for the Excess Program (page 8). Several firms switched from the PLF Excess Program to commercial competition for 2010 coverage. As a result, the number of attorneys covered by PLF Excess for 2010 was lower than was anticipated by the 2010 budget. We expect competition to continue and we do not anticipate any growth in participation for 2011.

The major revenue item for the Excess Program is ceding commissions. These commissions represent the portion of the excess assessment that the PLF gets to keep and are based upon a percentage of the assessment (premium) charged. Most of the excess assessment is turned over to reinsurers who cover the costs of resolving excess claims. We currently project ceding commission of $760,000 for 2010. The 2011 budget estimates ceding commissions to remain at this level.

After three or four years from the start of a given plan year, the two reinsurance treaties covering the first $5 million provide for profit commissions if excess claim payments are low. If there are subsequent adverse developments, prior profit commissions are returned to the reinsurance companies. In recent years, excess claims have increased and it is quite difficult to predict profit commissions in advance. As a result, no profit commissions have been included in the 2010 projections or 2011 budget.

Excess investment earnings were calculated using the same method described in the Primary Program revenue section.

The major expenses for the Excess Program are salary, benefits, and allocations from the Primary Program that were discussed in an earlier section.

IV. <u>Actuarial Rate Study for 2011</u>

This is the fourteenth time we have received a rate study from our actuaries to assist us in establishing the annual assessment. The attached rate study focuses on the estimate of the cost of 2011 claims. It relies heavily on the analysis contained in the actuaries' claim liability study as of

June 30, 2010. The methodology used in that study is discussed by separate memorandum. The rate study only calculates the cost of new 2011 claims. It does not consider adjustments to pending claims, investment results, or administrative operating costs.

The actuaries estimate the 2011 claim cost per attorney using two different methods. The first method (shown on Exhibit 1) uses regression analysis to determine the trends in the cost of claims. Regression analysis is a statistical technique used to fit a straight line to number of points on a graph. It is very difficult to choose an appropriate trend. Because of the small amount and volatility of data, different ranges of PLF claim years produce very different trend numbers. The selection of the starting and ending points is very significant. For the PLF, including a low starting point such as 1987 or a very high ending point such as 2000 skews the straight line upward. Because of these problems, the actuaries do not favor using this technique to predict future claim costs.

The second method (Exhibit 2) involves selection of expected claim frequency and claim severity (average cost). Claims frequency is defined as the number of claims divided by the number of covered attorneys. For the indicated amount, the actuaries have used a 2011 claims frequency rate of 14 percent and $19,500 as the average cost per claim (severity). The frequency rate is higher than the last rate study and the average cost is the same. The frequency rate was increased from 13.5 percent because 2010 is the third year in a row with higher frequency of claims. We felt the $19,500 severity factor was a little high last year; however, it looks to be more appropriate now given the increases in expense severity found in the 2008 and 2009 claim years.

We feel both the frequency and severity choices are reasonable. The actuaries prefer the result found with this second method. Their indicated average claim cost is $2,730 per attorney. This amount would only cover the estimated funds needed for 2011 new claims.

It is necessary to calculate a provision for operating expenses not covered by non-assessment revenue. As can be seen in the budget, the estimate of non-assessment revenue does not cover the budget for operating expenses. The 2011 shortfall is about $485 per lawyer assuming 7,006 full-pay lawyers.

The actuaries discuss the possibility of having a margin (additional amount) in the calculated assessment. On pages 8 and 9 of their report, the actuaries list pros and cons for having a margin in the assessment.

V. Staff Recommendations

If you add the operating expense portion of $485 per lawyer to the actuaries' indicated claim cost of $2,730, you would have an assessment of $3,215. We feel that it is appropriate to include a margin of $200 per attorney for adverse development of pending claims. This allows for a budget of about $1.4 million for adverse development of pending claims. While this amount sounds high, it is less than our current 2010 projection for adverse development ($1.5 million). An assessment of $3,500 would allow a projected budget profit of about $595,000.

We are concerned with trends found in the latest actuarial review of claims. There has been a significant increase in claims frequency for three years in a row. There are indications of increases in claims severity, particularly with the expense portion. This report indicates adverse development of pending claims and recommends an increase in claims expense of over $1 million for the first six months of 2010. It is very possible that future actuarial adjustments could be positive instead of negative. However, given recent trends, it seems prudent to provide for negative development in 2010 and 2011.

The PLF currently has negative combined retained earnings of about $500,000. The Board of Directors has a long-term goal of $12 million positive retained earnings. A 2011 assessment with some margin makes it more likely that some small progress will be made toward that retained earnings goal.

If we increase the assessment, we would like to maintain the assessment at that level for several years. Most Oregon attorneys prefer a stable assessment. We have some concerns about additional operating expenses in 2012. The cost of PERS for 2012 will be significantly higher than 2011. We are likely to have some additional costs in 2012 relating to the transition of senior PLF employees toward retirement. (The additional IT position in the 2011 budget is a first step in that direction.) An increase of $300 would make it more likely that we will be able to avoid addition assessment increases for a few years.

The PLF Primary assessment has been $3,200 since 2007. Current CPI figures indicate that there has been 12 percent inflation from the start of 2007 through the current date. If that 12 percent figure was applied to the 2007 assessment of $3,200, the assessment would be $3,584.

Given the factors discussed above, the PLF staff feels that the current Primary Program assessment should be raised $300 for 2011. Accordingly, we recommend setting the 2011 Primary Program assessment at $3,500.

The Professional Liability Fund Board of Directors adopted the recommendations contained in this memo at their October 8, 2010 meeting. The Oregon State Bar Board of Governors approves the PLF budget and assessment for the coming year.

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
2011 PRIMARY PROGRAM BUDGET
Presented to PLF Board of Directors on October 8, 2010

	2008 ACTUAL	2009 ACTUAL	2010 BUDGET	2010 PROJECTIONS	2011 BUDGET
Revenue					
Assessments including SUA	$21,592,781	$21,913,959	$22,234,000	$22,268,956	$24,706,000
Installment Service Charge	309,604	333,900	339,000	350,000	355,000
Investments and Other	(7,034,566)	4,805,068	2,099,556	611,024	2,211,854
Total Revenue	$14,867,819	$27,052,927	$24,672,556	$23,229,980	$27,272,854
Expenses					
Provision for Claims					
New Claims	$17,526,950	$18,648,114	$18,156,353	$18,525,000	$19,126,380
Pending Claims	($1,441,560)	$91,673	$690,000	$1,500,000	$1,401,200
Total Provision for Claims	$16,085,390	$18,739,787	$18,846,353	$20,025,000	$20,527,580
Expense from Operations					
Administration	$1,761,493	$1,977,797	$1,946,373	$2,029,739	$2,334,991
Accounting	501,569	525,401	539,816	538,845	663,146
Loss Prevention	1,699,410	1,679,807	1,787,078	1,709,070	1,782,238
Claims	1,900,729	2,163,248	2,290,352	2,253,788	2,389,198
Total Operating Expense	$5,863,201	$6,346,253	$6,563,619	$6,531,442	$7,169,573
Contingency	94,802	28,028	131,272	22,660	143,391
Depreciation	139,874	193,239	191,000	215,000	231,000
Allocated to Excess Program	(1,196,155)	(1,235,837)	(1,257,082)	(1,257,082)	(1,393,740)
Total Expenses	$20,987,112	$24,071,470	$24,475,162	$25,537,020	$26,677,804
Net Income (Loss)	($6,119,293)	$2,981,457	$197,394	($2,307,040)	$595,050
Number of Full Pay Attorneys	6,694	6,797	6,897	6,902	7,006

CHANGE IN OPERATING EXPENSES:

Increase from 2010 Budget	**9.23%**
Increase from 2010 Projections	**9.77%**

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
2011 PRIMARY PROGRAM BUDGET
CONDENSED STATEMENT OF OPERATING EXPENSE
Presented to PLF Board of Directors on October 8, 2010

