

D70J00
Maryland Automobile Insurance Fund

Operating Budget Data

	<u>CY 06</u> <u>Actual</u>	<u>CY 07</u> <u>Actual</u>	<u>CY 08</u> <u>Budgeted</u>	<u>CY 08</u> <u>Actual*</u>	<u>CY 09</u> <u>Budgeted</u>	<u>CY 08-09</u> <u>\$ Change</u>	<u>CY 08-09</u> <u>% Change</u>
Insured Division	\$45,664	\$44,001	\$50,061	\$49,488	\$51,591	\$2,104	4.3%
Uninsured Division	1,740	1,730	1,868	1,845	1,833	-\$12	-0.6%
Nonbudgeted Expenditures	\$47,404	\$45,731	\$51,929	\$51,332	\$53,425	\$2,092	4.1%

*2008 actuals are actuals through September 30, 2008, with estimates from October 1 through December 31, 2008.

- The calendar 2009 budget for the Maryland Automobile Insurance Fund (MAIF) increases by approximately \$2.09 million compared to calendar 2008, or 4.1%. This net increase results from an increase of approximately \$2.1 million, or 4.3%, in the Insured Division, partially offset by a decrease of \$11,542, or 0.6%, in the Uninsured Division.

Personnel Data

	<u>CY 06</u> <u>Actual</u>	<u>CY 07</u> <u>Actual</u>	<u>CY 08</u> <u>Budgeted</u>	<u>CY 08</u> <u>Actual*</u>	<u>CY 09</u> <u>Budgeted</u>	<u>CY 08-09</u> <u>Change</u>
Regular Positions**	434.00	400.44	452.90	439.40	460.90	21.50
Contractual FTEs**	3.00	4.16	4.16	4.58	3.58	-1.00
Total Personnel**	437.00	404.6	457.10	443.98	464.48	20.50

*2008 actual data is actuals through September 30, 2008, with estimates from October 1 through December 31, 2008.

**As reported by the Maryland Automobile Insurance Fund (MAIF).

- MAIF anticipates an increase of 21.50 positions from calendar 2008 to 2009 due to an expected increase in policies and related staffing needs.
- MAIF's calendar 2009 budget includes a decrease of 1.0 contractual full-time equivalent compared to calendar 2008 as a result of an intern position in calendar 2008 that was not continued in calendar 2009.

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Major Trends

Uninsured Division Reported Fewer Claims in Calendar 2008: MAIF reported that in calendar 2008 fewer claims were received, assigned, and outstanding compared to calendar 2007. The number of claims settled increased during this same time period.

Insured Division Policies Expected to Increase: Despite recent declines in the number of gross and net written policies, MAIF anticipates the number of these policies to increase between calendar 2008 and 2009.

Issues

Surplus of the Insured Division: Committee narrative in the 2008 *Joint Chairmen's Report* required MAIF and the Maryland Insurance Administration (MIA) to submit a report on three issues: identifying options on methods to determine the reasonableness of the surplus of MAIF; identifying who should be responsible for making the determination; and determining methods of reducing surplus if it is determined to be excessive. In October 2008, MAIF and MIA submitted a report in response to this request which outlined a planned annual evaluation of the Insured Division surplus. In November 2008, MAIF and MIA entered into a memorandum of understanding formalizing this evaluation process.

Surplus of the Uninsured Division: As of November 30, 2008, the Uninsured Division of MAIF had a surplus of approximately \$9.8 million. MAIF anticipates that this surplus will increase to approximately \$11.17 million in calendar 2009. A transfer of \$7.0 million from the Uninsured Division to the general fund is proposed in the Budget Reconciliation and Financing Act of 2009 (HB 101/SB 166). If enacted, this transfer is estimated to leave the Uninsured Division with a surplus of approximately \$4.17 million at the close of calendar 2009.

Recommended Actions

1. Adopt narrative requesting submission of the annual report on the Maryland Automobile Insurance Fund surplus to the committees.

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Operating Budget Analysis

Program Description

The Maryland Automobile Insurance Fund (MAIF) is an independent, nonbudgeted, State agency. MAIF operates on a calendar year basis.

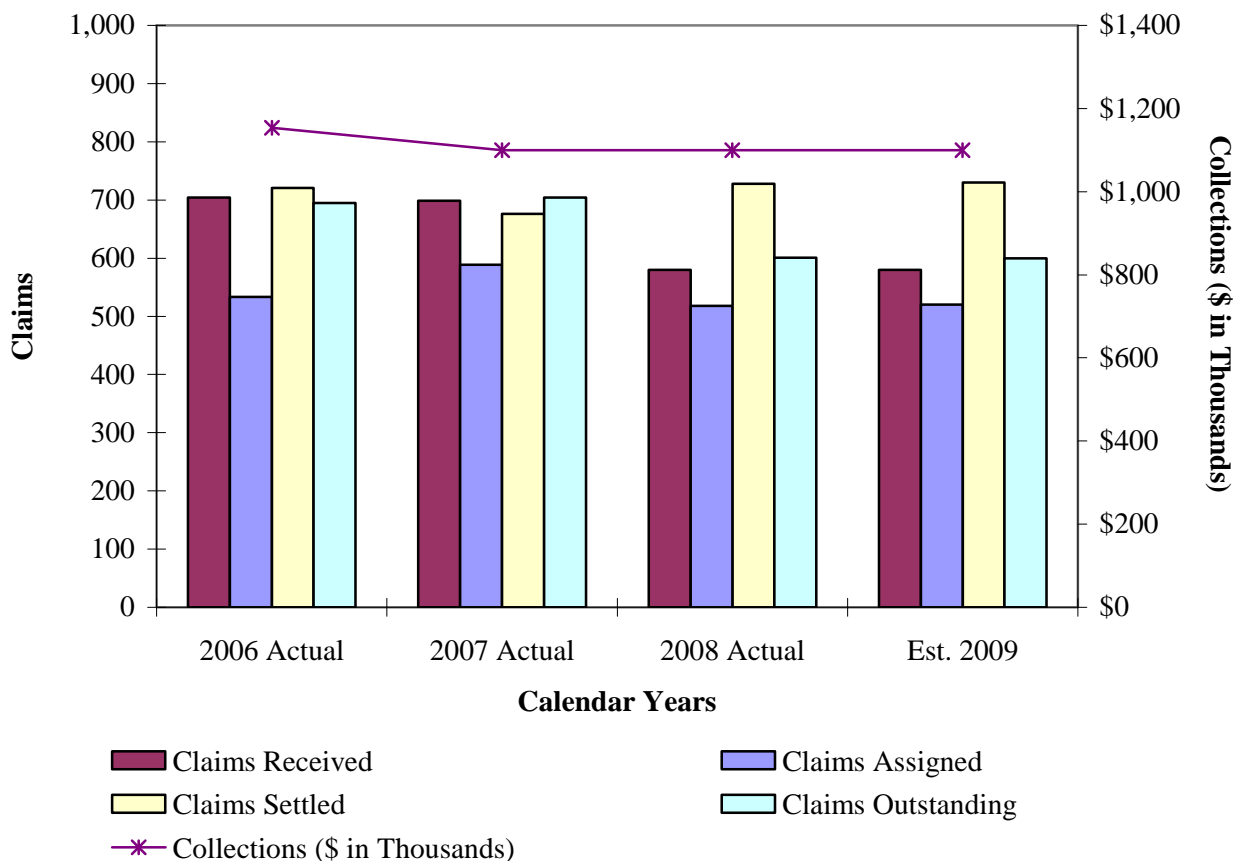
MAIF has two key responsibilities. First, MAIF provides automobile insurance policies for those residents of Maryland whose applications have been declined by private insurers. This is referred to as the Insured Division. The Insured Division, like other automobile insurance companies, handles claims for policyholders. In addition, MAIF works to minimize subsidizing these activities by Maryland's commercially insured motorists. The Insured Division is funded through premiums, investment income, and, when necessary, a surcharge on premiums statewide. MAIF is required to assess a surcharge on the Maryland automobile insurance industry whenever (1) the surplus of the Insured Division falls below the assessment threshold of 25% of the average net direct written premiums for the previous three years; and (2) there is an operating loss.

