

G99G00
Injured Workers' Insurance Fund

Operating Budget Data

(\$ in Thousands)

	<u>CY 07</u> <u>Actual</u>	<u>CY 08</u> <u>Working</u>	<u>CY 09</u> <u>Allowance</u>	<u>CY 08-09</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
Nonbudgeted Fund	\$42,870	\$44,670	\$43,795	-\$875	-1.96%
Total Funds	\$42,870	\$44,670	\$43,795	-\$875	-1.96%

- The Injured Workers' Insurance Fund's (IWIF) projected calendar 2009 budget decreases by \$875,000, or -1.96%, in nonbudgeted funds.

Personnel Data

	<u>CY 07</u> <u>Actual</u>	<u>CY 08</u> <u>Working</u>	<u>CY 09</u> <u>Allowance</u>	<u>FY 09-10</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
Regular Positions	404	404	383	-21	-5.20%
Total Personnel	404	404	383	-21	-5.20%

- A total of 21 positions will be deleted from the calendar 2009 budget, primarily in claims processing functions.

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

For further information contact: Dylan R. Baker

Phone: (410) 946-5530

Analysis in Brief

Major Trends

Productivity Indicators: Decline in per employee workload leads to staff reductions.

Financial Indicators: The Injured Workers’ Insurance Fund posted a net loss in calendar 2008.

Issues

Increase in Settlements and Impact on State Budgeting: An increase in the number of cases settled with claimants by IWIF has decreased potential long-term liabilities while increasing current pay-as-you-go expenditures. **The Department of Budget and Management should prepare a cost-benefit analysis on IWIF’s policy of settling cases. IWIF should identify settlement costs by agency in the annual Assessment Report.**

State Employees Risk Management Administration and Trends of Workers’ Compensation Claims for State Agencies: The State Employees Risk Management Administration (SERMA) program to reduce workers’ compensation claims was ineffective in fiscal 2008 and may duplicate efforts undertaken by StateStat activities. **The Department of Legislative Services recommends removing SERMA from IWIF and deleting the funding associated with the program from the State’s across-the-board workers’ compensation total.**

Competitiveness of State Workers’ Compensation Claim Contract: Recent audits and studies have proposed alterations to IWIF’s role as administrator of State workers’ compensation claims. **IWIF should comment on strategies for responding to the changes suggested by the Treasurer’s Office and the Maryland Insurance Administration.**

Recommended Actions

1. Adopt narrative to require a cost-benefit analysis of workers’ compensation claim settlements.
2. Add budget language to reduce Funding of State Employees Risk Management Administration in IWIF Assessment.

Updates

Update of Current Account and Long-term Liability Account: An accounting is provided of the two workers’ compensation accounts managed for the State by IWIF.

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Operating Budget Analysis

Program Description

The Injured Workers' Insurance Fund (IWIF) is a nonbudgeted, independent entity. IWIF is governed by a board of nine directors (appointed by the Governor to five-year terms), which approves the operating and capital budgets. By law, IWIF's calendar 2009 budget is submitted to the General Assembly for informational purposes only. The primary purpose of IWIF is to provide workers' compensation insurance to Maryland-based businesses that do not wish, or are not allowed, to self-insure. Financing for IWIF is derived solely from premium and investment income.

The primary goals of IWIF include:

- to create an internal organization structure that will promote revenue and profit stabilization;
- innovation in occupational medicine and safety to control costs;
- stress continuous learning and "employer of choice";
- emphasize technology platform to drive productivity and quality; and
- brand IWIF with workplace safety and insurance expertise.

Performance Analysis: Managing for Results

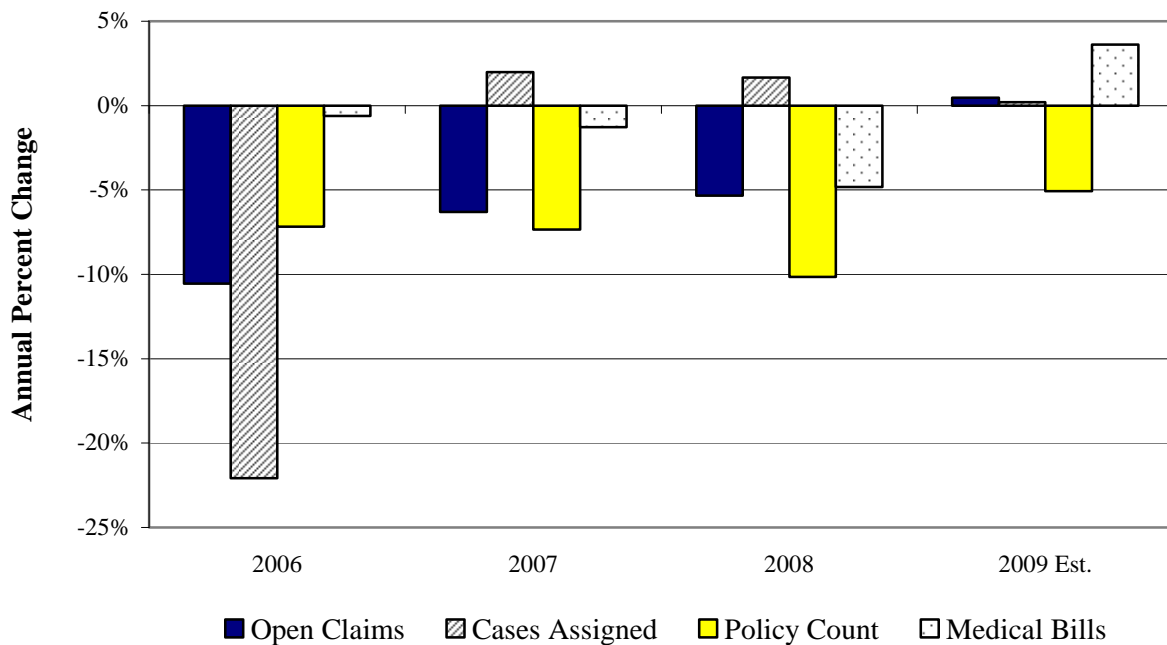
As an independent self-supporting entity, IWIF does not participate in the Managing for Results program. However, it tracks its performance through productivity and financial indicators that have been provided to the Department of Legislative Services (DLS).