	2008 ACTUAL	2009 ACTUAL	2010 BUDGET	2010 PROJECTIONS	2011 BUDGET
Expenses					
Salaries	$3,344,850	$3,640,425	$3,791,586	$3,759,711	$3,880,231
Benefits and Payroll Taxes	1,004,012	1,037,568	1,067,982	1,038,277	1,230,380
Professional Services	272,272	365,413	292,300	404,081	360,050
Early Termination of Lease	(86,196)	0	0	0	0
Auto, Travel & Training	99,936	78,177	87,450	79,600	84,750
Office Rent	490,270	475,857	490,000	483,648	490,903
Office Expense	182,798	159,840	179,200	177,300	172,300
Telephone (Administration)	19,967	26,247	34,000	34,000	34,000
L P Programs	438,240	426,127	508,800	440,783	483,200
OSB Bar Books	0	0	0	0	300,000
Defense Panel Program	0	19,230	0	3,700	20,700
Insurance	60,191	60,520	64,001	60,842	62,059
Library	20,167	31,341	27,500	25,500	26,000
Memberships & Subscriptions	14,940	18,605	15,800	19,000	20,000
Interest & Bank Charges	1,754	6,903	5,000	5,000	5,000
Other	0	0	0	0	0
Total Operating Expenses	$5,863,201	$6,346,253	$6,563,619	$6,531,442	$7,169,573
Allocated to Excess Program	($1,155,334)	($1,202,476)	($1,221,441)	($1,221,441)	($1,350,104)
Full Time Employees (See Explanation)	41.71	44.31	44.86	44.43	44.63
Number of Full Pay Attorneys	6,694	6,797	6,897	6,902	7,006
Non-personnel Expenses	$1,514,339	$1,668,260	$1,704,051	$1,733,454	$2,058,962
Allocated to Excess Program	($317,456)	($307,307)	($317,976)	($317,976)	($388,938)
Total Non-personnel Expenses	1,196,883	1,360,953	1,386,075	1,415,478	1,670,024

CHANGE IN OPERATING EXPENSES:

Increase from 2010 Budget	**9.23%**
Increase from 2010 Projections	**9.77%**

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
2011 PRIMARY PROGRAM BUDGET
ADMINISTRATION
Presented to PLF Board of Directors on October 8, 2010

	2008 ACTUAL	2009 ACTUAL	2010 BUDGET	2010 PROJECTIONS	2011 BUDGET
Expenses					
Salaries	$568,559	$618,342	$637,191	$629,853	$652,737
Benefits and Payroll Taxes	173,410	198,641	176,631	169,815	204,092
Staff Travel	25,840	17,871	15,350	16,300	16,850
Board of Directors Travel	37,400	40,968	36,000	37,700	39,000
Training	5,807	2,359	7,500	4,500	5,000
Investment Services	24,276	26,692	28,000	27,000	27,000
Legal Services	13,769	13,972	18,000	37,500	20,000
Actuarial Services	17,063	18,390	17,500	18,000	19,000
Information Services	73,866	102,041	103,500	108,728	84,000
Offsite System Backup	14,149	28,841	20,000	22,416	10,800
Electronic Record Scanning	16,098	108,690	30,000	100,000	100,000
Other Professional Services	50,260	41,537	39,500	54,637	47,250
Professional Services - Relocation	40,791	0	0	0	0
Pro Services - Medicare Reporting	0	2,550	12,000	12,000	12,000
OSB Bar Books	0	0	0	0	300,000
Early Termination of Lease	(86,196)	0	0	0	0
Office Rent	490,270	475,857	490,000	483,648	490,903
Equipment Rent & Maint.	36,641	37,630	43,000	41,000	41,000
Dues and Memberships	14,940	18,605	15,800	19,000	20,000
Office Supplies	82,789	72,154	80,000	85,000	80,000
Insurance	60,191	60,520	64,001	60,842	62,059
Telephone	19,967	26,247	34,000	34,000	34,000
Printing	21,544	10,953	13,000	12,000	12,000
Postage & Delivery	39,029	35,360	41,200	37,300	37,300
NABRICO - Assoc. of Bar Co.s	16,481	8,931	17,200	11,500	13,000
Bank Charges & Interest	1,754	6,903	5,000	5,000	5,000
Repairs	2,795	3,743	2,000	2,000	2,000
Miscellaneous	0	0	0	0	0
Total Operating Expenses	$1,761,493	$1,977,797	$1,946,373	$2,029,739	$2,334,991
Allocated to Excess Program	($437,368)	($450,185)	($472,598)	($472,598)	($559,903)
Administration Full Time Employees	6.61	8.88	9.13	9.10	8.90

CHANGE IN OPERATING EXPENSES:

Increase from 2010 Budget	**19.97%**
Increase from 2010 Projections	**15.04%**

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
2011 PRIMARY PROGRAM BUDGET
ACCOUNTING
Presented to PLF Board of Directors on October 8, 2010

	2008 ACTUAL	2009 ACTUAL	2010 BUDGET	2010 PROJECTIONS	2011 BUDGET
Expenses					
Salaries	$372,516	$399,415	$402,420	$404,330	$486,420
Benefits and Payroll Taxes	106,460	103,265	112,196	110,115	150,326
Travel	78	21	400	100	400
Financial Audit	22,000	22,700	23,800	23,800	25,000
Training	515	0	1,000	500	1,000
Total Operating Expenses	$501,569	$525,401	$539,816	$538,845	$663,146
Allocated to Excess Program	($118,083)	($121,609)	($120,166)	($120,166)	($144,052)
Accounting Full Time Employees	4.90	4.90	4.90	4.90	5.90

CHANGE IN OPERATING EXPENSES:

Increase from 2010 Budget	**22.85%**
Increase from 2010 Projections	**23.07%**

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
2011 PRIMARY PROGRAM BUDGET
LOSS PREVENTION (Includes OAAP)
Presented to PLF Board of Directors on October 8, 2010

	2008 ACTUAL	2009 ACTUAL	2010 BUDGET	2010 PROJECTIONS	2011 BUDGET
Expenses					
Salaries	$958,847	$968,696	$994,632	$990,968	$982,632
Benefits and Payroll Taxes	302,323	284,984	283,646	277,319	316,406
In Brief	64,756	64,818	62,000	48,000	62,000
PLF Handbooks	(20)	6,433	45,000	45,000	10,000
Library	18	325	500	250	300
Videotape	9,079	7,982	10,000	10,508	11,500
Audiotapes	18,856	20,175	16,000	16,000	18,000
Mail Distribution of Video and Audiotape	8,713	8,907	8,000	8,000	8,300
Web Distribution of Programs	13,065	12,255	8,250	8,000	13,000
Program Promotion	54,593	41,878	42,000	42,000	45,000
Expense of Closing Offices	13,989	11,891	13,500	13,500	14,000
Facilities	41,836	32,566	60,000	50,000	60,000
Speaker Expense	1,730	9,025	10,000	3,000	10,000
Accreditation Fees	670	787	1,200	1,200	1,200
Beepers & Confidential Phone	3,930	4,811	4,200	4,000	4,500
Expert Assistance	19,380	18,458	20,000	3,000	15,000
Bad Debts from Loans	3,650	500	0	0	0
Memberships & Subscriptions	10,421	10,653	11,850	11,450	12,050
Travel	38,298	31,743	38,500	33,925	39,050
Training	21,896	27,864	40,700	25,350	41,700
Downtown Office	113,380	115,056	117,100	117,600	117,600
Miscellaneous	0	0	0	0	0
Total Operating Expenses	$1,699,410	$1,679,807	$1,787,078	$1,709,070	$1,782,238
Allocated to Excess Program	($251,197)	($252,606)	($248,096)	($248,096)	($246,921)
L P Depart Full Time Employees (Includes OAAP)	13.90	12.28	11.83	11.83	11.83

CHANGE IN OPERATING EXPENSES:

Increase from 2010 Budget	**-0.27%**
Increase from 2010 Projections	**4.28%**

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
2011 PRIMARY PROGRAM BUDGET
CLAIMS DEPARTMENT
Presented to PLF Board of Directors on October 8, 2010

	2008 ACTUAL	2009 ACTUAL	2010 BUDGET	2010 PROJECTIONS	2011 BUDGET
Expenses					
Salaries	$1,444,928	$1,653,972	$1,757,343	$1,734,560	$1,758,442
Benefits and Payroll Taxes	421,819	450,678	495,509	481,028	559,556
Claims Audit	0	0	0	0	15,000
Training	11,062	6,615	8,000	6,000	7,000
Travel	2,753	1,412	2,000	3,000	2,500
Library & Information Systems	20,167	31,341	27,500	25,500	26,000
Defense Panel Program	0	19,230	0	3,700	20,700
Total Operating Expenses	$1,900,729	$2,163,248	$2,290,352	$2,253,788	$2,389,198
Allocated to Excess Program	($348,686)	($378,076)	($380,581)	($380,581)	($399,228)
Claims Depart Full Time Employees	16.30	18.25	19.00	18.60	18.00