The second responsibility of MAIF is to administer and pay claims to residents of Maryland who are involved in accidents in Maryland with motorists who are uninsured, or for hit and run incidents where a responsible party cannot be found. This function of MAIF is referred to as the Uninsured Division. The Uninsured Division may recover money paid out from the uninsured at-fault party through collections on notes and judgments. In addition, MAIF receives income from investments and uninsured motorist fines.

Performance Analysis: Managing for Results

As shown in **Exhibit 1**, the number of claims received, assigned, and outstanding decreased between calendar 2007 and 2008. All three of these measures are expected to remain near the calendar 2008 level in 2009. By contrast, the number of claims settled increased between calendar 2007 and 2008. The number of claims settled is expected to remain near the calendar 2008 level in 2009.

**Exhibit 1
Program Measurement Data
Uninsured Division
Calendar 2006-2009**

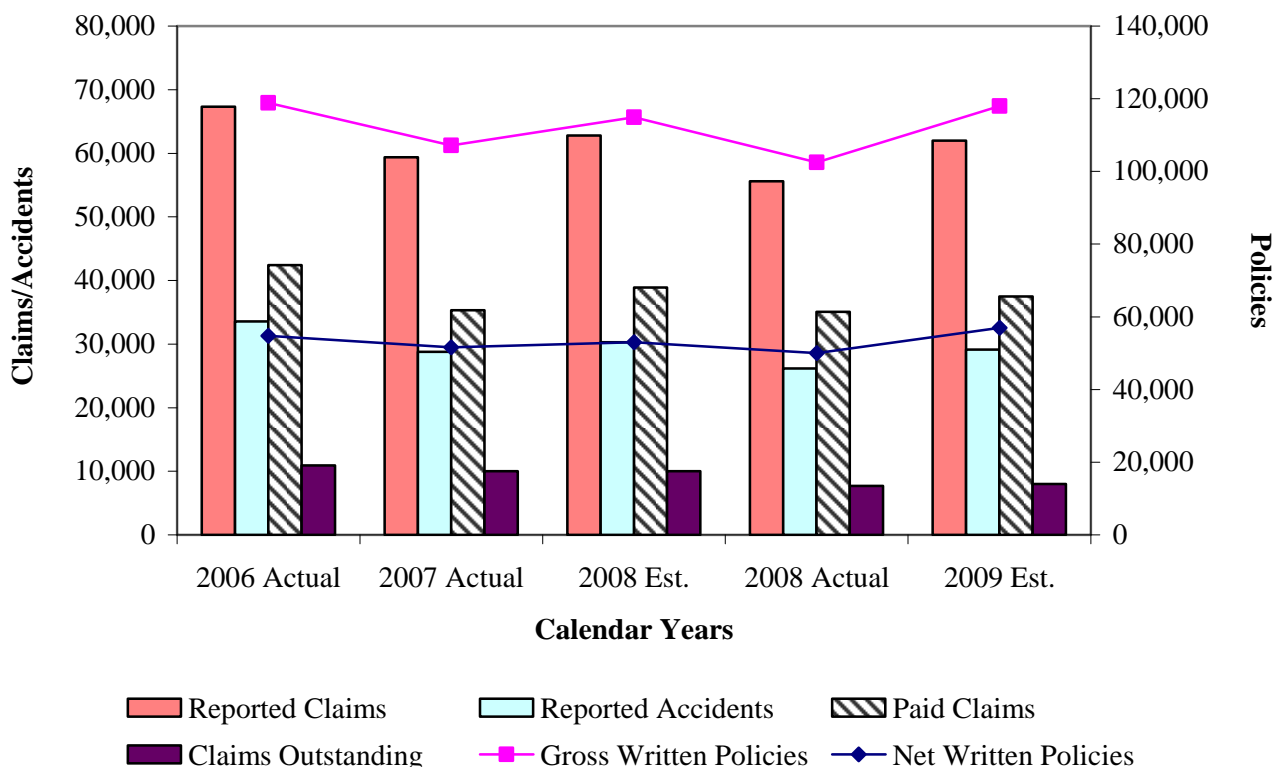


Note: Year-end adjustments and reserve changes may significantly alter the results. All 2008 numbers are subject to adjustment.

Source: Maryland Automobile Insurance Fund

As shown in **Exhibit 2**, despite an initial estimate of increases in all but one of the performance measures for the Insured Division between calendar 2007 and 2008, each of the measures decreased between these two years. However, each of these measures is again expected to increase between calendar 2008 and 2009. The largest expected increases are related to the number of policies. In calendar 2009, the number of gross written policies is expected to increase from 102,480 to 118,000, and the number of net written policies is expected to increase from 50,026 to 57,000.