Productivity Indicators

IWIF experienced declining business volumes between calendar 2005 and 2008. Total cases assigned to staff fell from 10,166 in calendar 2005 to 8,400 in calendar 2008, as an industrywide decline in injury reports contracted the total number of claims to be written. Competition across the industry further reduced IWIF’s share of the market, leading its policy totals to fall as well. These declines in workload presented to IWIF staff are reflected in the per employee responsibilities shown in **Exhibit 1**. From calendar 2005 to 2008, each of the fund’s employees was responsible for fewer open claims, policies, and medical bills, with case assignments stabilizing after a large initial drop off. These declines have prompted IWIF to reduce its workforce by 21 positions in calendar 2009 to 383 employees, which is projected to increase the cases handled by each employee.

Exhibit 1
Injured Workers’ Insurance Fund Productivity Measures
Calendar 2006-2009

Responsibility Per Staff Member



Source: Injured Workers’ Insurance Fund

Financial Indicators

From calendar 2007 to 2008, IWIF posted a loss of \$1.8 million, its first loss of income since 2002. As **Exhibit 2** indicates, the combination of declining net premiums earned and capital losses on investments overcame IWIF’s reduction of operating expenses.

Exhibit 2
Injured Workers’ Insurance Fund Status
Calendar 2004-2008
(\$ in Thousands)

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>\$ Change</u> <u>2007-08</u>	<u>% Change</u> <u>2007-08</u>
Balance Sheet Data							
<i>Assets</i>							
Total investments	\$989,390	\$1,098,709	\$1,155,032	\$1,356,948	\$1,363,297	\$6,349	0.5%
Cash and equivalents	176,480	198,256	266,503	186,875	188,164	1,289	0.7%
Subtotal Cash and Investments	\$1,165,870	\$1,296,965	\$1,421,535	\$1,543,823	\$1,551,461	\$7,638	0.5%
Other assets	78,416	85,122	91,986	94,632	87,410	-\$7,222	7.6%
Total Assets	\$1,244,286	\$1,382,087	\$1,513,521	\$1,638,455	\$1,638,871	\$416	0.0%
<i>Liabilities</i>							
Accrual unpaid claims and related expense	\$976,313	\$1,086,422	\$1,184,746	\$1,263,749	\$1,305,841	\$42,092	3.3%
Other liabilities	95,068	109,243	100,684	91,682	68,572	-23,110	-25.2%
Total Liabilities	\$1,071,381	\$1,195,665	\$1,285,430	\$1,355,431	\$1,374,413	\$18,982	1.4%
Total fund equity	172,905	186,422	228,001	283,024	264,458	-18,565	-6.6%
Total Liabilities and Fund Equity	\$1,244,286	\$1,382,087	\$1,513,431	\$1,638,455	\$1,638,871	\$416	0.0%
Income Statement Data							
<i>Income</i>							
Net premiums earned	\$286,164	\$321,168	\$321,249	\$290,824	\$244,315	-\$46,509	-16.0%
Other income	700	885	717	614	611	-3	-0.5%
Investment income and gains	77,890	65,066	76,501	83,843	37,260	-46,583	-55.6%
Total Income	\$364,754	\$387,119	\$398,467	\$375,281	\$282,186	\$93,095	-24.8%
Net claim expenses	255,609	281,194	278,663	256,118	216,677	-39,441	-15.4%
Net operating expenses	61,980	68,982	71,738	71,970	67,287	-4,683	-6.5%
Total Expenses	\$317,589	\$350,176	\$350,401	\$328,088	\$283,964	-\$44,124	-13.4%
Income/Loss	\$47,165	\$36,943	\$48,066	\$47,193	-\$1,778	-\$48,971	-103.8%

Note: Calendar 2008 figures are unaudited.

Source: Injured Workers’ Insurance Fund

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The State’s share of these costs is based on the percentage of total claims paid on behalf of State employees, which is recalculated each month. Some expenditures, such as the cost of marketing, are removed before the calculation is made. In the closeout for fiscal 2008, the percentage of IWIF’s total general and administrative (G&A) expenditures paid by the State was 23.89%, which is up from 20.56% in fiscal 2007. The calculation of this factor is shown for fiscal 2006 to 2008 in **Appendix 2**.

A reduction of non-State claim activity causes the percentage of total expenses paid by the State to increase, as its claims represent a larger share of the overall IWIF business portfolio. Conversely, the reduction of positions and other administrative costs should reduce the fees charged to the State. **IWIF is asked to comment on how the cost saving measures will translate into reduced administrative fees to offset the rising percentage of total G&A expenses borne by the State.**

Proposed Budget

The IWIF budget for calendar 2009 is shown in **Exhibit 3**. IWIF’s budget decreases \$875,000 between calendar 2008 expenditures and those budgeted for calendar 2009. A \$1.255 million reduction to salaries and personnel expenses chiefly associated with position eliminations is partially offset by rising operating costs of \$380,000, led by insurance payments (\$110,000) and travel and training expenses (\$135,000).