CHANGE IN OPERATING EXPENSES:

Increase from 2010 Budget	**4.32%**
Increase from 2010 Projections	**6.01%**

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
2011 PRIMARY PROGRAM BUDGET
CAPITAL BUDGET
Presented to PLF Board of Directors on October 8, 2010

	2008 ACTUAL	2009 ACTUAL	2010 BUDGET	2010 PROJECTIONS	2011 BUDGET
Capital Items					
Furniture and Equipment	$131,230	$13,075	$25,000	$5,000	$15,000
Telephone	0	0	5,000	0	2,000
Copiers / Scanners	31,490	42,733	10,000	10,000	20,000
Document Management & Scanning	58,862	10,410	20,000	10,000	15,000
Data Processing					
Hardware	24,537	3,052	25,000	29,995	30,000
Software	5,095	0	18,000	2,000	15,000
Personal Computers and Printers	19,532	29,933	25,000	13,000	23,000
Leasehold Improvements	1,081,148	15,800	8,000	3,000	8,000
Total Capital Budget	$1,351,894	$115,003	$136,000	$72,995	$128,000

Increase from 2010 Budget **-5.88%**

Decrease from 2009 Projections **75.35%**

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
2011 EXCESS PROGRAM BUDGET
Presented to PLF Board of Directors on October 8, 2010

	2008 ACTUAL	2009 ACTUAL	2010 BUDGET	2010 PROJECTIONS	2011 BUDGET
Revenue					
Ceding Commission	764,391	796,092	814,000	760,000	760,000
Profit Commission	44,233	11,298	0	0	0
Installment Service Charge	32,202	39,773	44,000	42,000	42,000
Other	325	4,739	3,500	1,300	1,500
Investment Earnings	(851,386)	534,515	259,496	132,952	245,761
Total Revenue	($10,235)	$1,386,417	$1,120,996	$936,252	$1,049,261
Expenses					
Allocated Salaries	$647,008	$681,121	$707,500	$707,500	$732,877
Direct Salaries	60,472	63,995	65,879	65,880	65,879
Allocated Benefits	190,870	214,048	195,965	195,965	228,289
Direct Benefits	19,621	19,615	18,721	18,490	21,121
Program Promotion	500	500	1,000	500	500
Investment Services	3,224	3,308	4,000	3,500	3,500
Allocation of Primary Overhead	317,456	307,307	317,976	317,976	388,938
Reinsurance Placement Travel	11,117	2,618	12,000	8,000	12,000
Training	0	0	1,000	0	1,000
Printing and Mailing	4,759	4,169	5,000	4,500	5,000
Other Professional Services	6,709	17,043	8,000	2,000	2,500
Software Development	0	0	0	0	0
Total Expense	$1,261,736	$1,313,724	$1,337,041	$1,324,311	$1,461,604
Allocated Depreciation	$40,821	$33,361	$35,641	$35,641	$43,636
Net Income	($1,312,792)	$39,332	($251,686)	($423,700)	($455,979)
Full Time Employees	0.35	1.00	1.00	1.00	1.00
Number of Covered Attorneys	2,585	2,589	2,642	2,400	2,400

CHANGE IN OPERATING EXPENSES:

Increase from 2010 Budget	**9.32%**
Increase from 2010 Projections	**10.37%**

Rudd and Wisdom, Inc.

CONSULTING ACTUARIES

Mitchell L. Bilbe, F.S.A.
Evan L. Dial, F.S.A.
Philip S. Dial, F.S.A.
Charles V. Faerber, F.S.A., A.C.A.S.
Mark R. Fenlaw, F.S.A.
Carl L. Frammolino, F.S.A.
Kenneth J. Herbold, A.S.A.
Christopher S. Johnson, F.S.A.

9500 Arboretum Blvd., Suite 200
Austin, Texas 78759

Post Office Box 204209
Austin, Texas 78720-4209

Phone: (512) 346-1590
Fax: (512) 345-7437
E-mail: cvf@ruddwisdom.com

Robert M. May, F.S.A.
J. Christopher McCaul, F.S.A.
Edward A. Mire, F.S.A.
Rebecca B. Morris, A.S.A.
Michael J. Muth, F.S.A.
Khiem Ngo, F.S.A.
Ronald W. Tobleman, F.S.A.
David G. Wilkes, F.S.A.

August 17, 2010

Mr. Ira Zarov
Mr. Tom Cave
Oregon State Bar Professional
Liability Fund
Post Office Box 1600
Lake Oswego, Oregon 97035-0889

Re: Year 2011 Assessment

Dear Ira and Tom:

At your request, we have analyzed the PLF Primary Fund's historical claims data available through June 30, 2010. Based on this analysis, we have projected the expected claim cost for the Primary Fund for the Calendar Year 2011 (CY 2011) and developed recommendations concerning the CY 2011 assessment for the Primary Fund.

Our assignment for this study was to focus on a projection of the Primary Fund's projected claim cost for CY 2011. We have not attempted to address the impact of investment income, installment surcharges, underwriting expenses or unallocated loss adjustment expenses. Based on our analysis we estimate that the PLF Primary Fund's CY 2011 average claim cost per attorney will lie in a range of $2,100 to $3,227 (see table on page 7 of this report) with an indicated average claim cost of $2,730 per attorney.

At June 30, 2010, the PLF Primary Fund has a deficit in its retained earnings (the equivalent of surplus for an insurance company) of approximately $3.8 million. Our recent study of claim liabilities recommended an increase in the liability for unpaid claims. After that adjustment, the Primary Program had a deficit of about $1.9 million for the first six months of 2010. At June 30, 2000, the PLF Primary Fund had retained earnings in excess of $7 million. Shortly after that, a combination of claims experience and investment results eliminated the Primary Fund's surplus. With a

recent history of negative retained earnings, it is important that the PLF Primary Fund charge an adequate rate and add a margin to regenerate surplus. Historically, net investment income and installment surcharges have offset the PLF's operating expenses. However, these items are no longer necessarily adequate to cover operating expenses completely. Thus, a supplement to provide for operating expenses is also appropriate. As stated above, a pure premium in the neighborhood of $2,730 per attorney for the 2011 claim year is reasonably likely to cover the Primary Fund's claim costs. If the Primary Fund covers approximately 7,000 full pay attorneys in CY 2011, then the Primary Fund should expect to increase its surplus by approximately $700,000 for each $100 that the assessment rate exceeds the Fund's claim and administrative costs on a per-attorney basis.

In our claim reserve report dated August 10, 2010 we recommended that the Primary Fund keep at least $5 million of surplus to be able to absorb adverse claim or investment experience which may occur in the future. We also described an approach for quantifying desired surplus levels using statistical confidence levels. In prior studies, we have noted the need for caution in establishing assessment rates for the PLF Primary Fund. This has not changed, and there are several reasons for the Board to exercise caution in setting the rate at this time.

1. The Fund's frequency has been volatile varying from a low rate of 11.4% in 1990 to a high rate of 14.7% in 2004. It has also varied significantly from year to year. This volatility makes it difficult to predict the Fund's frequency for a given year.

2. The Fund's claim costs have had a moderately positive trend since 1993, indicating that claim costs are increasing. Since 1999, the average claim cost per attorney has hovered in a range of $2,300 to $2,900 after being in the $1,800 to $2,000 range for most of the 1990's. The 2000 and 2001 claim years are the exceptions, as the average claim cost in 2000 spiked to $3,214 and the claim cost in 2001 dropped to $1,957.

3. The market value of the Fund's assets has been volatile, producing large gains in some years and losses in others during the past 16 years.

4. The Fund currently has a negative surplus position after accumulating as much as $10 million at the end of 1999. Volatile asset values tend to exacerbate a low or negative surplus situation. Surplus enables an insurance company or fund to withstand adverse experience (whether it is due to claims or asset values) without having to take drastic measures.