**Exhibit 2
Program Measurement Data
Insured Division
Calendar 2006-2009**



Note: Year-end adjustments and reserve changes may significantly alter the results. All 2008 numbers are subject to adjustment.

Source: Maryland Automobile Insurance Fund

MAIF indicates that the operations are counter-cyclical, which means that in times when the private market tightens, MAIF expects the Insured Division to grow. In calendar 2008, MAIF expected increases to occur based on indications that the private market was tightening underwriting standards; however, the increase in policies did not occur. Due to the current and expected conditions, MAIF continues to project increases in business in calendar 2009.

Calendar 2009 Projected Budget

MAIF, a nonbudgeted fund agency, submits its budget to the General Assembly for informational purposes only. As shown in **Exhibit 3**, MAIF's calendar 2009 budget is expected to increase by approximately \$2.09 million, or 4.1%, compared to calendar 2008. The majority of this increase occurs in the Insured Division budget, which increases by approximately \$2.1 million, or 4.3%, compared to calendar 2008. The budget of the Uninsured Division decreases slightly compared to calendar 2008, \$11,542, or 0.6%.

The most significant changes in the calendar 2009 budget for MAIF are in the areas of personnel, premium taxes, volume-related expenses, and employee bonuses.

Impact of Cost Containment

Although a nonbudgeted fund agency MAIF is participating in the furlough plan. MAIF indicates that each employee received a 2% salary reduction; some employees will receive an additional two or three furlough days. MAIF indicates that this will produce a reduction in salaries of approximately \$200,000.

However, MAIF anticipates these furloughs will increase costs by approximately \$225,000 as a result of negative impacts on activities such as additional days of rental cars and additional storage costs through increased claim loads.

The furlough plan was not anticipated at the time of the calendar 2009 budget, and as a result, this budget may be expected to change to reflect the furlough savings and expenses.

Personnel

One of the most significant changes in the calendar 2009 budget of MAIF is in the area of personnel costs. Overall, personnel costs are expected to increase by \$956,180 in calendar 2009.

This net increase includes an increase of approximately \$1.8 million related to 21.5 new positions and projected merit and cost-of-living adjustment (COLA) increases. MAIF anticipates that the business will expand during calendar 2009 as a result of the current economic conditions. As a result, it expects to need additional positions to accommodate the anticipated increase. MAIF reports that these positions will not be filled until volume dictates they are needed. MAIF indicates that it included in the budget for calendar 2009 a 3% merit pool for employees, approximately \$707,000 of the \$1.8 million increase. In the years that the State provides a COLA, MAIF indicates it reduces the overall merit pool by the same amount and provides the same level of COLA to its employees. In the years that the State does not provide a COLA, MAIF also does not provide a COLA. **MAIF should comment on the planned use of merit increases in calendar 2009 in light of the current fiscal situation.**

In addition, fringe benefits including health insurance, retirement, and Social Security also increase by approximately \$341,000.

Exhibit 3
Proposed Budget
Maryland Automobile Insurance Fund
(\$ in Thousands)

	Nonbudgeted Fund	Total
2008 Actual	\$51,332	\$51,332
2009 Proposed Budget	53,425	53,425
Amount Change	2,092	2,092
Percent Change	4.1%	4.1%
Where It Goes:		
Personnel Expenses		
21.5 new positions, employee cost-of-living adjustments, and merit increases		\$1,837
Social Security contributions		162
Retirement expenses.....		143
Health insurance		36
Workers' compensation premium assessment		-576
Temporary workers, contractual employees, and overtime		-658
Other fringe benefit adjustments.....		12
Other Changes		
Premium tax.....		492
Volume related expenses including appraisals, reinsurance, and commercial reporting services.....		383
Changes in employee bonuses		270
Replacement equipment due to replacement of furniture in the Baltimore House Counsel Office.....		40
Fuel, utilities, and motor vehicle operations.....		27
Travel due to training and related expenses.....		24
House Counsel Office in Prince George's County which opened in 2008.....		14
Decreases in contractual services primarily for computer software maintenance.....		-26
Communications.....		-148
Other		60
Total		\$2,092

Note: 2008 actual is actual data through September 30, 2008, and estimates from October 1 through December 31, 2008. The Maryland Automobile Insurance Fund operates on a calendar year basis.

Note: Numbers may not sum to total due to rounding.

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These increases are partially offset by a decrease of \$658,444 related to temporary workers, contractual employees, and overtime. This decrease is the result of temporary workers in the area of information technology in calendar 2008 which are not included in the calendar 2009 budget, the decrease of one contractual employee, and an anticipation of less overtime during this calendar year. An additional decrease of \$576,091 is the result of workers' compensation which had a higher than expected cost in calendar 2008.

Technical and Special Fees

The largest numerical change in the calendar 2009 budget for MAIF is in the area of technical and special fees. MAIF indicates that the increase of approximately \$1.2 million in this area is primarily the result of an anticipated increase in premium tax expenses, volume-related expenses, and a change in bonuses.

The premium tax is expected to increase by approximately \$492,000. MAIF, like other insurance companies, pays a 2% premium tax on the direct written premiums.

Volume-related expenses account for an increase of approximately \$383,000. These expenses include items such as appraisals used for underwriting purposes, commercial reporting services, and reinsurance.

The third significant increase within technical and special fees is related to a change in employee bonuses, which is expected to result in an increase of approximately \$270,000 in expenditures. In calendar 2009, MAIF has included in its budget approximately \$1.1 million for this purpose. These bonuses are distributed based on the collective performance of MAIF. **MAIF should comment on the planned use of employee bonuses in light of the current fiscal situation.**

House Counsel Office Expenditures

Several changes in the calendar 2009 budget are the result of House Counsel Offices in Baltimore City and Prince George's County. MAIF indicates that an increase of \$40,479 in replacement equipment is due primarily to the replacement of all the furniture in the Baltimore House Counsel Office which is expected to occur during calendar 2009.

A net increase of \$13,682 is due to the opening of the House Counsel Office in Prince George's County at the end of calendar 2008. This net increase results from:

- an increase of \$92,505 in supplies and materials;
- an increase of approximately \$46,000 related to rent; and
- a decrease of \$124,823 in additional equipment for furniture which was purchased in calendar 2008.