Exhibit 3
Proposed Budget
Injured Workers’ Insurance Fund
(\$ in Thousands)

How Much It Grows:	<u>Nonbudgeted Fund</u>	<u>Total</u>
Calendar 2008	\$44,670	\$44,670
Calendar 2009 Budget	<u>43,795</u>	<u>43,795</u>
Amount Change	-\$875	-\$875
Percent Change	-1.96%	-1.96%
Personnel Expenses		
Average 2.5% merit increase		\$478
Employee and retiree health insurance		70
Employee Retirement and Pension Plan		-100
Corporate Achievement Sharing Plan		-245
Temporary and contractual employees		-415
Elimination of 21 positions		-1,122
Other		79
Other Changes		
Training and travel		135
Insurance		110
Facilities costs		95
Ongoing contractual services		90
Special project consulting and legal expenses		55
Other operating costs		55
Vehicle maintenance and other automobile expenses		50
Supplies, computer maintenance, and equipment rental		40
Staff costs		35
Telecommunications		25
Printing		10
Advertising and promotion		-10
Postage		-30
Janitorial services		-55
Building security		-70
Reduction of internal audit fees		-155
Total		-\$875

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

Issues

1. Increase of Settlements and Impact on State Budgeting

The Injured Workers’ Insurance Fund is the third-party workers’ compensation claims administrator for the State of Maryland. Because the State is self-insured, it pays the actual value of claims, as reported by IWIF in an annual assessment. Traditionally, the State includes a nominal amount to prefund the long-term liabilities associated with outstanding claims in the annual pay-as-you-go payments determined by the assessment. However, a recent initiative by IWIF to settle outstanding claims has altered the mechanics of the State’s payment system.

Fiscal 2010 Allowance Claims Paid Increases

In the State’s annual workers’ compensation assessment from IWIF, the claims paid levels correspond to actual payments made two years prior. So, the fiscal 2010 assessment in the allowance reflects fiscal 2008 actual payouts across all agencies. As **Exhibit 4** shows, the net claims paid increases by \$10.5 million in fiscal 2010 over the fiscal 2009 amount. A significant portion of this increase is due to pay-as-you-go dollars being devoted to the settlement of outstanding claims in historically high amounts.

Exhibit 4
State Workers’ Compensation Claims and Charges
Fiscal 2008-2010

	2008		2009		2010	
	<u>\$ Expended</u>	<u>\$ Change</u>	<u>\$ Expended</u>	<u>\$ Change</u>	<u>\$ Expended</u>	<u>\$ Change</u>
Net Claims Paid	\$48,220,153	\$3,229,445	\$46,769,154	-\$1,450,999	\$57,275,036	\$10,505,872
Net Operating Expenses Charged	10,066,531	-407,272	10,090,009	23,478	10,330,806 ¹	240,797
State Risk Management Office	660,000	-140,000	583,105	-76,895	628,091	44,986
Unfunded Liability	6,078,308	-3,921,692	5,000,000	-1,078,308	0	-5,000,000
Cash Cushion	3,979,657	479,657	2,011,074	-1,968,583	0	-2,011,074
Final Assessment	\$69,004,649	-\$689,863	\$62,453,342	-\$4,551,307	\$68,233,933	\$3,780,591

¹Net operating expense was lowered by \$565,981 to offset an outstanding overcharge from fiscal 2005.

Source: Injured Workers’ Insurance Fund

Settlements Advantageous for Long-term but Costly in the Short-term

The settlement of claims is a common practice of workers’ compensation insurers and third-party administrators. While settlements have always been utilized by IWIF, in 2007 it began focusing on settling State claims open for more than four years. The practice is advantageous in the long-term for several reasons. One, it removes a liability from the State account, thus lowering the future outlays required by the State. Two, once the claim no longer needs to be tracked, the administrative costs associated with its periodic maintenance are eliminated. Three, because injury-based claims can have extended time horizons and even resurface if subsequent illnesses can be linked to the original injury, settlements reduce the long-term exposure of the State to additional costs. Finally, settlements often offer advantageous terms as claimants may accept a cash-in-hand payout that is worth less than the annuitized payments may have been.

This final reason is illustrated in **Exhibit 5**. In fiscal 2008, settlements brokered by IWIF removed 1,060 cases from the State’s liability ledger. The cash payments needed to retire these claims totaled \$13.0 million dollars, but the amount of reserves associated with them that was removed from the State’s required reserve level was \$20.6 million, a savings of over \$7.5 million. This activity was substantially greater than the fiscal 2007 IWIF settlement efforts, which closed 781 cases by making payments of \$7.2 million. In addition to these savings, however, there are considerable budgetary implications to this strategy.

Exhibit 5 Settlements, Dollar Values, and Impact on Long-term Liability Fiscal 2007-2008

	<u>2007</u>	<u>2008</u>	<u>\$ Change 2007-08</u>	<u>% Change 2007-08</u>
Dollars Paid	\$7,242,969	\$13,005,887	\$5,762,919	79.6%
Long-term Reserve Reduction	\$16,114,292	\$20,645,945	\$4,531,653	28.1%
# of Settlements	781	1,060	279	35.7%

Source: Injured Workers’ Insurance Fund

Settlements are costly to the State in the short-term for the following reasons:

- Higher Pay-as-you-go Payments:** As Exhibit 4 shows, the net paid claims portion of the annual assessment grew by \$10.5 million in fiscal 2010 to \$57.3 million. This assessment is nearly equal to the fiscal 2008 levy after all operating expenses associated with administering the claims are included. It should be noted that the \$57.3 million fiscal 2008 claims totals included several atypically high payouts of greater than \$750,000 for catastrophic injuries. The initial fiscal 2011 estimate for claims costs, which removes these catastrophic payouts, predicts a reduction on net claims payments to \$51.0 million.