Data and Methodology

The analysis utilizes case incurred amounts for indemnity and expense as of June 30, 2010, provided by the PLF staff. The term "case incurred" is used herein to describe the estimated value placed on a claim by the PLF staff. The value includes both the paid and unpaid portions of the claim. The indemnity and expense components of incurred claims for each semiannual reporting period are reviewed separately. These amounts have been developed based on actuarial development factors, which are used to estimate the amount by which ultimate losses can be expected to differ from the case incurred amounts established by the PLF. We make this determination by analyzing the actual periodic changes (measured at semiannual intervals) in case incurred amounts. The purpose of this approach is to adjust for any pattern of over or under-reserving by the PLF staff that may have appeared in the experience data.

The methodology and judgment utilized in selecting the actuarial development factors for this review are consistent with that utilized in our determination of reserves for unpaid losses as of June 30, 2010. While the development factors used in this analysis represent our best judgment concerning future development patterns, it should be noted that attorneys professional liability insurance is a volatile line of business that is affected by legislation, judicial interpretation and the economy. This may cause future development patterns to differ from those exhibited in the claim data at June 30, 2010.

The PLF has provided information concerning the historical and estimated future number of full pay equivalent attorneys. This has provided the basis for the exposure data used in our analysis. The number of full pay attorneys is determined as the total assessment for a given year divided by the assessment rate for the year. Effective with the 2006 plan year, the PLF reduced the discounts given to attorneys with limited prior PLF coverage ("step rating"). This distorts the calculation of the number of full pay attorneys as the same number and distribution of attorneys will now generate more assessment dollars. Based on data from 2001 through 2005, this change generates approximately 2% more assessment dollars and therefore 2% more full pay equivalent attorneys. Two years ago, we adjusted the number of full pay attorneys for 2006 and 2007 to get the exposure data on a basis consistent with prior years. For this analysis the change in the number of full pay equivalent attorneys does not appear to have a material impact on the results. For that reason we have used the unadjusted number of full pay equivalent attorneys as provided.

In this analysis, we have concentrated only on the claim costs. We have made no calculations of 2011 investment income or operating expenses. It is our

understanding that the PLF staff will include a discussion of those factors in their recommendations regarding the 2011 assessment.

Provision for Claims

The foundation for the determination of a provision for claims is the expected claim cost for the assessment period. This analysis anticipates a calendar year 2011 assessment period with the bulk of the policies written January 1, 2011. To determine the expected claim cost for this period, we used the following approach:

1. Claims experience was analyzed for calendar years 1983 through 2009. The ultimate incurred claims used in this analysis are the same as those determined in connection with our estimate of PLF Primary Fund reserves as of June 30, 2010. We have described the methodology used in that determination in separate correspondence.

   Exhibit 1 presents a summary of this analysis, including ultimate incurred claims, number of claims, frequency, severity, and claim cost for calendar years 1983 through 2009. The average claim cost per attorney for calendar years 1983 through 2009 is displayed in the column captioned "Untrended Claim Cost." The untrended claim cost is determined by dividing (a) the ultimate incurred claim amounts reported during each calendar year by (b) the attorney exposure for that year. Therefore, the claim cost represents the average incurred claims for an average attorney insured for the full calendar year.

2. The current coverage limits ($300,000 per claim) have been in place since 1987. We have focused our analysis on the experience period, which includes calendar years 2000 through 2009. We note that a $25,000 claim expense allowance was implemented in 1995 and an additional $25,000 claim expense allowance (for a total of $50,000) was added in 2005. The experience for periods since 1995 reflects the first allowance. Only the 2005 through 2009 experience reflects the second expense allowance. We do not believe that the impact of the second allowance on claims expense is significant enough to invalidate the use of data from previous periods in our analysis. We have omitted the 2010 claims from the experience period because these claims are new, and there is only six months of data. Each calendar year claim cost is trended to the middle of CY 2011, the approximate midpoint of the exposure to be incurred during the assessment period. The purpose of trending is to recognize the tendency of claim costs to increase over time.

3. Selecting an appropriate trend rate is an important step in applying the methodology described above. The 1992 - 2008 experience period indicates a trend close to 2%. Between 1992 and 1998, claim costs were flat (i.e., no measurable trend) with values in a range of $1,800 to $2,000 per attorney. The 1999 and later claim years give the trend line an upward slope because average claim cost increased by approximately $570 per attorney in 1999 and the average cost has stayed in that range since that time. The net effect of this experience is that it is difficult to select a specific trend. However, we note that the Primary Fund's claim cost trend has generally been in the 2% to 3% range.

4. Having established a framework for reviewing the claims experience, we must develop a method for determining the expected cost of claims to be reported in CY 2011. For this purpose, we have employed two different approaches:

   a. Based on the analysis described in (1) through (3) above we have selected a range of claim cost trends that we believe to be appropriate. These trends are applied to each calendar year's untrended claim cost to produce for each calendar year a range of claim costs trended to July 1, 2011. The averages of these trended claim costs provide a range of expected claim costs for claims to be reported in 2011. These calculations are displayed in Exhibit 1.

   b. As an alternative to the approach described above we have used the claims data and professional judgment to select a range of claim frequencies and a range of average claim severities. Multiplying the claim frequencies by the average severities also produces a range of expected claim costs. This approach is displayed in Exhibit 2.

5. For each of the methods described above parameters representing expected future claim experience must be selected. The following paragraphs describe our rationale for the parameters we have selected.

   a. As stated above, the first method requires the selection of appropriate trend rates for annual claim costs. In Exhibit 1, we have selected 1.00%, 2.00%, and 4.00% trends for our range of values. As we noted in the reserve report, the selection of beginning and ending points can have a significant impact on the conclusions about average trend rates. Depending on the period selected, the PLF Primary Fund has had claim cost trends in the 2% to 4% range.

   b. To implement the second method, selection of appropriate claim frequency and claim severity parameters is required. At the low end, we have selected a 12% frequency and a $17,500 average severity. Since 1995, there have been only

three years with claim frequencies less than 13%. Two of those years, however, were 2006 and 2007. The average claim size has been at or below $17,500 in five of the past 10 years. Even so, these parameters would be characterized as optimistic.

The indicated estimate is based on 14.00% frequency and $19,500 severity. The PLF Primary Fund's average frequency since 2000 is 13.3%. The Primary Fund has experienced claim frequency of 13% or higher every year between 1997 and 2005. The experience of the past seven years leads us to expect that the Primary Fund's claim frequency will be between 13% and 14%. However, the frequency for 2008 through the first half of 2010 has been 13.84% after two years at 11.90%. We believe that we should pick parameters that give the program an excellent chance to be adequate. So, an incurred frequency of less than 14.00% would be a welcome result.

The Primary Fund's average claim size (i.e., severity) is a more difficult selection. Between 1993 and 1998, the average severity never exceeded $14,500, falling in a range of $12,600 to $14,500. In 1999, severity jumped to $16,578 and spiked to $23,593 in 2000. Average claim severities for the last 10 years have increased approximately 2% in the aggregate during the past year. Only three years, however, have had an average severity as high as $19,500. Based on recent experience, we believe that $19,500 will prove to be an adequate severity estimate for 2011 claims.

With a deficit of approximately $3.8 million, we believe that the Board should set an assessment rate for 2011 that will not only cover the claim cost and operating expenses, but also continue to recoup some of the Primary Fund's financial losses.

At the upper end of the range, we have selected a 15.0% frequency and a $21,000 average severity. The PLF Primary Fund has experienced frequency in excess of 14% in 1995, 1999, 2004, and 2009. Three of the ten full years since 2000 have produced an average severity at or above $19,700. The average severity for claim year 2000 ($23,593) is the largest in the Fund's history.

c. We have noted in the past that attorneys professional liability insurance is a volatile line of business. It is reasonable to expect that there will be years in the future that will have significantly higher than expected claim costs. Years with lower than expected claim costs are also to be expected. This uncertainty with regard to future experience suggests the need for caution in rating.

6. The table below summarizes our estimates of the CY 2011 expected claim cost.

Estimate	*Method 1* *Average Trended Claim Cost*	*Method 2* *Frequency x Severity*
Low	$ 2,648	$ 2,100
Indicated	2,828	2,730
High	3,227	3,150

As a check on the reasonableness of the results from Method 2, we have determined the trend rates applied to the average trended claim costs over the 2000 – 2009 period, which produce expected claim costs approximately the same as the three estimates. A negative 2.55% trend reproduces the low estimate, while a 1.45% trend produces the indicated estimate and a 3.65% trend is needed for the high estimate. These determinations were made to provide additional perspective to the analysis. The trended claim costs under the three trend assumptions are presented in Exhibit 2.