MAIF should comment on the appropriateness of this expansion and the re-appointment of the Baltimore office even as other agencies are constrained from program enhancements.

MAIF Uninsured Division Financial Statement

Exhibit 4 shows the financial statement for the Uninsured Division of MAIF. MAIF operates on a calendar year basis, in accordance with State regulations for insurance companies. The 2008 information is actual data as of November 30, 2008, and does not include December estimates. Comparisons between calendar years may be over- or understated because information for December is not included.

Exhibit 4 Maryland Automobile Insurance Fund Uninsured Division

	Actual 2007	Actual as of 11/30/2008¹	Revised Estimated 2009
Motor Vehicle Administration Fines	\$2,451,940	\$2,578,546	\$2,656,000
Collections on Notes and Judgments	1,100,169	1,115,053	1,100,000
Investment Income	612,913	649,533	650,000
Income	\$4,165,022	\$4,343,132	\$4,406,000
Claims Incurred	\$759,738	\$1,022,170	\$1,052,800
Claims Expenses Incurred	719,275	635,628	740,900
Collection Expenses	541,370	448,217	557,600
Administrative Expenses	660,621	736,823	680,400
Expenditures	\$2,681,004	\$2,842,838	\$3,031,700
Net Gain	\$1,484,018	\$1,500,294	\$1,374,300
Beginning Surplus	\$7,146,385	\$8,851,534	\$9,792,000
Net Income	1,484,018	1,500,294	1,374,300
Unrealized Gain (Losses)	221,131	-559,435	0
Ending Surplus	\$8,851,534	\$9,792,393	\$11,166,300
Proposed Transfer to General Fund²			-7,000,000
Ending Surplus after Proposed Transfer	\$8,851,534	\$9,792,393	\$4,166,300

¹Year-end adjustments and reserve changes may significantly change the results. All 2008 numbers are subject to adjustment.

²Transfer of \$7.0 million proposed in the Budget and Reconciliation Financing Act of 2009 (HB 101/SB 166).

Notes: The Maryland Automobile Insurance Fund operates on a calendar year basis for its financial statements in accordance with State regulations for insurance companies. December results are not yet available, so 2008 financial results are shown as of November 30, 2008. MAIF advises that the proposed transfer will impact investment income for 2009 and out-years until the surplus increases to a similar level. The calendar 2009 estimates for the Uninsured Division are largely based on recent experience.

Source: Maryland Automobile Insurance Fund; Department of Legislative Services

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MAIF anticipates a total income of approximately \$4.4 million in calendar 2009, which is a modest increase of \$62,868 compared to calendar 2008. This increase is primarily related to the Motor Vehicle Administration (MVA) uninsured motorist penalty fee. This fee has been indexed annually based on the Consumer Price Index – All Urban Consumers – Medical Care since its reinstatement to MAIF in fiscal 2002 at a level of \$2.0 million. The income from collections on notes and judgments and investment income are estimated to stay at approximately the calendar 2008 level in 2009; both increased modestly between calendar 2007 and 2008.

The calendar 2009 total expenditures are estimated to be approximately \$3.0 million, an increase of \$188,862 compared to calendar 2008, a relatively similar percent increase in expenditures as the increase between calendar 2007 and 2008. Expenditure estimates in the areas of claims expenses incurred, collection expenses, and administrative expenses are based on the calendar 2007 actual level inflated by 3%.

MAIF indicates that it is difficult to project the number of claims it will receive from year-to-year in the Uninsured Division. For calendar 2009, claims incurred are expected to remain relatively near the calendar 2008 level, an increase of approximately \$31,000, or approximately 3%.

MAIF anticipates a net gain of approximately \$1.37 million in calendar 2009. This estimated net gain is smaller than the net gain in either calendar 2008 or 2007. At this level of net gain, MAIF anticipates a closing surplus in calendar 2009 of approximately \$11.17 million.

In recent years, MAIF has experienced either an unrealized gain or loss which directly impacts the level of surplus. Given current market conditions, MAIF was conservative with its estimate for calendar 2009 and anticipates neither an unrealized gain nor loss.

Exhibit 4 includes the Department of Legislative Services (DLS) estimate of the impact of a transfer of \$7.0 million from the Uninsured Division to the general fund in fiscal 2009 that is proposed in the Budget Reconciliation and Financing Act of 2009 (HB 101/SB 166). After accounting for the proposed transfer, the Uninsured Division closing surplus would be approximately \$4.17 million. MAIF indicates that such a transfer is likely to negatively impact the level of investment income in future years.

MAIF Assessment Threshold

MAIF is required to assess a surcharge on the Maryland automobile insurance industry which may be passed on to policyholders of those companies after two triggers occur. First, the surplus of the Insured Division must be below 25% of the three-year average of the net direct written premiums. Second, it must experience an operating loss.

The assessment threshold varies from year to year as a result of changes in the three-year average of the net direct written premiums.

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Exhibit 5 shows the recent and estimated assessment thresholds. The net direct written premium is expected to increase from calendar 2007 through 2009. Despite these anticipated increases, the three-year average of net direct written premiums is expected to continue to decline from the calendar 2007 level through 2009. As a result of the expected decline in the three-year average of net direct written premiums, the assessment threshold is also expected to decline through calendar 2009 compared to the calendar 2007 level. In calendar 2009, the assessment trigger is expected to be approximately \$33.7 million.

**Exhibit 5
Assessment Threshold
Insured Division
Calendar 2007-2009**

	<u>Direct Written Premium</u>	<u>3-year Average</u>	<u>Assessment Threshold</u>
2005	\$193,575,436		
2006	153,127,206		
2007	128,672,269	\$158,458,304	\$39,614,576
2008 Est.	135,600,000	139,133,158	34,800,000
2009 Est.	140,700,000	134,990,756	33,700,000

Note: The Maryland Automobile Insurance Fund operates on a calendar year basis for its financial statements in accordance with State regulations for insurance companies. December results are not yet available, so 2008 financial results are shown as of November 30, 2008. Year-end adjustments and reserve changes may significantly alter the results. All 2008 numbers are subject to adjustment.

Source: Maryland Automobile Insurance Fund

MAIF Insured Division Financial Statement

Exhibit 6 shows the financial statement for the Insured Division of MAIF. MAIF operates on a calendar year basis in accordance with State regulations for insurance companies. The 2008 data is actual as of November 30, 2008, and does not include estimates through December. Comparisons between calendar years may be over- or understated because information for December is not included.