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- **More Difficult to Pre-fund Liability:** The amount of State funding contributed directly to the long-term liability is crowded out by the growing pay-as-you-go portion. The fiscal 2010 allowance contains no liability pre-funding, a function of tight fiscal conditions and the greater pay-as-you-go requirements.
- **Administrative Costs Increase:** The higher claims-related work undertaken by IWIF generates higher fees. The base administrative fees are calculated by the percentage of IWIF’s business that the State represents, so more State claims equals a larger share. Logically, as more claims of a higher dollar value are processed by IWIF, the total administrative costs associated with them increases. As a result, administrative fees for fiscal 2008 claims were more than \$800,000 higher than fiscal 2007 levels.

However, identifying these costs is difficult because of current data reporting formats.

Need for Greater Clarity in Annual Assessment Report

When IWIF presents the State’s assessment for the upcoming fiscal year, it shows the following component pieces of the final charge, by agency: claim activity, administration fee, State Employees Risk Management Administration (SERMA) contributions, and unfunded liability contributions. The totals for the IWIF administration fee, SERMA funding, and unfunded liability are prorated by the size of agency’s claims activity and distributed accordingly. In the current presentation of this information, all claims related activity, payments and settlements alike, are grouped together to arrive at the claims subtotal. As discussed, settlements do not represent pay-as-you-go funding in the same sense as standard claims payouts and should be separated to allow the State to accurately gauge the functional distribution of its annual funding.

As such, the Department of Budget and Management (DBM) should prepare a cost-benefit analysis on IWIF’s policy of settling cases. The report should identify DBM’s plans for funding the liability and describe the most advantageous mixture of dollar contributions into the long-term liability account and case settlements. IWIF should identify settlement claims costs by agency, with accompanying detail on the reserves reduction associated with each settlement, in its annual Assessment Report.

2. State Employees Risk Management Administration and Trends of Workers’ Compensation Claims for State Agencies

The State Employees Risk Management Administration began in 1989 via executive order as a mechanism to address employee safety issues within State government. Governor O’Malley, in signing Executive Order 01.01.2008.03 on February 15, 2008, reaffirmed a commitment to the program. Since fiscal 2004, a portion of agency assessments have been devoted each year to the program, which is administered by IWIF as a direct pass-through unconnected to its internal budgeting.

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SERMA’s recent budgeting totals are highlighted in **Exhibit 6**. Personnel expenses, which represent the bulk of the expenses, fund seven positions: one supervisor, five Risk Management Consultants (RMC), and one coordinator. Unlike the majority of agencies funded with State money, there is no direct accountability through the budgeting process or DBM human resources oversight for the work undertaken by these seven positions or the associated expenditures made.

Exhibit 6
State Employees Risk Management Administration Budget
Calendar 2006-2009
(\$ in Thousands)

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>\$ Change</u> <u>2008-09</u>	<u>% Change</u> <u>2008-09</u>
Salaries and Fringe Benefits	\$560	\$570	\$613	\$641	\$28	4.6%
Contractual Position	0	0	0	57	57	n/a
Total Compensation	560	570	613	698	85	13.9%
Travel	6	7	7	7	0	0.0%
Training	8	7	7	6	-1	-14.3%
Facility Costs	46	29	29	29	0	0.0%
Postage Costs	10	11	11	11	0	0.0%
Telecommunications	6	10	6	7	1	16.7%
Advertising/Promotion	2	6	10	9	-1	-10.0%
Staff Costs	1	1	1	1	0	25.0%
Printing	15	0	0	0	0	n/a
Consulting Services	10	3	3	2	-1	-33.3%
Automobile Expense	67	17	18	19	1	5.6%
Supplies	20	4	4	3	-1	-25.0%
Other Operating Costs	30	60	59	27	-32	-54.2%
Total G &A Expenses	\$781	\$725	\$768	\$819	\$51	6.7%
Actual Expenditures	\$660	\$583	\$628	\$730	\$102	16.2%
<i>% of Budget Expended</i>	<i>84.5%</i>	<i>80.4%</i>	<i>81.8%</i>	<i>89.2%</i>		

G&A: general and administrative

Note: Fiscal 2009 expenditures are estimated based on historical performance.

Source: Injured Workers’ Insurance Fund; Department of Legislative Services

The SERMA Program

Analysis of the FY 2010 Maryland Executive Budget, 2009

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SERMA’s principal role is to support agency development of safety programs and policies, conduct hazard assessments, and provide safety training. The unit’s RMCs make written safety recommendations and ergonomic assessments following visits and inspections of State-owned and leased spaces. The program focuses on the eight largest State agencies from which approximately 85% of State employee workers’ compensation claims originate. Those agencies are the Department of Health and Mental Hygiene, the Department of Human Resources, the Department of Juvenile Services, the Maryland Transit Administration, the remaining Maryland Department of Transportation modes, the Department of Public Safety and Correctional Services, the Department of State Police, and the University of Maryland, College Park.

