

D70J00
Maryland Automobile Insurance Fund

Operating Budget Data

(\$ in Thousands)

	<u>CY 10</u> <u>Actual</u>	<u>CY 11</u> <u>Budgeted</u>	<u>CY 11</u> <u>Actual*</u>	<u>CY 12</u> <u>Budgeted</u>	<u>CY 11-12</u> <u>\$ Change</u>	<u>CY 11-12</u> <u>% Change</u>
Insured Division	\$43,142	\$45,839	\$43,130	\$46,354	\$3,224	7.5%
Uninsured Division	2,327	2,438	2,417	2,523	\$106	4.4%
Nonbudgeted Expenditures	\$45,469	\$48,277	\$45,547	\$48,877	\$3,330	7.3%

* 2011 actual is actuals through September 30, 2011, and estimates from October 1, 2011, through December 31, 2011.

- The calendar 2012 budget for the Maryland Automobile Insurance Fund (MAIF) increases by \$3.3 million, or 7.3%, compared to calendar 2011. The majority of this increase occurs in the Insured Division, an increase of \$3.2 million, or 7.5%.
- The largest increases occur as a result of a planned incentive compensation payment for employees, personnel expenditures, and a public service announcement campaign targeting uninsured drivers.

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

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Personnel Data

	<u>CY 10 Actual</u>	<u>CY 11 Budgeted</u>	<u>CY 11 Actual*</u>	<u>CY 12 Budgeted</u>	<u>CY 11-12 Change</u>
Regular Positions**	388.00	377.60	374.70	355.80	-18.90
Contractual FTEs**	<u>2.00</u>	<u>2.50</u>	<u>1.40</u>	<u>1.60</u>	<u>0.20</u>
Total Personnel**	390.00	380.10	376.10	357.40	-18.70

* 2011 actual is actuals through September 30, 2011, and estimates from October 1, 2011, through December 31, 2011.

** As reported by the Maryland Automobile Insurance Fund.

- MAIF adjusts the total positions each year to reflect its anticipated needs. The calendar 2012 budget eliminates 17.9 regular positions in the Insured Division and 1.0 position in the Uninsured Division. Position eliminations occur through attrition.
- The calendar 2012 budget of MAIF increases the contractual full-time equivalent by 0.2 compared to calendar 2011 due to the increased number of working hours for an existing contractual position.

Analysis in Brief

Major Trends

Claims Received and Assigned Decrease in the Uninsured Division: Following an increase in calendar 2010, the number of claims received and assigned in the Uninsured Division decreased in calendar 2011 (3.1 and 4.4%, respectively). Despite the decrease, claims activity remains elevated compared to recent experience.

Policies Dwindle in the Insured Division: In most years since calendar 2006, the numbers of gross and net written policies in the Insured Division have declined. After a slight rebound in calendar 2010, the number of gross and net written policies fell by more than 20% in calendar 2011. MAIF indicates that possible reasons for the decrease are the current economic conditions and rate increases in calendar 2011.

Claims Activity Continues to Fall: The number of claims and accidents reported in the Insured Division has fallen in recent years. The pace of the decline increased in calendar 2011 when the number of claims and accidents reported decreased by 19.4 and 21.0%, respectively.

Issues

Uninsured Division Surplus Not Sufficient to Cover Transfer: The Budget Reconciliation and Financing Act of 2011 transferred \$4.0 million from MAIF, contingent on the enactment of Chapter 312 of 2011, which altered employee compensation requirements for the agency. As a result of this transfer, the Uninsured Division surplus is expected to fall below \$0 in calendar 2011 and 2012. MAIF reports that, despite this, it will be able to pay claims to all those entitled to such a claim.

Annual Report on the Reasonableness of the Surplus of the Insured Division: In response to committee narrative in the 2008 *Joint Chairmen's Report* (JCR), the Maryland Insurance Administration (MIA) indicated that it would annually produce a report on the reasonableness of the surplus of the Insured Division of MAIF. In the report for calendar 2009, MIA determined that MAIF's surplus was not excessive. As of this writing, the report for calendar 2010 is not available.

Recommended Actions

1. Adopt committee narrative requesting an annual report on the reasonableness of the surplus of the Insured Division.
2. Adopt committee narrative requesting a report on an analysis of the point at which MAIF's surplus would be deficient.