Rating Margin: Theoretical Considerations

Generally, it is appropriate to include in an insurance rate a provision for adverse deviation from expected experience. The purpose of this rating margin is to increase the insurance organization's chances for rating adequacy by making a reasonable provision for adverse fluctuation in claims experience.

Because this methodology utilizes the average trended claim cost from the experience period, statistically, there is a 50% probability that actual results will be better than expected and a 50% probability that actual results will be worse than expected, assuming the trend factor provides an appropriate basis for projection. The typical insurance organization considers it prudent to increase its probability of success substantially above the 50/50 position. This is accomplished by establishing a rating margin either statistically, based on the observed fluctuations in the experience data, or subjectively, based on actuarial and management judgment.
It is sometimes appealing to establish the margin based on a mathematical measure of the statistical fluctuation observed in the experience data, e.g., the standard deviation. Frequently, however, the data is not sufficiently credible for such a purpose and, in any event, the approach may be too esoteric. As a result, it is often convenient and equally effective to establish the margin based on a subjectively chosen percentage of

the expected claim cost. The selection of the percentage margin requires management to exercise judgment based on the organization's willingness to accept risk, its ability to withstand adverse experience, its position in the competitive market, etc.

The ability of the typical insurance organization to withstand adverse experience depends in part on the adequacy of its surplus (the equivalent of PLF Primary Fund's retained earnings). A strong surplus position permits a lower rating margin, while a weaker surplus position would require a larger margin. Likewise, an organization's surplus relative to its surplus goal might also influence management's judgment regarding the margin to be included in its rates.

The PLF's unique circumstances allow it to be significantly less conservative than a commercial insurer in establishing its rates. The mandatory participation requirement and PLF's ability to establish future assessments to fund prior deficits provide at least as much protection against adverse experience as a strong surplus position provides the typical commercial insurer. As a result, a rating margin is not nearly as important to the PLF Primary Fund as it is to the typical insurer and management has more discretion in the judgment it exercises in this regard. While there is certainly an argument to be made that under normal circumstances the PLF Primary Fund should incorporate no margin in its rating, some consideration may be in order concerning minimizing the frequency of rate adjustments, retained earnings position and goals, etc.

Rating Margin: Practical Considerations

The PLF's unique circumstances allow it to be significantly less conservative than a commercial insurer in establishing rates. Nevertheless, there are several considerations, which indicate that under certain conditions some additional margin in the rate may be appropriate:

1. The Primary Fund presently has significantly negative retained earnings. A margin in the assessment rate would enable the Primary Fund to reduce its deficit as well as provide a cushion to absorb adverse claim experience, such as a higher than expected number of reported claims or adverse development on existing and future claims.

2. The Primary Fund's assets are reported at market value, and investment results vary from year to year. The PLF uses asset allocation to limit volatility but investment income can not be predicted precisely for rating purposes. Thus,

investment risk, as well as claim risk, becomes an important consideration in the rating process.

In spite of the considerations listed above, there are also factors, which indicate that an additional margin in the rate may not be needed at this time:

1. Attorneys are required to participate in the PLF's Primary Fund, and the PLF has the ability to set future rates at whatever level it deems necessary to maintain the financial soundness of the Fund.

2. The PLF also operates an Excess Fund to provide attorneys with coverage in excess of $300,000. The Excess Fund currently (through June 30, 2010) has retained earnings of approximately $3.3 million. While the accounting on the two Funds is separate and it is not the goal of the PLF staff for the Excess Fund to subsidize the Primary Fund, the assets of the two Funds are commingled, and nothing prevents the two Funds from supporting each other financially.

3. Unlike other members of NABRICO, the PLF's Primary Fund is not constrained by competition. Since the coverage is mandatory, the PLF has the ability to assess policyholders to meet the Primary Fund's financial needs without fear of losing market share. The staff and Board of Directors of the PLF believe that they have an obligation to the attorneys of the state of Oregon not to abuse this privilege. Thus, they are reluctant to overreact to adverse experience. They will implement rate increases when experience clearly dictates that increases are required.

For your consideration, we have developed expected CY 2011 claim costs without a margin and with 10% and 20% margins. A 10% margin is subjective and is a commonly used level in much of our rate work with other insurance entities. For the values displayed in Exhibit 1, one standard deviation is approximately 20% of the expected claim cost. The table below summarizes our estimates of the CY 2011 claim costs:

Claim Cost Estimates	*Expected CY 2011 Average Claim Cost*					
	Average Trended Claim Cost Method			*Frequency x Severity Method*		
	No Margin	*10% Margin*	*15% Margin*	*No Margin*	*10% Margin*	*15% Margin*
Low	$2,648	$2,913	$3,178	$2,100	$2,310	$2,520
Indicated	2,828	3,111	3,394	2,730	3,003	3,276
High	3,227	3,550	3,872	3,150	3,465	3,780

Prior to 1999, we had recommended rates that proved (with the benefit of hindsight) to be too high. The rates proposed for the 2000 through 2004 rate studies have proven to be inadequate. For the 2000 through 2010 policy years, we have projected pure premiums (i.e., claim costs) between $1,958 and $2,633. At this point, we believe that the actual claim costs for those years will be between $1,748 and $3,214. The table below summarizes these results:

Policy Year	***Expected Claim Cost at Time of Study***	***Estimated Claim Cost at 6/30/2009***
2000	$ 1,958	$ 3,214
2001	1,980	1,957
2002	2,160	2,343
2003	2,236	2,633
2004	2,228	2,547
2005	2,520	2,503
2006	2,538	2,268
2007	2,544	1,748
2008	2,470	2,947
2009	2,527	2,636
2010	2,633	2,582

We believe that $2,730 per attorney is reasonably likely to cover the cost of 2011 claims. This is 3.7% higher than the claim cost we proposed in the analysis we performed last year. This value reflects higher frequency (14.00% vs. 13.50%) and the same claim severity ($19,500 vs. $19,500) that we used last year. Please note that this rate is based on professional judgment and a focus on recent claim experience.

Important Considerations

Credibility

Attorneys professional liability insurance is a low frequency, high severity exposure. Accordingly, a block of attorneys professional liability insurance policies generates lower credibility than a similar-sized block of a high frequency, low severity exposure like automobile insurance. Due to its size and nature, the PLF Primary Fund's block of business does not possess as much credibility as an actuary would prefer in developing rates. While one would prefer to enhance the predictability of experience by relying upon an outside source of data to compliment PLF Primary Fund's actual experience, we do not believe that any reasonably comparable body of data exists. This is the result of the lack of industry loss data for this line of coverage and the tremendous variations in risk among jurisdictions. We believe that the economic and judicial climate that exists in Oregon is substantially different from that of other jurisdictions. In addition, due to its mandatory nature, the PLF Primary Fund claim experience can be expected to be substantially different from that of other jurisdictions. This difference renders loss data developed in other jurisdictions inapplicable for the purpose of establishing rates for Oregon attorneys. Accordingly, despite expected weaknesses in the credibility of the historical data, we believe it is the best basis for establishing PLF Primary Fund rates.

Retained Earnings

We understand that the PLF Primary Fund has a goal of maintaining a level of retained earnings (surplus) sufficient to stabilize assessments. The question of how much surplus the PLF Primary Fund should maintain has been considered. In our reserve report dated August 10, 2010, we have discussed an approach that may help the PLF Primary Fund quantify its desired surplus level. It is clear to us that it is beneficial for the Primary Fund to have some surplus. It is also clear that the PLF was not established for the purpose of making a profit. The mandatory nature of the PLF Primary Fund and its ability to assess covered attorneys suggests a significantly smaller amount of surplus than would be appropriate for a commercial insurer or for one of the PLF's sister organizations in other states.

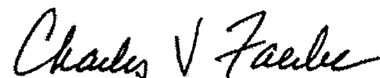
Miscellaneous Issues

Attorneys professional liability insurance has been a volatile line of coverage subject to sudden adverse change. To the extent that unexpected adverse occurrences influence the PLF Primary Fund's experience, projections of expected claim cost and the assessment based on these conclusions could prove inadequate. Significant upward trends in the claim cost of attorneys professional liability insurance have occurred in some jurisdictions. The potential for change makes periodic rate analyses necessary. We suggest that these analyses continue to be performed on an annual basis.