Exhibit 7 shows the annual activities of the unit. From fiscal 2005 through 2008, the RMCs have made approximately 2,448 agency and facility visits and have developed 3,855 recommendations. Approximately 10,650 State employees have received training on various risk management topics such as back injury prevention, accident investigation, driver training, root cause analysis, hazard recognition, and hazard communication. Fiscal 2007 figures show a decline in service due to the absence of two RMCs, as one was vacant and another was on extended medical leave. Fiscal 2008, on the other hand, sees increases in the number of employees trained, as staffing levels stabilized and large conferences boosted total figures above levels achieved through agency visits alone.

Exhibit 7
State Employees Risk Management Administration Activities
Fiscal 2005-2009

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>Total 2005-08</u>	<u>2009 Est.</u>
Site Visits	709	578	481	680	2,448	634
Recommendations Issued	1,321	811	1,078	645	3,855	942
Employees Trained	2,907	2,030	2,031	3,679	10,647	2,824

Source: Injured Workers’ Insurance Fund

Unclear Connection Between SERMA Program and State Claims Experience

The value of the training visits made and recommendations issued by SERMA can most reliably be measured by the workers’ compensation claim experience of the major agencies that are the focus of the safety programs. As shown in **Exhibit 8**, the claim costs for every major agency under SERMA’s purview, except the State Police, increased from fiscal 2005 to 2008, with fiscal 2008 being an especially expensive year after relative stability during the three prior fiscal years. Similarly, the total number of claims across State agencies had fallen from fiscal 2005 to 2007 but spiked in fiscal 2008. In sum, over the last four-year period, total claims were 1.9% lower than they had been in fiscal 2005 while the dollars paid by the State have grown by 26.5%.

Exhibit 8
Actual Value and Number of State Workers' Compensation Claims
Fiscal 2005-2009

Value of Claims	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>\$ Change</u> <u>2007-2008</u>	Average Annual		<u>2009 Est.</u>
						<u>% Change</u> <u>2005-2008</u>	<u>% Change</u> <u>2007-2008</u>	
Department of Health and Mental Hygiene	\$7,266,632	\$7,048,051	\$6,859,522	\$7,849,203	\$989,681	2.6%	14.4%	\$6,675,800
Department of Human Resources	2,139,212	1,949,394	1,690,168	2,308,344	618,176	2.6%	36.6%	1,969,354
Department of Juvenile Services	1,011,596	1,822,766	2,219,468	2,930,717	711,249	42.6%	32.0%	2,741,978
Transportation (excluding MTA)	4,791,968	5,430,685	5,168,408	5,231,054	62,646	3.0%	1.2%	4,574,106
Maryland Transit Administration	6,952,500	6,070,913	6,675,908	8,957,540	2,281,632	8.8%	34.2%	8,119,132
Dept. of Public Safety and Correctional Services	10,455,138	12,222,914	12,084,217	15,419,517	3,335,300	13.8%	27.6%	13,819,726
Maryland State Police	5,159,762	4,864,831	4,309,040	4,230,926	-78,114	-6.4%	-1.8%	3,773,710
University of Maryland, College Park	2,368,265	1,560,733	1,656,792	2,706,844	1,050,052	4.6%	63.4%	2,105,708
Other Agencies	4,941,127	6,991,318	5,971,617	7,414,455	1,442,838	14.5%	24.2%	7,551,446
Total Value of Claims	\$45,086,200	\$47,961,605	\$46,635,140	\$57,048,600	\$10,413,460	8.2%	22.3%	\$51,330,960
Frequency of Claims								
Department of Health and Mental Hygiene	1,516	1,620	1,606	1,614	8	2.1%	0.5%	1,544
Department of Human Resources	338	327	321	330	9	-0.8%	2.8%	326
Department of Juvenile Services	383	359	316	349	33	-3.1%	10.4%	362
Transportation (excluding MTA)	723	734	651	703	52	-0.9%	8.0%	646
Maryland Transit Administration	596	605	588	625	37	1.6%	6.3%	676
Dept. of Public Safety and Correctional Services	1,874	1,748	1,785	1,735	-50	-2.5%	-2.8%	1,978
Maryland State Police	588	591	523	526	3	-3.6%	0.6%	440
University of Maryland, College Park	559	509	525	577	52	1.1%	9.9%	468
Other Agencies	1,540	1,549	1,484	1,507	23	-0.7%	1.5%	1,282
Total Frequency of Claims	8,117	8,042	7,799	7,966	167	-0.6%	2.1%	7,722

MTA: Maryland Transit Administration

Source: Injured Workers' Insurance Fund

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A link between SERMA’s activities and the executive order’s charge to help control escalating workers’ compensation loss costs is not evident. While a portion of fiscal 2008 increases derive from the settlement of existing claims and catastrophic claims that add approximately \$1.8 million, a connection between the 10,650 employees specifically trained in workplace safety is not supported by the figures. A cumulative impact from trainings over the years resulting in reduced costs would be the desired outcome. As the previous two exhibits illustrated, this was not the case. In fact, SERMA’s recommendations and employees trained totals grew from fiscal 2007 to 2008, at the same time that claim numbers and total costs increased.

Funding Accountability

Even assuming a clear and measurable benefit to the program were apparent, SERMA’s funding situation demands scrutiny. The funding for the program is distributed across all State agencies and added on a prorated basis to the annual assessment, effectively embedding a fraction of the cost in each department’s annual workers’ compensation contribution. As Exhibit 6 showed, the budgeted salary and fringe benefits for the seven SERMA positions totaled \$613,000 in fiscal 2008, an average of \$87,571 per employee. According to the fiscal 2008 DBM Annual Personnel Report, the average State employee – one subject to budgeting actions such as salary reductions, benefit changes, and State performance review criteria – earned approximately \$64,785 in salary and direct fringe benefits.

