Report of the Maine Self-insurance Guarantee Fund Study Group

January 3, 1996

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Introduction

Pursuant to Public Law 1995 Chapter 398, the Commissioner of the Department of Professional and Financial Regulation convened a study group to address issues related to the financial status of the Maine Self-Insurance Guarantee Fund. Representatives of the Maine Self-Insurance Guarantee Association, the Bureau of Insurance and the Public Advocate were required to participate in the study. Concerns about the Fund's financial status were raised during the Legislature's consideration of LD 1548, *An Act to Clarify and Amend Provisions of the Maine Insurance Code and Workers' Compensation Self-Insurance*. As a result, a report on the Guarantee Fund was requested by the Joint Standing Committee on Banking and Insurance. Specifically, the report must address the Maine Self-Insurance Guarantee Fund's financial status, the current level of assessments and whether or not the Fund can meet the expenses for payment of covered claims in the event of a self-insurer's insolvency.

Catherine Longley, Commissioner of the Department of Professional and Financial Regulation, convened the group for its first meeting on September 11, 1995. Additional meetings were held on October 16, November 2 and December 11. The study group consisted of the Commissioner; Alison Webb, Maine Self-Insurance Guarantee Association; Nancy Litwinski and Richard Johnson, Bureau of Insurance; and William Black, Office of the Public Advocate.

Self-Insurance in the Workers' Compensation Market

Maine law allows employers to self-insure for workers' compensation coverage for their employees. In order to self-insure, employers and employer groups must obtain the approval of the Bureau of Insurance. Authorization to self-insure is conditioned on several factors which include proof of solvency and financial ability to pay compensation and the deposit of cash reserves, adequate securities, irrevocable standby letters of credit, an actuarially determined fully funded trust, written guarantee of a parent corporation with appropriate security or the posting of surety bonds. In Maine, self-insurance represents a sizeable piece of the workers' compensation market. For many employers, self-insurance is a viable alternative to the purchase of an insurance policy for workers' compensation. In a 1994 report on "The State of Competition in the Workers' Compensation Market in

Maine," the Bureau of Insurance estimated that private employers who are self-insured represented over 40% of the Maine market in terms of total premium dollars. There are approximately 143 individual self-insurers and 19 group self-insurers in the State, representing approximately 905 Maine employers.

The Maine Self-Insurance Guarantee Association

The Maine Self-Insurance Guarantee Association (MSIGA) was created by the Legislature in 1981. The Association is a nonprofit unincorporated legal entity governed by a nine member Board of Directors. While the Association is an instrumentality of the State, the Association's debts and liabilities do not constitute debts and liabilities of the state. The Association is subject to examination and regulation by the Superintendent of Insurance. The purpose of MSIGA is to provide mechanisms for the payment of covered workers' compensation claims under self-insurance coverage, to avoid excessive delay in payment, to avoid financial loss to claimants because of the insolvency of a self-insurer, and to assist the Superintendent of Insurance, when asked, in detecting insolvencies among self-insurers. MSIGA fulfills its purpose through administration of the Maine Self-Insurance Guarantee Fund.

As a condition of their authority to self-insure, all self-insurers, except some public employers, are required to be members of the Association. Member self-insurers are assessed a percentage of their estimated annual standard premium[1] and the amounts of the assessments are paid into the Maine Self-Insurance Guarantee Fund. The fund is financially managed by the Guarantee Association; claims management is contracted out by the Association to a third party administrator. By statute, the Guarantee Fund cannot exceed $2,000,000 plus all subsequent initial assessments on new member self-insurers. Since the Guarantee Fund has reached the $2,000,000 level at the present time, the Association can currently assess only new member self-insurers. Upon approval of an application for the authority to self-insure, the Superintendent of Insurance must notify the Association of new members. New member self-insurers must pay an assessment into the Fund for the first 30 months of their membership in the Association. Individual self-insurers are assessed 1% of their estimated annual standard premium and group self-insurers are assessed 0.1% of their estimated annual standard premium.

The Maine Self-Insurance Guarantee Association is obligated to use the Guarantee Fund to pay covered claims of an insolvent self-insurer until the self-insurer obtains

[1]Estimated annual standard premium is calculated as follows: payroll by workers' compensation classification code multiplied times NCCI's loss cost advisory rates multiplied times the self-insurer's experience modification factor multiplied times 1.2.

a workers' compensation insurance policy. A covered claim is an unpaid claim against an insolvent self-insurer that relates to an injury compensable under the Workers' Compensation Act that occurs while the self-insurer is a member of the Association.