While the PLF must cope with the uncertainty and volatility associated with the attorneys professional liability line of coverage, it has significant advantages over other organizations. These advantages enhance the PLF's chances for appropriately establishing the assessment. The mandatory nature of the program avoids the disruption that occurs in a commercial company's block of business that results from consumer response to the competitive market. The PLF is not required to make assumptions regarding its exposure base for the period for which the assessment is to be established. Also, writing one policy form with uniform coverage features and limits and a common renewal date greatly strengthens the rating process. Because of these attributes, the PLF does not have to "aim at a moving target," as do its sister organizations in other states. While periodic analyses are important to the PLF's success, the resulting revisions are more likely to be refinements than sudden large increases.

As in the past, we have enjoyed the opportunity to work with you and we look for ward to discussing the results of this analysis. If you have any questions, or if there are other issues that should be addressed, please let us know.

Sincerely,



Charles V. Faerber, F.S.A., A.C.A.S

CVF: ms
Enclosure

cc: Mr. Philip S. Dial
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Exhibit 1

Oregon State Bar Professional Liability Fund

Historical Claim Analysis and
Projection of Expected Claim Cost
Claims Evaluated as of 6/30/10

Calendar Year	(1) *Ultimate Incurred Claims (000's)*	*Number of Claims*	*Exposure*	*Frequency*	*Severity*	(2) *Untrended Claim Cost*	*Claim Cost Trended to 7/1/11* *@ 1.00%*	*@ 2.00%*	*@ 4.00%*
1983	$ 7,672	480	4,533	0.106	$ 15,984	$ 1,693	$ 2,236	$ 2,947	$ 5,075
1984	7,176	456	4,676	0.098	15,738	1,535	2,008	2,620	4,425
1985	8,357	569	4,648	0.122	14,687	1,798	2,329	3,009	4,985
1986	8,292	474	4,668	0.102	17,493	1,776	2,278	2,914	4,735
1987	5,962	465	4,700	0.099	12,821	1,268	1,611	2,040	3,251
1988	6,381	416	4,786	0.087	15,338	1,333	1,676	2,102	3,286
1989	7,522	505	4,868	0.104	14,895	1,545	1,923	2,389	3,662
1990	9,067	569	4,989	0.114	15,935	1,817	2,240	2,755	4,142
1991	9,490	635	5,126	0.124	14,945	1,851	2,259	2,751	4,057
1992	10,367	640	5,257	0.122	16,198	1,972	2,382	2,873	4,155
1993	10,048	700	5,373	0.130	14,355	1,870	2,237	2,671	3,789
1994	9,866	681	5,504	0.124	14,487	1,792	2,123	2,510	3,492
1995	11,017	825	5,635	0.146	13,354	1,955	2,292	2,684	3,662
1996	9,092	721	5,763	0.125	12,611	1,578	1,832	2,123	2,841
1997	10,527	769	5,680	0.135	13,689	1,853	2,130	2,445	3,209
1998	10,431	761	5,773	0.132	13,707	1,807	2,056	2,337	3,009
1999	13,760	830	5,792	0.143	16,578	2,376	2,677	3,013	3,804
2000	18,827	798	5,857	0.136	23,593	3,214	3,586	3,997	4,949
2001	11,595	775	5,926	0.131	14,962	1,957	2,161	2,385	2,896
2002	14,070	816	6,006	0.136	17,243	2,343	2,562	2,800	3,334
2003	16,080	815	6,108	0.133	19,730	2,633	2,851	3,085	3,603
2004	15,982	923	6,276	0.147	17,316	2,547	2,730	2,925	3,351
2005	15,799	842	6,312	0.133	18,764	2,503	2,657	2,819	3,167
2006	14,824	780	6,537	0.119	19,006	2,268	2,383	2,504	2,759
2007	11,498	781	6,577	0.119	14,722	1,748	1,819	1,892	2,045
2008	19,729	903	6,694	0.135	21,848	2,947	3,037	3,128	3,315
2009	17,915	973	6,797	0.143	18,412	2,636	2,689	2,742	2,851
2010 (6 Mos)	8,911	469	3,451	0.136	19,000	2,582	2,608	2,634	2,685
Experience Period:				2000 - 2009	2000 - 2009		2000 - 2009	2000 - 2009	2000 - 2009
Selected Trend:					$ 18,415	101.80%	1.00%	2.00%	4.00%
Mean Value for the Period:				0.133	$ 18,596	101.62%	$ 2,648	$ 2,828	$ 3,227
Standard Deviation of Claim Costs:							481	549	746
Standard Deviation as a percent of the Mean Value:							18.17%	19.43%	23.12%

(1) Includes loss and loss adjustment expense
(2) Untrended Claim Cost = Ultimate Incurred Claims / Exposure

Exhibit 2

Oregon State Bar Professional Liability Fund

Historical Claim Analysis and Projection of Expected Claim Cost Claims Evaluated as of 6/30/10

Calendar Year	(1) *Ultimate Incurred Claims (000's)*	*Number of Claims*	*Exposure*	*Frequency*	*Severity*	(2) *Untrended Claim Cost*	*Claim Cost Trended to 7/1/11* @ -2.55%	@ 1.45%	@ 3.65%
1983	$ 7,672	480	4,533	0.106	$ 15,984	$ 1,693	$ 821	$ 2,533	$ 4,618
1984	7,176	456	4,676	0.098	15,738	1,535	764	2,264	4,040
1985	8,357	569	4,648	0.122	14,687	1,798	919	2,614	4,566
1986	8,292	474	4,668	0.102	17,493	1,776	931	2,546	4,353
1987	5,962	465	4,700	0.099	12,821	1,268	682	1,792	2,999
1988	6,381	416	4,786	0.087	15,338	1,333	736	1,856	3,041
1989	7,522	505	4,868	0.104	14,895	1,545	875	2,121	3,400
1990	9,067	569	4,989	0.114	15,935	1,817	1,057	2,459	3,859
1991	9,490	635	5,126	0.124	14,945	1,851	1,104	2,469	3,792
1992	10,367	640	5,257	0.122	16,198	1,972	1,207	2,592	3,897
1993	10,048	700	5,373	0.130	14,355	1,870	1,175	2,423	3,565
1994	9,866	681	5,504	0.124	14,487	1,792	1,155	2,289	3,297
1995	11,017	825	5,635	0.146	13,354	1,955	1,293	2,461	3,470
1996	9,092	721	5,763	0.125	12,611	1,578	1,071	1,958	2,701
1997	10,527	769	5,680	0.135	13,689	1,853	1,291	2,267	3,061
1998	10,431	761	5,773	0.132	13,707	1,807	1,292	2,179	2,880
1999	13,760	830	5,792	0.143	16,578	2,376	1,743	2,824	3,653
2000	18,827	798	5,857	0.136	23,593	3,214	2,419	3,766	4,768
2001	11,595	775	5,926	0.131	14,962	1,957	1,511	2,260	2,800
2002	14,070	816	6,006	0.136	17,243	2,343	1,857	2,667	3,235
2003	16,080	815	6,108	0.133	19,730	2,633	2,141	2,954	3,507
2004	15,982	923	6,276	0.147	17,316	2,547	2,125	2,817	3,273
2005	15,799	842	6,312	0.133	18,764	2,503	2,144	2,729	3,104
2006	14,824	780	6,537	0.119	19,006	2,268	1,993	2,437	2,713
2007	11,498	781	6,577	0.119	14,722	1,748	1,577	1,852	2,018
2008	19,729	903	6,694	0.135	21,848	2,947	2,728	3,077	3,282
2009	17,915	973	6,797	0.143	18,412	2,636	2,503	2,713	2,832
2010 (6 Mos)	8,911	469	3,451	0.136	19,000	2,582	2,516	2,620	2,676