The fiscal 2010 allowance, which reflects actual expenditures for fiscal 2008, shows a total of \$628,091 included in the assessment for SERMA costs, or 81.8% of the budget. The difference is primarily due to the long-term vacancy in a RMC position mentioned above that causes salary and expenses associated with the position – such as travel and auto costs – to be removed from charges to the State. So, while the lower service level associated with the absence is manifest, the ability to maintain desired outcomes (*i.e.* reduction of claims costs) is not. In fact, the fiscal 2009 budget, which will be reflected in the fiscal 2011 SERMA allocation, contains \$57,000 to fund a contractual position that presumably would help fill the void the vacancy has created. Such autonomous creation of positions corresponds to IWIF’s nonbudgeted independent business units (as described in Labor & Employment Article 10-113) but is inappropriate for positions directly funded by State dollars.

Possible Steps Forward

Because of SERMA’s existence outside of budgetary and performance-based oversight, despite being funded wholly by State agencies, DLS recommends that the program be removed from IWIF. If discontinued, Maryland would not be without monitors of the agency workers’ compensation issues. The StateStat review process tracks, measures, and demands accountability for the very issues of whose prevention SERMA is tasked. Given the Administration’s affirmation of the unit’s importance, instead of funding SERMA through the workers’ compensation assessment, it could bring the positions it feels necessary to carry out these functions through the Board of Public Works’ (BPW) ‘Rule of 50’. The presence of SERMA in the State budget would provide a truer accounting of this program’s costs and fortify the statistical measures being adjudged periodically through StateStat. Moreover, targeted solutions to the problems identified through monthly StateStat

meetings could be developed, rather than relying on generalized safety trainings to all agencies that have difficulty producing quantifiable outcomes. As such, **DLS recommends deleting the funding associated with SERMA from the State’s across-the-board workers’ compensation total.**

3. Competitiveness of State Workers’ Compensation Claim Contract

As part of the July 2007 audit of the State Treasurer’s Office (STO), the Office of Legislative Audits raised concerns regarding the State’s relationship with IWIF, the third-party workers’ compensation claim administrator. Audits’ chief findings were:

- services provided by IWIF have not been subject to a competitive bid process;
- appropriateness of making advance payments to IWIF has not been adequately assessed; and
- STO had not ensured the propriety of amounts paid to IWIF.

State Treasurer’s Audit Response

STO replied to these recommendations in the January 2008 testimony to the House Economic Matters Committee:

- With regard to a competitively bid contract, STO cited the 93-year relationship between the State and IWIF (and its past incarnations, which were created by the General Assembly) as its basis for not proffering a departmental initiative to bid out the contract under its oversight responsibilities, as it awaits explicit legislative direction to make such a move.
- As for the appropriateness of making advance payments that IWIF holds in reserve, STO stated that altering the arrangement would require the funds in the State’s long-term liability account to be withdrawn and incorporated into the general fund. This change would likewise oblige the interest earnings of these funds intended to prefund the State’s workers’ compensation liability to accrue instead to the general fund. Again, STO expressed reservations about undertaking such a change without an expression of intent from the Governor and the General Assembly.
- In response to the concerns about adequate monitoring of the amounts sent to IWIF, STO stated that the State workers’ compensation relationship is an agreement between BPW and IWIF. As such, it defers action until a pronouncement of oversight measures is developed by BPW that defines the steps to be taken. No such mandate has appeared to date.

IWIF’s Audit Response

IWIF also replied to these concerns at the January 2008 hearing:

- With regard to a competitively bid contract, IWIF referred to the importance of preserving its historic relationship with the State. IWIF mentioned that it provides services on a nonprofit, cost basis and provides economies of scale due to its sizeable market share that lowers the costs that the State pays. One such cost saver is the inclusion of the State within its large reinsurance coverage policy. Finally, IWIF mentioned the close working relationships developed through collaborative undertakings with the State, such as SERMA and the Bethlehem Steel settlement, as benefits of the current system. No mention was made as to why this historical relationship and the beneficial terms of arrangement it provides would not help it secure a competitively bid contract.
- As for the appropriateness of making advance payments, IWIF contends that it is, in fact, paid after it has disbursed claims payments. The annual assessment is placed into the current account, but IWIF only withdraws funds as a reimbursement for claims it has already paid on the State’s behalf. Otherwise, IWIF does not access the current account, and all interest accrued remains in the account for the State’s benefit.
- In terms of account monitoring, IWIF states that its financial statements are open to STO, that monthly accountings of transactions are sent to DLS and DBM, and that an annual Assessment Report with agency-specific claims data is sent to DBM and the Treasurer. Finally, IWIF notes that it is currently audited by the Maryland Insurance Administration (MIA).