In the event that the Association cannot meet its statutory obligations for the payment of covered claims of insolvent members, the Association has the authority to make post-insolvency assessments on individual and group member self-insurers. Post-insolvency assessments for individual self-insurers can be made in an amount not to exceed 2% each year of their annual standard premium, but the total assessments paid by an individual member cannot exceed 2.5% of their annual standard written premium in any calendar year. For group self-insurers, the limit on post-insolvency assessments is 0.2% each year of their annual standard premium and the overall limit in any calendar year is 0.25%.

In the event that the Association cannot meet its obligations to pay covered claims through the post-insolvency assessment mechanism, the Association does have statutory authority to borrow money to carry out its statutory obligations. This authority to borrow is reflected in the Association's plan of operation.

Besides responsibility for the Guarantee Fund, the Association is also responsible for collecting and reporting claims related data from individual and group self-insurers to the Bureau of Insurance. In this capacity, MSIGA acts as a Self-Insurance Statistical Advisory Organization (SISAO). This data collection function was added to MSIGA's responsibilities in 1987 as part of the workers' compensation reforms. Every authorized self-insurance entity in the state must fulfill the reporting requirements of the SISAO, even those self-insuring public entities that are statutorily exempt from paying assessments to the Guarantee Fund. In addition, the expenses of the SISAO are covered through assessments on self-insurers based on a self-insurers' proportional share of claims incurred and paid for the year in which the assessment is based.

Financial Position of the Guarantee Fund

Assessment income varies from year to year, depending on the number of new members which are being assessed. The table below shows assessment income since 1990.

Year	Total assessment income
1990	$441,286
1991	$437,043
1992	$287,611
1993	$335,055
1994	$340,420
1995	$292,557*

*This figure includes $5,364 in interest paid due to a late assessment payment.

Assuming no significant increase in membership, assessment income will decrease considerably over the next few years. The table below shows projected assessment income for 1996-1999. (This projection assumes that no new members will be added to the Association, assumes that annual estimated standard premium will remain at its current levels, and assumes that two current appeals of the Board's assessment will result in new member assessments being paid.)[2]

Year	Projected assessment income
1996	$181,407
1997	$ 41,923
1998	$ 1,754
1999	$ 14

The Association's Investment Guidelines call for a total rate of return in any 12 month period to exceed the rate of return of a hypothetical portfolio consisting of reinvested 91-day Treasury Bills. Maturities are limited to 740 days and must be scheduled so as to insure reasonable liquidity to meet the needs of the Fund.

While a limited range of investment instruments is permitted, in practice the Guarantee Fund assets are invested in $99,000 or $100,000 certificates of deposit. Maturities vary, and at least one certificate matures each month. Certificates of deposit are placed in FSLIC or FDIC insured banks through the United States having a 6.5% equity ratio or greater at the time of investment.

There have been three insolvencies since the inception of the Association in 1981. In February of 1990, Wilner Wood Products instituted bankruptcy proceedings. A total of $12,764 was paid in claims expenses from the Guarantee Fund as a result of this insolvency. The company's reinsurance limit was pierced in that same year and as a result no further MSIGA liability is anticipated with respect to this insolvency.

On June 18, 1994, the Bureau of Insurance terminated St. Johnsbury Trucking Co.'s authority to self-insure due to deteriorating financial condition and a filing in bankruptcy court. In 1993 a total of $50,514 was paid out of the Guarantee Fund in administrative expenses. No claims payments were made from the Guarantee Fund in that year.

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[2]Bureau of Insurance staff and the self-insurance community are currently considering a change in the determination of new member status, so that if a self-insurer changes ownership or reorganizes and if the new entity assumes the workers' compensation liabilities of the self-insurer, the new entity would not be considered a new member of the Association for purposes of new member assessment. If this change were made retroactive and refunds were required, the effect on the Guarantee Fund would be refunds of approximately $300,000. In addition, projected new member assessments would decrease by approximately $26,800 in 1996 and by $8,400 in 1997. If this legislation is not passed, the two employers who are currently contesting their assessments will likely pursue their appeals. If they prevail, a total of $267,377 will be returned to the members and projected new member assessments will decrease by approximately $24,400 in 1996 and by $8,400 in 1997.

On June 23, 1995, Bradlees' Inc. filed for Chapter 11 protection in bankruptcy court. Bradlees continues to self-insure in Maine and there have been no payments from the Guarantee Fund as a result of this bankruptcy.

As of December 31, 1994, the Guarantee Fund balance was $2,525,647 plus $550,355 in interest earned since the Fund reached $2,000,000.[3] In 1995, total revenues to the fund are estimated to be $292,557 (new member assessment income) plus $170,161 (interest income). Total expenditures from the Fund are estimated to be $600,000 in claims payments, legal and administrative fees associated with the St. Johnsbury Trucking Company's insolvency, leaving the Fund balance at approximately $2,881,644.