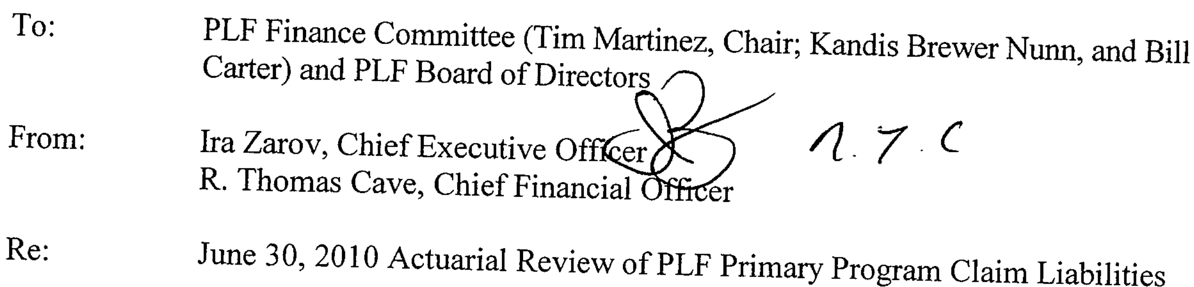
	@ -2.55%	@ 1.45%	@ 3.65%
Selected Average Claim Severity:	$ 17,500	$ 19,500	$ 21,000
Selected Frequency:	x 12.00%	x 14.00%	x 15.00%
Average Trended Claim Cost During Period:	$ 2,100	$ 2,730	$ 3,150
Experience Period:	2000 - 2009	2000 - 2009	2000 - 2009
Trend Needed To Reproduce Above Results:	-2.55%	1.45%	3.65%
Average Trended Claim Cost During Period:	$ 2,100	$ 2,727	$ 3,153
Standard Deviation of Claim Costs:	349	523	720
Standard Deviation as a percent of the Average Trended Claim Cost:	16.62%	19.17%	22.85%

(1) Includes loss and loss adjustment expense
(2) Untrended Claim Cost = Ultimate Incurred Claims / Exposure

Professional Liability Fund

Ira R. Zarov
Chief Executive Officer

September 20, 2010



To: PLF Finance Committee (Tim Martinez, Chair; Kandis Brewer Nunn, and Bill Carter) and PLF Board of Directors

From: Ira Zarov, Chief Executive Officer
R. Thomas Cave, Chief Financial Officer

Re: June 30, 2010 Actuarial Review of PLF Primary Program Claim Liabilities

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I. Recommended Actions

We have received the attached report from our actuaries reviewing June 30, 2010 PLF Primary Program claim liabilities.

We agree with the indicated estimates made by the actuaries. Accordingly, we suggest that the Finance Committee recommend to the PLF Board of Directors the following actions:

1. Adopt the following liabilities for claims as of June 30, 2010:

Indemnity Liabilities	$13.5 million
Expense Liabilities	11.5 million
Total Liabilities	$25.0 million

2. Adopt an average claim cost figure of $19,500 ($10,000 indemnity and $9,500 expense) to be used to calculate claim liabilities for new claims for the last six months of 2010.

3. Readopt the goal for combined Excess and Primary Program Retained Earnings of $12.0 million. The potential of poor investment results continues to be a component of this goal.

503.639.6911 I Oregon Toll Free: 1.800.452.1639 I Fax: 503.684.7250 I www.osbplf.org
Street Address: 16037 SW Upper Boones Ferry Rd. I Suite 300 I Tigard, OR 97224
Mailing Address: PO Box 231600 I Tigard, OR 97281-1600

II. Effect of Adopting these Figures

The PLF has actuarial reviews of claim liability estimates every six months because of the great variation in PLF claim severity and frequency. For financial statements prepared between actuarial reviews, claim liabilities are increased for each new claim at an adopted average cost amount and reduced when payments are made on any pending claim.

The financial statement effect of adopting the recommended estimated claim liabilities is an **increase** in claim costs of **$1,007,285**. The changes break down as follows:

	6/30/10 Liabilities Using 12/31/09 Report plus the First Half of 2010 Claims at $19,000 Average	Liabilities Using 6/30/10 Actuarial Estimates	Difference
Indemnity	$13,360,923	$13,500,000	$139,077
Expense	$10,631,792	$11,500,000	$868,208
Total	$23,992,715	$25,000,000	$1,007,285

In other words, the Primary Program Balance Sheet liability for claims as of June 30, 2010 will be $1,007,285 higher with the actuarial adjustment than if we simply used the December 31, 2009 study plus the $19,000 average cost figure (adopted last February) for each of the 475 claims made during the first half of the 2010. The Primary Program Income Statement will reflect an increase in claim expense of $1,007,285 because of this adjustment.

The actuaries recommend a total average claim cost figure of $19,500 for new claims received during the second half of 2010. This is an increase of $500 from the previous recommendation. This is the first recommended increase in two years. The average claim cost figures to be used in calculating interim financial reports until the next actuarial study would be as follows:

	6/30/10	12/31/09	Difference
Average Indemnity	$10,000	$10,000	$0
Average Expense	$9,500	$9,000	$500
Total	$19,500	$19,000	$500

III. Discussion of Actuarial Methods

We have discussed the actuarial methods many times in the past. The actuaries use a combination of development ratios and selected average costs.

Development ratios are computed based upon the way past estimates of semi-annual classes of claims have changed over successive six-month periods. For example, an actuary predicts that the total of estimates set by the claim attorneys will increase (or decrease) by a specific percentage between months 18 and 24, another percentage between months 24 and 30, etc. By mapping the ultimate development of PLF claims in this fashion, the actuary calculates what the ultimate cost will be of each claim based upon current claim attorney estimates.

The PLF Primary Program has had essentially the same aggregate $300,000 coverage limit since 1987. The vast majority of claims (over 98%) settle within those coverage limits. However, during the last ten years, more claims have equaled or exceeded coverage limits. The increase in the number of limit claims has not been even from year to year. As the auditors discuss on page 2, the auditors apply loss development factors to claims individually and limit development of any given claim to the Primary Program coverage limits.

This general methodology assumes that there are no changes in the long-term timing of claim estimates and payments. The analogy has been made that using this actuarial technique is like navigating a car by only looking out of the rear window. This works fine when the road is straight or uniformly curved. Unfortunately for the PLF, significant changes may occur in the road including changes in claims personnel, the number of claim files handled by each claim attorney, claim estimating philosophies, and overall economic conditions. In addition, PLF claims are not homogeneous or numerous from an actuarial standpoint. All of these factors disrupt the pattern of claim estimates and produce a road full of twists and turns. Because of the volatility and small universe of PLF claims, the data does not smooth out as well as other actuarial driven systems such as automobile damage claims.

The actuaries recalculate the development ratios with each study to try to make them more accurate for current conditions. The actuaries compute these ratios for both estimates and actual payments of indemnity and claims expense. (Claims expense is defined as payments made to individuals other than the claimant; e.g., defense costs.)

The term severity is often used in the actuarial study. Severity means the average cost of each claim within a particular set of claims. Indemnity severity is the average amount paid to claimants. Expense severity is the average amount paid for defense and other costs of settling claims. It is often easier to see trends if we compare severity (average costs) from period to period. After the actuary calculates the ultimate total cost of claims for any period using the development ratios, this total cost is divided by the number of claims in the period to get the "developed severity" or "developed average severity". When the term "developed severity" is used in this report, it means that the average cost was calculated using development factors.

Historically, PLF claims attorneys have based their claim cost estimates on available knowledge. Each claim estimate starts at zero rather than a set minimum value. For very new claims, the development ratios are high due to the fact that new information obtained in later periods often causes estimates to be increased. Any small fluctuation up or down in the claim attorney estimates for recent claims are greatly magnified when actuarial development factors are applied.

Because of problems in applying development factors to recent periods, the actuaries also compute average costs using regression analysis. The actuaries describe their use of this method on pages 3 and 4 of their report. Regression analysis is a statistical technique used to calculate a trend line given several data points. Unfortunately, regression analysis is of limited value when the amount of data is small and volatile. Additionally, the starting and ending data points can also significantly affect the calculated trend. Accordingly, the actuary uses significant judgment to chose an appropriate average for a given period rather than strictly rely upon mathematical calculations.

For the latest two or three years of claims, the actuaries use a combination of results obtained from development factors and those obtained from average severity estimates. The table below summaries the approach:

Year Claims Reported	*Weights Applied at June 30, 2010*		*Weights Applied at December 31, 2010*	
	Development Factor Results	*Average Severity Results*	*Development Factor Results*	*Average Severity Results*
2008	75%	25%	100%	0%
2009	25	75	50	50
2010	0	100	0	100

The particular average severity figures are selected by the actuaries after reviewing developed severity and the trends indicated by regression analysis for each year.