Maryland Insurance Administration Study

In response to Chapter 612 of 2008, MIA reported on various aspects of IWIF that it had been charged to study, such as the soundness of IWIF’s ratemaking, how State law applies differently to other insurers than it does to IWIF, and the impact of IWIF’s non-participation in the National Council on Compensation Insurance, Inc. data gathering efforts. While the report contained numerous recommendations, the major change suggested by MIA is that IWIF be subject to all laws governing other competitive workers’ compensation insurers, although it would continue the historical role of insurer of last resort. Any change in the business model stemming from MIA’s recommendations could drastically alter the State’s payment of workers’ compensation claims. **Therefore, IWIF should comment on strategy for responding to the changes suggested by the Treasurer’s Office and the Maryland Insurance Administration.**

Recommended Actions

1. Adopt the following narrative:

Increasing Short-term Cost of Settlements: The budget committees are concerned by the large fiscal 2008 increase in pay-as-you-go workers’ compensation claims costs that represent the settlement of outstanding claims and the future budgeting implications of pursuing this strategy. The committees request that the Department of Budget and Management (DBM) prepare a cost-benefit analysis on the Injured Workers’ Insurance Fund’s (IWIF’s) policy of settling cases. The report should identify DBM’s plans for funding the long-term liability and describe the most advantageous mixture of dollar contributions into the long-term liability account and payouts through case settlements. IWIF, in turn, should identify settlement costs by agency, with accompanying detail on the reserves reduction associated with each settlement, in its annual Assessment Report.

Information Request	Authors	Due Date
Cost-benefit analysis of settling claims	DBM	September 30, 2009
Identification of settlements in Assessment Report	IWIF	As required

2. Add the following section:

SECTION X. AND BE IT FURTHER ENACTED, That the funding of the State Employees Risk Management Administration included in the State’s workers’ compensation assessment from the Injured Workers’ Insurance Fund (subobject 0175) shall be reduced in fiscal 2010 by the following amounts:

<u>Executive</u>	<u>General</u>	<u>\$392,413</u>
<u>Executive</u>	<u>Special</u>	<u>168,404</u>
<u>Executive</u>	<u>Federal</u>	<u>27,618</u>
<u>Executive</u>	<u>Current Unrestricted</u>	<u>14,795</u>
<u>Executive</u>	<u>Current Restricted</u>	<u>16,526</u>
<u>Judiciary</u>	<u>General</u>	<u>6,282</u>
<u>Legislative</u>	<u>General</u>	<u>296</u>

Explanation: This language provides for a reduction of all funding associated with the State Employees Risk Management Administration (SERMA) program, which is currently included in the statewide assessment for workers’ compensation claim administration paid to the Injured Workers’ Insurance Fund (IWIF) through all agency budgets. Reimbursable funds of \$1,217 and nonbudgeted funds of \$539 – though not explicitly budgeted – will also be reduced as a consequence of this action. The total estimated fiscal 2010 reduction is \$628,091.

Updates

1. Update of Current Account and Long-term Liability Account

Current Account

Functionally, the aggregated assessment collected from the departments is placed into two bank accounts entrusted to IWIF: one for the operating expenses related to annual claims; and another to pre-fund the long-term liability. DBM deposits the entire appropriation for these two purposes into the appropriate account at the beginning of the fiscal year. IWIF, in turn, pays the State claims it receives on a monthly basis and then draws a reimbursement for the claims it has paid from the balance in the operating account. It sends a record of these transactions to DBM and DLS. The figures as they relate to the accounts maintained by IWIF are encapsulated in **Exhibit 9**.

Exhibit 9
Injured Workers' Insurance Fund Claims Operating Account
Fiscal 2006-2008

	<u>2006</u>	<u>2007</u>	<u>2008</u>
Balance @ June 30 Begin Year	\$6,014,233	\$3,280,643	\$12,414,484
Source:			
Account Funding	55,459,333	64,694,511	62,926,351
Interest Income (Before Bank Fees)	1,089,022	1,830,657	1,608,083
Total Source	56,548,355	66,525,168	64,534,434
Use:			
Claims Paid (Net of Reimbursements)	48,001,883	46,777,685	56,377,686
Reinsurance	1,913,811	1,558,810	986,446
Claim Cost Allocation	9,122,897	9,346,672	10,847,023
Bank Fees	5,000	5,000	5,000
	59,043,592	57,688,167	68,216,155
Reconciliation:			
June Activity Cash Transfer in Transit	4,711,927	5,008,768	5,487,629
June Cash Transfer	-4,950,281	-4,711,927	-5,008,768
Other – Credit from Claim Cost Recon.			-52,749
Bank Balance @ June 30 End Year	3,280,643	12,414,484	9,158,875
Reconciling Items:			
June Activity Cash Transfer in Transit	-4,711,927	-5,008,768	-5,487,629
Other			
State of Maryland, June 30 Book Balance	-\$1,431,284	\$7,405,716	\$3,671,246

Source: Injured Workers' Insurance Fund

Long-term Liability

Exhibit 10 shows the most recent accounting of the dedicated account for pre-funding the State's long-term workers' compensation liability. As of December 31, 2008, it contained \$38.7 million. The liability for which these funds are intended to pay was estimated by Deloitte Consulting to be \$270.1 million at the end of fiscal 2008, an increase of \$17.2 million from fiscal 2007's actuarial calculation.

Exhibit 10 Injured Workers' Insurance Fund Long-term Liability Account and Funded Status Fiscal 2007-2009

Bank Balance @ June 30, 2007	\$26,082,177	
<i>Fiscal 2008 Transactions</i>		
Account Funding	\$6,078,308	
Interest Income	1,235,647	
Bank Balance @ 6/30/08	\$33,396,132	
<i>Fiscal 2009 Transactions (to date 12/31/08)</i>		
Account Funding	\$5,000,000	
Interest Income	319,465	
Bank Balance @ 12/31/08	\$38,715,597	
Estimated Long Term Liability		Funded Status
as of June 2007	\$252,869,000	10.3%
as of June 2008	270,106,000	12.4%
Proposed Budget Reconciliation and Financing Act Transfer	-\$18,000,000	7.7% ¹

¹As of December 31, 2008

Source: Injured Workers' Insurance Fund; Deloitte Consulting

As discussed in the Issues section, the fiscal 2010 allowance contains no funding to pay down the liability, although the settlement of over 1,000 cases reduced the liability's growth by an estimated \$20.6 million. Moreover, the Budget Reconciliation and Financing Act of 2009 (HB 101/SB 166) proposes a transfer of \$18.0 million from the account to the State general fund. If adopted, the transfer would reduce the funded status of the liability from the current 12.4% funded level to 7.7% funded, and \$20.7 million would remain in the account.