Exhibit 6
Maryland Automobile Insurance Fund
Insured Division

	<u>Actual</u> <u>2007</u>	<u>Actual as of</u> <u>11/30/2008*</u>	<u>Estimated</u> <u>2009</u>
Earned Premium	\$139,554,443	\$111,829,912	\$128,600,000
Investment Income	28,375,822	7,019,988	12,000,000
Other Income	20,461	64,968	0
Income	\$167,950,726	\$118,914,868	\$140,600,000
Claim Incurred	\$89,785,545	\$76,423,701	\$94,500,000
Claim Expenses Incurred	30,223,918	25,549,242	30,900,000
Other Expenses	30,272,315	27,950,168	34,200,000
Expenditures	\$150,281,778	\$129,923,111	\$159,600,000
Net Gain (Loss)	\$17,668,948	-\$11,008,243	-\$19,000,000
Beginning Surplus	\$178,308,502	\$184,753,525	\$138,700,000
Net Income	17,668,948	-11,008,243	-19,000,000
Change to Non-admitted Assests	-11,223,924	-35,071,807	0
Ending Surplus	\$184,753,526	\$138,673,475	\$119,700,000
Assessment Threshold	\$39,614,576	\$34,800,000	\$33,700,000
Ratio of Surplus to Assessment Threshold	4.66	3.98	3.55

* Year-end-adjustments and reserve changes may significantly alter the results. All 2008 numbers are subject to adjustment.

Note: The Maryland Automobile Insurance Fund operates on a calendar year basis for its financial statements in accordance with State regulations for insurance companies. December results are not yet available so 2008 financial results are shown as of November 30, 2008.

Source: Maryland Automobile Insurance Fund; Department of Legislative Services

After a decline in overall income of the Insured Division between calendar 2007 and 2008, income is anticipated to increase by approximately \$21.7 million in calendar 2009 compared to 2008. However, if the total income for calendar 2008 is annualized, the increase in calendar 2009 is much smaller at approximately \$10.9 million. Consistent with expectations of increased policies the amount of earned premium is expected to increase to \$128.6 million in calendar 2009. This is an increase of approximately \$16.8 million between calendar 2008 and 2009, or \$6.6 million on an annualized basis. Despite the anticipated increase, earned premiums are estimated to be lower than the calendar 2007 actual level.

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MAIF indicates that it intended to be conservative in the estimate of investment income as a result of the recent market unpredictability. However, the level of investment income is expected to increase to \$12.0 million in calendar 2009. This level of investment income remains well below the calendar 2007 level.

Total expenditures are expected to increase by approximately \$29.7 million between calendar 2008 and 2009. If total expenditures in calendar 2008 are annualized, the expected increase between calendar 2008 and 2009 reduces to approximately \$12.0 million. This increase is larger than the anticipated increase in income. This level of expenditure would also be higher than calendar 2007 when the income of the Insured Division was also higher. The majority of this increase occurs in claims incurred, which is expected to increase to \$94.5 million in calendar 2009 from the level of \$76.4 million as of November 30, 2008. MAIF anticipates a higher level of policies in calendar 2009, which MAIF indicates typically also, increases claims-related losses and other related expenses.

Due to the greater increase in expenditure than income, MAIF anticipates a net loss in calendar 2009, or \$19.0 million, which is larger than the net loss in calendar 2008.

The estimated ending surplus in calendar 2009 is \$119.7 million, which is approximately \$19.0 million lower than the ending surplus of calendar 2008 and approximately \$65.0 million lower than calendar 2007. The estimated calendar 2009 surplus and assessment threshold produces a ratio of 3.55, which is lower than the calendar 2007 and 2008 level.

Of note in calendar 2009, MAIF did not estimate a change in non-admitted assets, which largely reflects fluctuations in the stock market because this is where the differences between the cost and market price of stocks are recorded. In the prior two calendar years, calendar 2007 and 2008, MAIF has experienced a negative change in non-admitted assets of approximately \$11.2 million and \$35.0 million, respectively. In light of this and the current market unpredictability, it would be reasonable to conclude that MAIF will experience a negative change to non-admitted assets in calendar 2009. This may further deteriorate the calendar 2009 ending surplus. **MAIF should comment on how a lower investment income or a negative change to non-admitted assets in calendar 2009 would impact the ending calendar 2009 surplus and operations of the Insured Division.**

MAIF Active Vehicle Analysis

Exhibit 7 provides information on the distribution of MAIF policies within the State by territory. The distribution by territory may impact the number and value of expected claims.

Exhibit 7
Active Vehicle Analysis
Insured Division
Calendar 2005-2008

<u>Territory</u>	<u>2005</u>	<u>Dist %</u>	<u>2006</u>	<u>Dist %</u>	<u>2007</u>	<u>Dist %</u>	<u>2008</u>	<u>Dist %</u>
Baltimore City	9,033	9.0%	7,673	9.1%	6,096	7.9%	5,111	6.9%
Inner Baltimore County	5,940	5.9%	4,921	5.8%	4,477	5.8%	4,015	5.4%
Outer Montgomery County	4,893	4.9%	3,741	4.4%	3,525	4.6%	3,330	4.5%
Outer Prince George's County	8,075	8.0%	7,169	8.5%	6,648	8.6%	6,746	9.1%
Outer Baltimore County	4,163	4.1%	3,326	3.9%	2,775	3.6%	2,376	3.2%
Inner Montgomery County	4,504	4.5%	3,558	4.2%	3,312	4.3%	3,204	4.3%
Inner Prince George's County	20,618	20.5%	18,178	21.5%	18,113	23.4%	18,599	25.0%
Eastern Shore	5,463	5.4%	4,605	5.4%	4,598	5.9%	4,767	6.4%
Rest of the State	38,017	37.8%	31,363	37.1%	27,848	36.0%	26,132	35.2%
Total Vehicles	100,706	100.0%	84,534	100.0%	77,392	100.0%	74,280	100.0%

Source: Maryland Automobile Insurance Fund

Overall, the distribution in calendar 2008 continued several trends from previous calendar years. As in several recent years, inner and outer Prince George's County as well as the Eastern Shore had a higher share of policies in calendar 2008 than in 2007. By contrast, several territories including Baltimore City had a decreasing share of policies in calendar 2008.