IV. Discussion of Liability Adjustment

During most of the 1990's, the actuarial adjustments were relatively small and often downward. Until 1999, the severity trends were flat or even negative. When the PLF Primary Program had increases in the frequency of new claims, there were often offsetting decreases in claim severity. Starting with the 1999 claim year, the period of stable costs ended. This change was not immediately apparent during 1999. However, the two actuarial reports done for 2000 broke the trend of downward adjustments. Both reports recommended large increases in estimated claim liabilities because of higher than expected claim costs for the claim years 1999 and 2000. Since 2000, claim frequency and severity has varied greatly from claim year to claim year. Actuarial reports have recommended adjustments (sometimes large) both up and down.

The following chart shows the reserve adjustments from the past twelve actuarial reports

Date	Increase (Decrease)
June 30, 2010	$1,007,285
December 31, 2009	$1,001,266
June 30, 2009	($909,593)
December 31, 2008	($1,329,625)
June 30, 2008	($112,000)
December 31, 2007	($26,915)
June 30, 2007	$521,535
December 31, 2006	$496,271
June 30, 2006	$2,095,462
December 31, 2005	$720,361
June 30, 2005	($151,868)
December 31, 2004	($1,116,451)

Claims reported before 2008 are discussed on page 5 of the actuaries report. Most of the claims from these years are closed. However, the claims that are open tend to be larger than average and are still subject to change. Development of these claims since the last actuarial report was worse than expected. With this report, estimates for indemnity went up by $234,000. All of this increase was from the 2006 and 2007 claim years. Overall, the estimate for expenses was increased by $149,000. Most claim years decreased a small amount but a large increase for 2006 claims ($301,000) offset those reductions.

PLF staff has reported concerns about 2008 claims for some time and the adverse development of these claims continued with this report. The actuaries discuss 2008 claims on pages 5 and 6. Claims frequency increased during 2008 to 13.5 percent after being below 12 percent for 2006 and 2007. Average developed severity was higher than most prior years with the latest calculations indicating $12,289 for indemnity and $9,542 for defense. The actuaries recommend increasing the liability for 2008 claims by $343,000 (an increase of $171,000 for indemnity and $172,000 for expense).

Results from the 2007 and 2008 claim years illustrate the volatility and variation in claims frequency and severity experienced in recent years. Claims frequency went from 11.9 percent in 2007 to 13.5 percent in 2008. Developed severity changed from $7,900 for indemnity and $6,821 for expense in 2007 to $12,289 for indemnity and $9,542 for expense in 2008.

Claims reported in 2009 are discussed on page 6 of the report. Claim frequency spiked to 14.3 percent which is much higher than recent experience. Fortunately, average developed indemnity severity is somewhat lower than recent years at $8,843 and much lower than 2008. The average developed severity for expense increased significantly with this report to $9,604. Because these

claims are relatively new, the actuaries are using average costs to calculate 75 percent of the estimated liabilities for 2009. The figures that they chose were $9,000 for indemnity and $9,400 for expense.

The actuaries discuss claims reported during the first half of 2010 on pages 6 and 7 of their report. The frequency of new claims is still high at 13.6% but down from 2009 levels. Average developed severity is lower than 2008 and 2009 at $8,019 for indemnity and $8,804 for expense. However, since these claims are very new and information is incomplete, the actuaries expect severity to increase. They used average costs of $9,500 for indemnity and $9,500 for expense to calculate 100 percent of the liability.

V. Estimated Claim Cost for the Second Half of 2010

We base our claim liabilities solely on actuarial figures only twice a year, in June and December. During other months, we use the most recent actuarial estimates, increase that amount by the number of new claims multiplied by average cost, and subtract actual current claim payments.

In their December 31, 2009 report, the actuaries recommended using $19,000 for each new claim made during the first half of 2010. The actuaries' recommendations for the next six months are discussed on page 7 of the actuary report. They recommend using $19,500 per claim for new claims during the second six months of 2010. The expense average was increased by $500 because of the increases in expense severity for the 2008 and 2009 claim years.

As we have discussed earlier, there has been great volatility in claim severity in during the last three years. Given the increases in average developed expense severity for the 2008 and 2009 claim years, we agree with the actuaries' recommendation to increase the estimate for expense.

VI. Confidence Levels and Retained Earnings

On pages 9 and 10 of their report, the actuaries describe appropriate levels of PLF Primary retained earnings and their calculations of confidence levels. Details of their calculations of confidence levels can be found in Exhibit 8. The actuaries report that their calculations indicate that the recommended claim liabilities are "adequate approximately 50 percent of the time". In other words, the actual claim costs will be at this level **or lower** 50 percent of the time. An additional $6.4 million increases the confidence level to 70 percent. At that level, the claim liabilities will be too high 69 percent of the time.

The actuaries also mention that the PLF's recent claim volatility "highlights a fundamental weakness in the confidence level approach." The confidence level calculations have mirrored the volatility in claim results and have gone up and down significantly with each of the past ten actuarial studies. The 70 percent confidence level has varied from $6.8 to $3.2 million.

The PLF Board of Directors reviews the goal for combined Primary and Excess Program retained earnings each six months based in part upon information from the actuarial report. The purpose of positive retained earnings is to allow assessment stability even in times of poor financial results. In February, 2010, the Board of Directors decided to adopt a goal of $12.0 million for combined Primary and Excess Program retained earnings. When setting this goal, the Board of Directors considered potential adverse development of Primary Program claims, the potential of reinsurance failure for the Excess Program, and potential poor investment performance. When they included investment performance as a factor, the BOD added $3.0 million to the former goal of $9.0 million.

Variation in claims results and financial performance has caused volatility in Primary Program financial results. As the actuaries discuss on page 9 of their report, the PLF Primary Program financial statements showed positive retained earnings of over $9 million at the end of 1999. Extremely poor claim results quickly turned those positive retained earnings negative. As of December 31, 2003, the Primary Program showed negative retained earnings of $8.5 million. Good financial results reduced the negative amount to $4.2 million as of December 31, 2006. The PLF Primary Program had extremely good investment returns and excellent claim results during 2007 which produced net income of $5.6 million and positive retained earnings of $1.4 million. The unprecedented poor investment performance of 2008 caused the Primary Program to lose $6.2 million and end 2008 with negative retained earnings of $4.9 million. In 2009, the Primary Program had net income of slightly less than $3.0 million for 2009 and negative retained earnings of about $1.9 million. The investment results for the first six months of 2010 were very poor. If the Board of Directors adopts the recommended claim liability, the Primary Program will have a loss of nearly $2 million for the first six months of 2010 with negative retained earnings of about $3.9 million.

The PLF Excess Program has 100 percent reinsurance for losses. As a result, the financial results are relatively predictable. The Excess Program will have positive retained earnings of about $3.3 million as of June 30, 2010. Combined retained earnings for both programs are a negative $500,000.

The PLF staff recommends that the BOD readopt the goal of $12.0 million. As in the past, we do not suggest large increases in the assessment to rapidly accomplish this goal. Rather, we hope that the assessment will be set to make gradual progress toward this goal over a long period. The time frame used for past goals has often been ten years. Generally the approach has been to not lower the assessment during good times until the retained earnings goal was reached. Accordingly, the assessment was not lowered after the great results of 2006 and 2007. That decision proved to be wise given the poor results of 2008. Unfortunately the good financial results of 2009 have been nearly offset by 2010 results to date.

We feel the most significant results of this study are the following:

1. The actuaries recommend an increase in claim estimates (indemnity and expense) of over $1.0 million. This is the second straight $1.0 million increase.

2. Defense severity increased for the 2008 and 2009 claim years. Because of these increases, the actuaries recommend increasing the average cost for expense $500 to $9,500.

3. While the frequency of new claims continued to be high for the first six months of 2010, it was lower than the 2009 pace.

The Finance Committee will discuss the actuarial report during its meeting at 8:00 a.m. on October 5, 2010 and prepare recommendations for the Board of Directors. The full Board of Directors will then act upon the committee's recommendations at the October 8, 2010 Board Meeting.