Injured Workers' Insurance Fund
Calendar 2005-2009
(\$ in Thousands)

	<u>2005</u> <u>Actual</u>	<u>2006</u> <u>Actual</u>	<u>2007</u> <u>Budget</u>	<u>2008</u> <u>Budget</u>	<u>2009</u> <u>Budget</u>	<u>2008-09</u> <u>Change</u>	<u>2008-09</u> <u>% Change</u>
Positions							
Regular Positions	400.0	398.0	404.0	404.0	383.0	-21.0	-5.2%
Objects							
Salaries and Fringe Benefits	\$30,472.0	\$32,328.9	\$34,265.0	\$35,835	\$34,580	-1,255.0	-3.5%
Training	214.0	258.4	295.0	275.0	355.0	80.0	29.1%
Travel	213.7	232.5	300.0	295.0	350.0	55.0	18.6%
Facility Costs	682.6	685.6	920.0	900.0	870.0	-30.0	-3.3%
Postage Costs	619.3	726.7	735.0	700.0	670.0	-30.0	-4.3%
Telecommunications	340.1	369.3	405.0	390.0	415.0	25.0	6.4%
Advertising/Promotion	1,131.3	1,033.8	1,090.0	1,090.0	1,080.0	-10.0	-0.9%
Staff Costs	205.9	209.6	205.0	200.0	235.0	35.0	17.5%
Printing	159.5	133.4	150.0	160.0	170.0	10.0	6.3%
Contractual Services	845.7	879.8	820.0	800.0	890.0	90.0	11.3%
Consulting Services	1,081.6	738.9	900.0	900.0	795.0	-105.0	-11.7%
Legal Expenses	255.0	314.4	200.0	425.0	430.0	5.0	1.2%
Automobile Expense	133.6	144.6	160.0	160.0	210.0	50.0	31.3%
Supplies	727.3	718.1	695.0	625.0	630.0	5.0	0.8%
Computer Maintenance	238.9	235.4	295.0	260.0	260.0	0.0	0.0%
Other Operating Costs	1,081.0	1,197.3	1,435.0	1,655.0	1,855.0	200.0	12.1%
Total G&A Objects	\$38,401.5	\$40,206.7	\$42,870.0	\$44,670.0	\$43,795.0	-\$875.0	-2.0%
Capital Budget	4,158.0	3,749.0	2,400.0	2,977.0	3,568.0	591.0	19.9%
Total	\$42,559.5	\$43,955.7	\$45,270.0	\$47,647.0	\$47,363.0	-\$284.0	-0.6%
Funds							
Nonbudgeted Funds	\$42,559.5	\$43,955.7	\$45,270.0	\$47,647.0	\$47,363.0	-\$284.0	-0.6%

G&A: general and administrative

Source: Injured Workers' Insurance Fund

**Injured Workers' Insurance Fund
Claims Paid and State Share
Fiscal 2006-2008**

2008				
	<u>Regular</u>	<u>Beth.Steel</u>	<u>State</u>	<u>Total</u>
Gross Paid Losses Per	\$177,707,240.23	\$2,446,055.90	\$58,772,290.70	\$238,925,586.83
Assumed Claims	3,501,134.44	0.00	0.00	3,501,134.44
Reimbursements	-3,043,556.26	-2,944.08	-1,828,623.22	-4,875,123.56
Reinsurance Recoveries	-1,035,361.74	0.00	-565,981.00	-1,601,342.74
Net Paid Losses	\$177,129,456.67	\$2,443,111.82	\$56,377,686.48	\$235,950,254.97
Percentage of Total	75.07%	1.04%	23.89%	
2007				
	<u>Regular</u>	<u>Beth.Steel</u>	<u>State</u>	<u>Total</u>
Gross Paid Losses	\$176,439,086.02	\$2,861,940.35	\$48,404,599.94	\$227,705,626.31
Assumed Claims	6,637,115.93	0.00	0.00	6,637,115.93
Reimbursements	-2,754,728.70	-1,074.11	-1,367,875.12	-4,123,677.93
Reinsurance Recoveries	-2,388,743.94	0.00	-259,039.90	-2,647,783.84
Net Paid Losses	\$177,932,729.31	\$2,860,866.24	\$46,777,684.92	\$227,571,280.47
Percentage of Total	78.19%	1.26%	20.56%	
2006				
	<u>Regular</u>	<u>Beth.Steel</u>	<u>State</u>	<u>Total</u>
Gross Paid Losses	\$172,777,094.79	\$3,003,569.12	\$49,464,337.62	\$225,245,001.53
Assumed Claims	5,814,079.24	0.00	0.00	5,814,079.24
Reimbursements	-3,295,011.26	-4,786.10	-1,409,230.76	-4,709,028.12
Reinsurance Recoveries	-1,764,126.26	0.00	-53,223.54	-1,817,349.80
Net Paid Losses	\$173,532,036.51	\$2,998,783.02	\$48,001,883.32	\$224,532,702.85
Percentage of Total	77.29%	1.34%	21.38%	

Source: Injured Workers' Insurance Fund