Baltimore City, inner, and outer Prince George's County continue to have the highest shares of policies in the State. In calendar 2008, inner Prince George's County had 25% of the MAIF policies in the State.

Issues

1. Surplus of the Insured Division

The 2008 *Joint Chairmen's Report* directed MAIF and the Maryland Insurance Administration (MIA) to submit a report on three issues: (1) identifying options on methods to determine the reasonableness of the surplus of the Insured Division of MAIF; (2) who should be responsible for making the determination; and (3) methods of reducing surplus if it is determined to be excessive. In October 2008, MAIF and MIA submitted a response to this request.

Background of MIA and MAIF

MAIF and MIA began by providing background information on insurance regulation, the role of MIA in insurance regulation, MAIF and its unique role, and the assessment threshold of MAIF. This discussion included several key points.

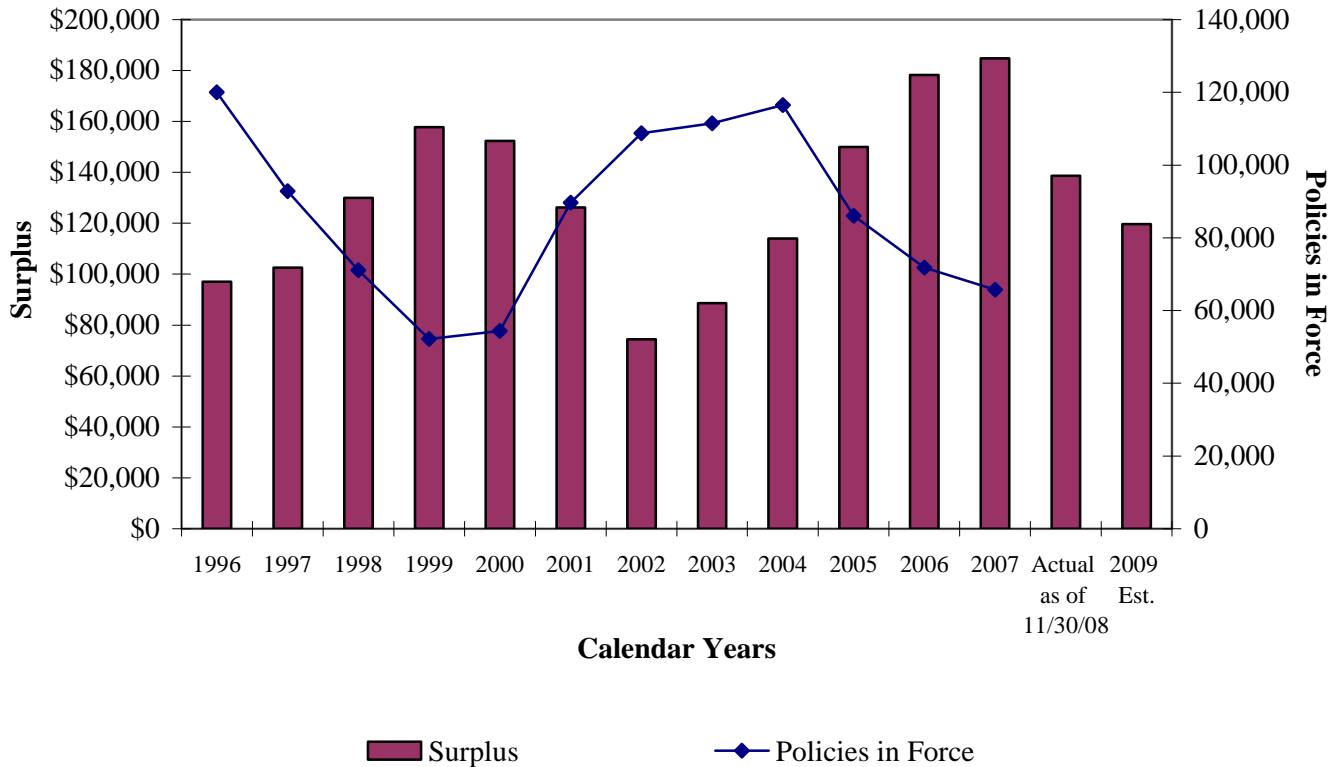
Insurance companies adhere to risk-based capital standards which establish a minimum level of capital required. MIA, however, expects insurance companies to maintain a higher level. The report also noted that other factors (*e.g.*, size and diversity of business) are also considered in an evaluation of an insurer's capital.

MAIF has a different statutory standard for its Insured Division surplus. This statutory standard, referred to as the assessment trigger, is based on the three-year average of net direct written premiums and whether there is an operating loss. The assessment trigger is the point at which MAIF's surplus falls to a level in which other insurance companies and ultimately the policyholders of those companies are required to pay a certain amount of money to build the surplus of MAIF. No assessments have occurred since 1989. The current standard was developed in 1995.

History of Surplus

MAIF and MIA then discussed the recent history of the surplus, calendar 1995 to August 31, 2008. The surplus may vary based on economic conditions and the number of policies issued, as shown in **Exhibit 8**. These changes highlight the counter-cyclical nature of MAIF’s business.

Exhibit 8
History of Policies and Surplus
Insured Division
Calendar 1996-2009
(\$ in Thousands)



Note: Year-end adjustments and reserve changes may significantly alter the results. All 2008 numbers are subject to adjustment. Policies in force are policies in effect on December 31 of each year.

Source: Maryland Automobile Insurance Fund; Department of Legislative Services

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From calendar 1995 through 1999, the surplus of MAIF increased from \$111.0 million to \$158.0 million as the number of policies decreased. However, as policies grew from calendar 2000 through 2002, the surplus decreased from \$158.0 million to \$74.0 million. The surplus grew again after this time reaching a height of \$190.0 million in October 2007, as policies generally decreased. Economic conditions since that time have reduced MAIF's surplus, so that by the end of August 2008, it had decreased to \$171.0 million.

Since the time of the report, economic conditions have continued to decline, and the surplus has also continued to decline to a level of approximately \$138.7 million as of November 30, 2008.

External and unique factors of MAIF influence the amount of surplus. External factors are equity and bond markets, health of the industry, industry underwriting standards, industry catastrophic losses, and the reinsurance market. Unique factors to MAIF are high cancellations which limit the ability of MAIF to offset costs of writing new policies and the difficulties of controlling operating expenses during periods of policy growth.