It is difficult to estimate future expenditures from the Fund. Based on current information about St. Johnsbury's claims, the Association does not anticipate a post-insolvency assessment. The Association has filed a claim in bankruptcy court and some funds could be deposited in the Guarantee Fund as a result. On the other hand, It is unclear at this time what the potential liability to the Fund might be as a result of Bradlees' insolvency. And, while the Association has no knowledge of impending bankruptcies, there is always the potential for other self-insurers to become insolvent.

Post-Insolvency Assessments

In 1994, the total estimated annual standard premium for members of the Association, as reported to the Superintendent, was $182,006,280. A very rough calculation of a possible maximum post-insolvency assessment is $2,708,698 annually. The actual maximum post-insolvency assessment would vary, depending on which member became insolvent and which members were determined to be members of the Association for purposes of the insolvent member's assessment.

MSIGA Evaluation Model & Assumptions

To evaluate the financial capacity of MSIGA to continue workers' compensation benefits to injured workers, a model was developed to test whether the current law and plan of operation would cover the unfunded liability if a major self-insured employer was unable to make payments required under the Workers' Compensation Act. The model is set forth on page 8 of the report. In accordance with the law mandating this report, the model assumes one major bankruptcy. It is important to understand the assumptions utilized in preparing the model:

The model assumes that a large employer with security less than the projected ultimated claim liability became insolvent. [Note: Claims prior to October 1, 1981

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[3]The Association currently records interest income in an Administrative Fund, separately from new member assessments. As an asset of the Association, interest income, in addition to new member assessments, is available for payment of claims.

are excluded, because they are not covered by the Guarantee Association.] Although the self-insurance law and Bureau of Insurance regulations impose higher security amounts on those self-insured employers not in the strongest financial condition, it is possible that a company's financial position could deteriorate quickly. In the example used in the model, the employer had security posted based on case reserves as required by section 403(8) of Title 39-A M.R.S.A., but the ultimate liability is that projected in the most recent actuarial analysis presented by the self-insurer's actuarial consultant.

The model uses as the assessment base the estimated standard premium of the member individual and group self-insurers, excluding the insolvent self-insurer, and assumes an average annual payroll growth of 3% per year. In the last five years, the state average weekly wage has grown by 3.1% per year, but the growth rate has slowed to less than 2% in recent years. Long term projections of Earnings, Wages and Salaries, made available by the Maine State Planning Office, indicate real long term growth of approximately 2.0% per year. This suggests that the 3% growth rate selected in the model is reasonable for the short term and probably is conservative in the long term.

It should be noted that the model makes no assumptions about changes in the self-insurance market. All self-insurers who are members of the Association at the time of the insolvency of a self-insurer are liable for the post-insolvency assessment of that insolvent self-insurer, even if they leave self-insurance for the commercial market. Since the pool of assessable self-insurers is fixed on the date of the insolvency, the Study Committee did not include in the model projections of the size of the self-insurance market in the future.

The Association earns interest on funds held or received during the year. The assumed investment yield in the model is 5%. The Association is authorized to borrow funds, however it is uncertain whether MSIGA could borrow funds to meet cash flow needs, so the input to the model is structured to avoid any cash negative balance. The major cash outflow are benefits to injured workers and dependents. The payout pattern is derived from the latest actuarial report filed by the insolvent self-insurer's consulting actuary. Claims would be paid out over a number of years, but the biggest draws on the Fund would be during the third and subsequent years, just after the surety bond posted for the employer was used up. The other cash outflow from MSIGA would be administrative expenses, which would include legal and claims administration expenses related to the insolvency and other administrative expenses related to the operation of the Association.

The Study Committee looked at different possible outcomes, with different values for assessment rates, administrative expenses, interest rates, and growth rates in the assessment base. The selected scenario includes a 3% growth rate in the assessment base, a maximum assessment rate of 2.5% for individual self-insurers and .25% for group self-insurers, and an interest rate of 5%. Administrative expenses are assumed to be a combination of annual administrative cost at $88,179 in 1996 and increasing at 3% per year and the cost of the insolvency:

$100,000 for the first and second years, $5000 per year thereafter, and $450 per open claim per year.

A model incorporating these assumptions is set forth on page 8. Obviously any variations to those assumptions could affect the outcome of the model and the impact on the Guarantee Fund.