Reasonableness of Surplus

MAIF and MIA also provided an analysis of the reasonableness of MAIF's current surplus by comparing it to that of other insurance companies. This analysis focused on comparing MAIF's surplus to assessment ratio to the ratio of surplus to risk-based capital standards of other companies. MAIF and MIA concluded that private companies would not likely view the surplus of MAIF as excessive based on these comparisons at this time.

Surplus Evaluation

MAIF and MIA also discussed the methods by which MAIF's surplus should be evaluated and the formal process of evaluation that MAIF and MIA intend to begin. MAIF and MIA recommended that MAIF's surplus be analyzed using (1) the ratio of surplus to assessment trigger; (2) surplus under risk-based capital standards; (3) ratio of premiums to surplus; (4) external economic factors; (5) trends in automobile insurance; (6) 24-month financial projections; (7) type of insurance; (8) quality of risk; (9) geographic scope of policies; (10) market share and competitive position; (11) best interest of insurance consumer; and (12) any other information as determined by the commissioner. This list of factors contains some of the same types of information used to analyze other insurance companies.

In a formal review process, MIA would require the MAIF Board of Trustees to assess the surplus and provide information to MIA. MIA would then conduct a review of MAIF's surplus. If the surplus is determined to be excessive, MIA would request MAIF to develop a plan to reduce the surplus, including a description of methods and a timeline. The commissioner could require certain actions, such as reducing premiums or require rebates, if the plan by MAIF is determined not to be acceptable.

On November 14, 2008, MAIF and MIA signed a MOU formalizing the proposed evaluation plan. This MOU will require MAIF to annually submit the information to MIA for review by May 1, beginning in 2009. MIA will then conduct a review, and the commissioner will make a determination on the reasonableness of the surplus by June 30. A report with this determination will be submitted to the Presiding Officers of the General Assembly and the chair and vice chair of the Senate Finance and House Economic Matters committees and will be available on the web site of MIA. **DLS recommends this report also be annually submitted to the budget committees.**

2. Surplus of the Uninsured Division

Since MAIF's creation in the 1972 session, one of the primary duties has been to take the responsibility of the operations of the Unsatisfied Claim and Judgment Fund (UCJF), which paid claims by persons involved in accidents with uninsured or unknown drivers. The UCJF was created through Chapter 837 of 1957.

Factors Influencing Surplus

The income streams of the Uninsured Division are relatively stable. One of the primary sources of income is the MVA uninsured motorist penalty fee. MAIF indicates that it has received funds from the MVA uninsured motorist penalty fee since the responsibilities for this function began in 1973, with one exception.¹ For one year, fiscal 2001, as a result of Chapter 568 of 2001, MAIF did not receive these funds and was not expected to receive it again until fiscal 2008. However, Chapter 440 of 2002 restored this funding to the Uninsured Division at a level of \$2.0 million indexed each year based on the Consumer Price Index – All Urban Consumers – Medical Care. In calendar 2009, MAIF expects to receive approximately \$2.66 million from this penalty.

The Uninsured Division also receives income through investments and collections on notes and judgments. Section 20-608 of the Insurance Article allows MAIF to collect from the uninsured at-fault party the funds paid out, providing for some level of recovery for claims losses. The collections on notes and judgments have fluctuated within a relatively small range in recent years providing a relatively stable income source, with a low of \$1.1 million in calendar 2007 and a high of \$1.57 million in 2001.

Following the calendar 2002 transfer of \$20.0 million from the Uninsured Division to the general fund, investment income has played a relatively small role in the overall level of income for the Uninsured Division.

The expenditures levels have shown more unpredictability than income in recent years. From calendar 1999 through 2009, the total expenditures of the Uninsured Division have ranged between a low of approximately \$2.68 million in calendar 2007 and a high of approximately \$4.44 million in calendar 2005.

¹ The current uninsured motorist penalty fee is \$150 for the first 30 days and an additional \$7 for each day after 30 days.

History of Surplus

As shown in **Exhibit 9**, the surplus of the Uninsured Division has increased in most years since calendar 1999. The surplus decreased in only three of these years: calendar 2002, 2004, and 2005. In calendar 2002, \$20.0 million from the Uninsured Division was transferred to the general fund as a result of Chapter 440 of 2002; absent this transfer, the surplus would have been expected to increase by \$574,069 based on the net income and unrealized loss.

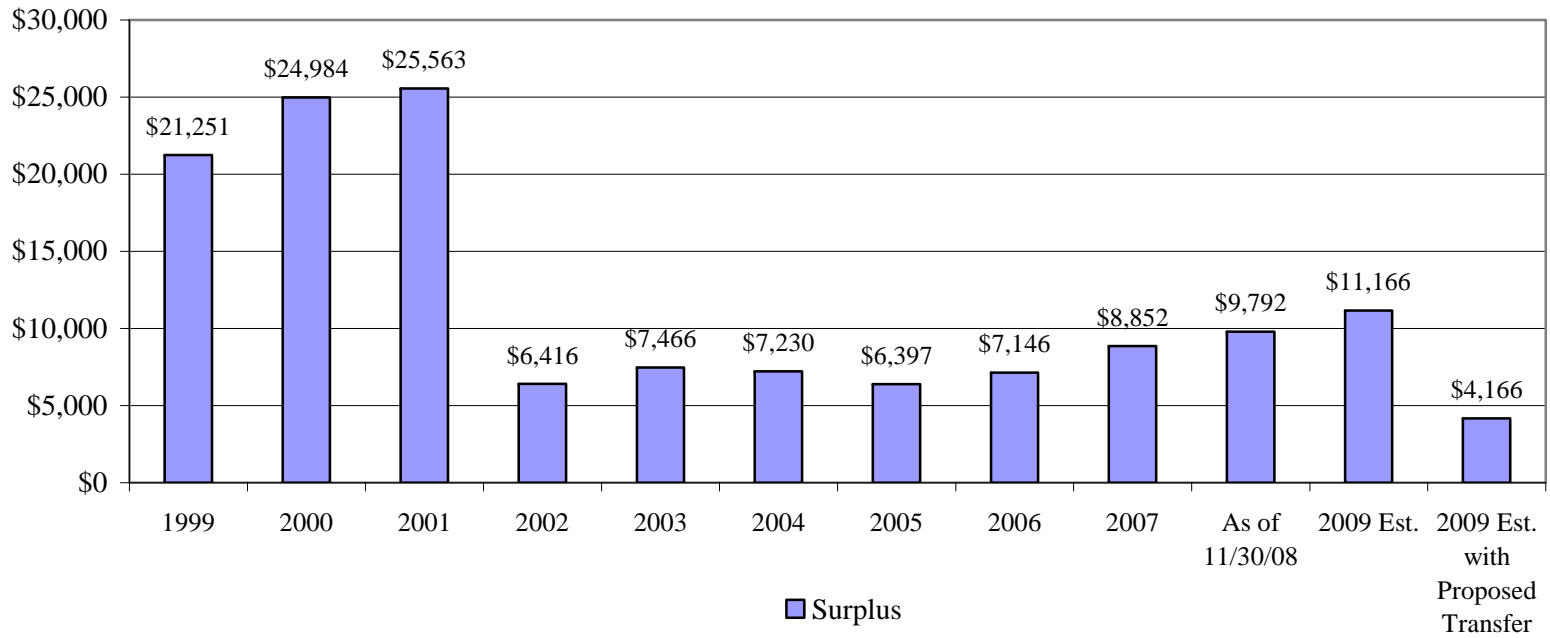
As of November 30, 2008, the MAIF Uninsured Division surplus was approximately \$9.79 million, an increase of approximately \$941,000 from calendar 2007. In calendar 2009, the surplus is expected to increase to approximately \$11.17 million.