MAJOR INSOLVENCY EVALUATION MODEL

	Estimated Growth in Payroll	Investment Interest Rate	Individual Assessment Rate	Group Assessment Rate	Amount of Security		Administrative Expense	Administrative Expense Growth			
	0.03	0.05	0.025	0.0025	16800000		88179	0.02			
Year	Beginning Assets	Assessment Base Individual Self-Insured	Assessment Base Group Self-Insured	New Member Assessments	Benefits Paid	Investment Income	Administrative Expense	Balance Prior to Security Offset	Security Offset	Net Benefits Paid	Net Fund Balance
1996	$ 2,226,779	$ 126,850,216	$ 57,927,139	$ 161,407	$ 10,132,831	$ 190,539	$ 329,479	$ (4,217,833)	$ 6,667,369	0	$ 5,585,319
1997	$ 5,585,319	$ 130,655,722	$ 59,664,953	$ 41,923	$ 8,701,629	$ 306,500	$ 253,843	$ 649,669	$ (2,034,260)	$ 2,034,260	$ 7,063,195
1998	$ 7,063,195	$ 134,575,394	$ 61,454,902	$ 1,754	$ 6,663,092	$ 271,450	$ 125,091	$ -		$ 6,663,092	$ 4,066,238
1999	$ 4,066,236	$ 138,612,656	$ 63,298,549	$ 14	$ 5,501,726	$ 153,669	$ 107,576	$ -		$ 5,501,726	$ 2,234,181
2000	$ 2,234,181	$ 142,771,036	$ 65,197,505		$ 4,647,523	$ 86,204	$ 104,948	$ -		$ 4,647,523	$ 1,300,184
2001	$ 1,300,184	$ 147,054,167	$ 67,153,430		$ 3,937,947	$ 59,995	$ 106,857	$ -		$ 3,937,947	$ 1,159,613
2002	$ 1,159,613	$ 151,465,792	$ 69,168,033		$ 3,195,266	$ 74,368	$ 108,804	$ -		$ 3,195,266	$ 1,889,476
2003	$ 1,889,476	$ 156,009,765	$ 71,243,074		$ 3,144,067	$ 115,061	$ 110,790	$ -		$ 3,144,067	$ 2,828,031
2004	$ 2,828,031	$ 160,690,058	$ 73,380,367		$ 2,772,494	$ 174,286	$ 112,816	$ -		$ 2,772,494	$ 1,797,289
2005	$ 1,797,289	$ 165,510,760	$ 75,581,778		$ 2,343,882	$ 136,568	$ 114,882	$ -		$ 2,343,682	$ 1,205,983
2006	$ 1,205,983	$ 170,476,083	$ 77,849,231		$ 1,939,104	$ 120,310	$ 116,990	$ -		$ 1,939,104	$ 1,052,810
2007	$ 1,052,810	$ 175,590,365	$ 80,184,708		$ 1,561,145	$ 125,389	$ 119,140	$ -		$ 1,561,145	$ 1,334,002
2008	$ 1,334,002	$ 180,858,076	$ 82,590,249		$ 1,190,139	$ 152,112	$ 121,332	$ -		$ 1,190,139	$ 2,065,814
2009	$ 2,065,814	$ 186,283,819	$ 85,067,957		$ 777,594	$ 202,506	$ 123,589	$ -		$ 777,594	$ 1,854,133
2010	$ 1,854,133	$ 191,872,333	$ 87,619,995		$ 403,569	$ 204,868	$ 125,850	$ -		$ 403,569	$ 2,031,167
2011	$ 2,031,167	$ 197,628,503	$ 90,248,595		$ 206,646	$ 222,346	$ 128,177	$ -		$ 206,646	$ 2,435,323
2012	$ 2,435,323	$ 203,557,358	$ 92,956,053		$ 108,530	$ 248,822	$ 130,551	$ -		$ 108,530	$ 2,445,064
2013	$ 2,445,064	$ 209,664,079	$ 95,744,735		$ -						

Initial Security Amount $16,800,000

MSIGA Assessments Individual/Group
1996 through 2003 2.5%/.25%
2004 through 2008 1.0%/.10%
2009 through 2011 .25%/.025%
2012 0%

3% Growth in Assessment Base

5% Investment Income Rate

Findings and Recommendations

The Bureau of Insurance monitors the financial condition of self-insurers.

The Guarantee Fund balance is approximately $2,881,644 as of December 31, 1995.

Based on the current financial position of the Guarantee Fund and the assumptions used in the model and set forth in this report, the Guarantee Fund would be adequate to pay covered claims as required under the Workers' Compensation Act in the event of an insolvency of a major self-insurer.

Based on current law, it is unclear whether the successor entity to a self-insurer would be liable for the post-insolvency assessments of the self-insurer. The Study Committee recommends that this issue be clarified through statutory change, so that the assessment base for an insolvency cannot deteriorate as a result of the purchase, sale, or other reorganization of any self-insurer liable for the post-insolvency assessment.

The Study Committee recommends that changes should be made to the Association's Plan of Operation to clarify the following:

If the Guarantee Fund balance falls below $2 million, the Association has the authority to assess its members to increase the Fund balance to $2 million.

Interest income is considered an asset of the Guarantee Fund and should not be segregated from Guarantee Fund assets in the financial audit of the Association.

Respectfully Submitted

S. Catherine Longley
January 3, 1996