Proposed Transfer of Surplus

The Budget Reconciliation and Financing Act of 2009 (HB 101/SB 166) proposes to transfer \$7.0 million from the Uninsured Division to the general fund in fiscal 2009, which would occur during the calendar 2009 operations of MAIF. As shown in Exhibit 4, DLS estimates the Uninsured Division surplus to be approximately \$4.17 million following this proposed transfer at the close of calendar 2009. MAIF anticipates that the proposed transfer would reduce investment outcome until the surplus rebuilds to the current level.

MAIF should comment on whether it anticipates having enough funds available after the proposed transfer to meet expenses in calendar 2009 and 2010.

**Exhibit 9
Surplus History
Uninsured Division
Calendar 1999-2009
(\$ in Thousands)**



Note: Year-end adjustments and reserve changes may significantly alter the results. All 2008 numbers are subject to adjustment.

Source: Maryland Automobile Insurance Fund; Department of Legislative Services

Recommended Actions

1. Adopt the following narrative:

Annual Report on the Reasonableness of the Surplus of the Insured Division of the Maryland Automobile Insurance Fund (MAIF): The response to the *2008 Joint Chairmen’s Report* request by MAIF and the Maryland Insurance Administration (MIA) indicated that MIA will produce annually a report on the determination of the reasonableness of the surplus of the Insured Division of MAIF to the Presiding Officers of the General Assembly and the chair and vice chair of the Senate Finance and House Economic Matters committees. The committees request MIA submits this report to the budget committees concurrent with its submission to the Presiding Officers of the General Assembly and the chair and vice chair of the Senate Finance and House Economic committees.

Information Request	Author	Due Date
Annual report on the reasonableness of the surplus of the Insured Division of MAIF	MIA	Concurrent with submission to the Presiding Officers of the General Assembly and the Chair and Vice Chair of the Senate Finance and House Economic Matters Committees and annually thereafter

**Object/Fund Difference Report
Maryland Automobile Insurance Fund**

<u>Object/Fund</u>		<u>CY 2007 Actual</u>	<u>CY 2008 Projected</u>	<u>2009 Estimated</u>	<u>CY08-CY09 Amount Change</u>	<u>Change</u>
Positions						
01	Regular	400.44	439.40	460.90	21.5	4.9%
02	Contractual	4.16	4.58	3.58	-1.00	-21.8%
Total Positions		404.60	443.98	464.48	20.50	4.6%
Object						
01	Salaries, Wages & Fringe Benefits	\$29,958,179	\$33,671,332	\$34,627,512	\$956,180	2.8%
02	Tech & Special Fees	8,488,336	7,903,901	9,126,411	1,222,510	15.5%
03	Communications	1,336,920	1,547,522	1,399,221	-148,301	-9.6%
04	Travel	128,670	152,489	176,720	24,231	15.9%
06	Fuel & Utilities	489,094	499,179	518,092	18,913	3.8%
07	Motor Vehicle Operations & Main	165,842	464,468	472,075	7,607	1.6%
08	Contractual Services	4,137,360	5,272,227	5,245,948	-26,279	-0.5%
09	Supplies & Materials	410,242	385,271	477,776	92,505	24.0%
10	Equipment Replacement	8,184	31,683	72,162	40,479	127.8%
11	Equipment Additional	219,854	979,917	855,094	-124,823	-12.7%
13	Fixed Charges	379,958	398,679	449,544	50,865	12.8%
14	Land & Structures	8,048	25,782	4,000	-21,782	-84.5%
Total Objects		\$45,730,686	\$51,332,450	\$53,424,555	\$2,092,105	4.1%
Funds						
07	Nonbudgeted Fund	\$45,730,686	\$51,332,450	\$53,424,555	\$2,092,105	4.1%
Total Funds		\$45,730,686	\$51,332,450	\$53,424,555	\$2,092,105	4.1%

Note: 2008 actuals are actual through September 30, 2008, and estimates from October 1 through December 31, 2008.

**Fiscal Summary
Maryland Automobile Insurance Fund**

<u>Program/Unit</u>	<u>CY07 Actual</u>	<u>CY08 Actual</u>	<u>CY09 Estimate</u>	<u>Change</u>	<u>CY07-CY08 %Change</u>
42 Insured Division	\$44,000,935	\$49,487,845	\$51,591,492	\$2,103,647	4.3%
47 Uninsured Division	\$1,729,751	\$1,844,605	\$1,833,063	-\$11,542	-0.6%
Total Expenditures	\$45,730,686	\$51,332,450	\$53,424,555	\$2,092,105	4.1%
Nonbudgeted Fund	\$45,730,686	\$51,332,450	\$53,424,555	\$2,092,105	4.1%
Total Appropriations	\$45,730,686	\$51,332,450	\$53,424,555	\$2,092,105	4.1%

Note: 2008 actuals are actual through September 30, 2008, and estimates from October 1 through December 31, 2008.