Updates

Strategic Consulting Expenditures: In November 2009, the Office of Legislative Audits released a fiscal compliance audit of MAIF, which included a recommendation that certain expenditures such as strategic consulting, marketing, public relations, advertising, lobbying services, and producer appreciation events be disclosed to the budget committees. The 2010 JCR requested detail on these expenditures for calendar 2009, 2010, and 2011. In calendar 2012, MAIF anticipates spending \$7.3 million on these services, an increase of \$765,138 compared to calendar 2011. The majority of the increase results from a planned outreach campaign directed to uninsured motorists.

Employee Compensation Changes: Chapter 312 of 2011 altered the requirements related to employee compensation for MAIF. MAIF conducted an independent market study and, as a result, increased the compensation for some positions. In addition, MAIF employees received a merit increase mid-year in calendar 2011 and are expected to receive an additional increase in calendar 2012.

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Maryland Automobile Insurance Fund

Operating Budget Analysis

Program Description

The Maryland Automobile Insurance Fund (MAIF) is an independent, nonbudgeted State agency. Similar to other insurance companies, MAIF operates on a calendar year basis. MAIF has two main responsibilities.

First, MAIF provides automobile insurance policies for the 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 carriers, handles claims for policyholders. The Insured Division is funded through premiums, investment income, and when necessary, a surcharge on premiums statewide.

Second, MAIF administers and pays 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.

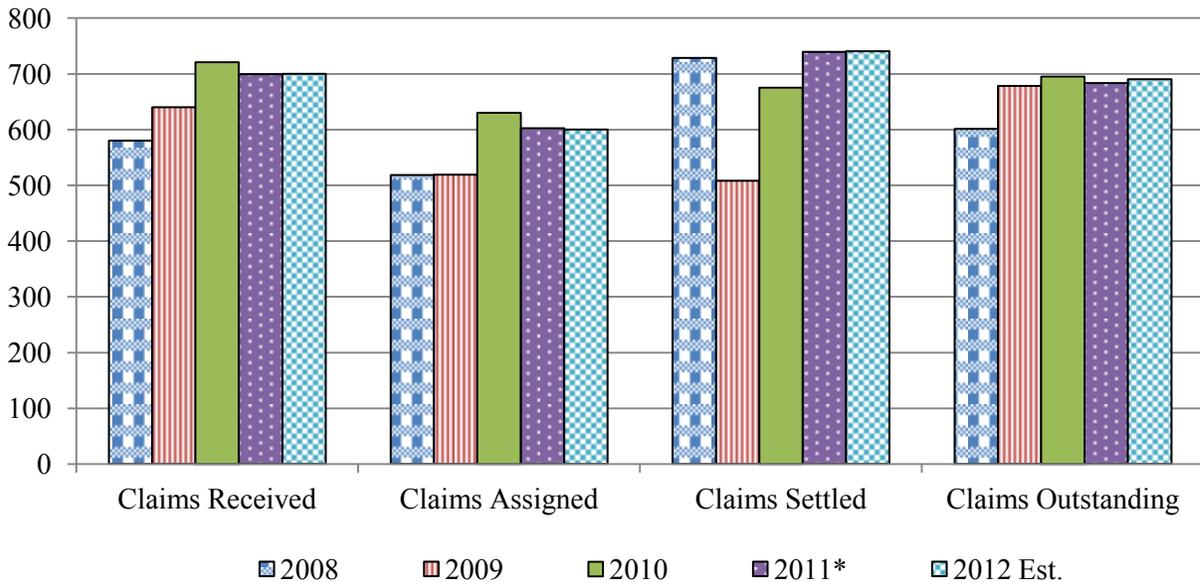
MAIF's three key goals are:

- to offer insurance to all eligible citizens of the State who are unable to obtain private insurance;
- to handle claims of the policyholders and claimants in a manner that is fair, expedient, and professional; and
- to provide services efficiently to minimize the subsidy from the State's insured motorists.

Performance Analysis: Managing for Results

MAIF does not control the number of claims received and assigned in the Uninsured Division. Claims assigned are a function of the eligible claims received. The number of claims received by the Uninsured Division increased in calendar 2009 and 2010 compared to the prior year, as shown in **Exhibit 1**. Although both decreased in calendar 2011, the levels remained elevated compared to other recent years.

**Exhibit 1
Claims Activity
Uninsured Division
Calendar 2008-2012**



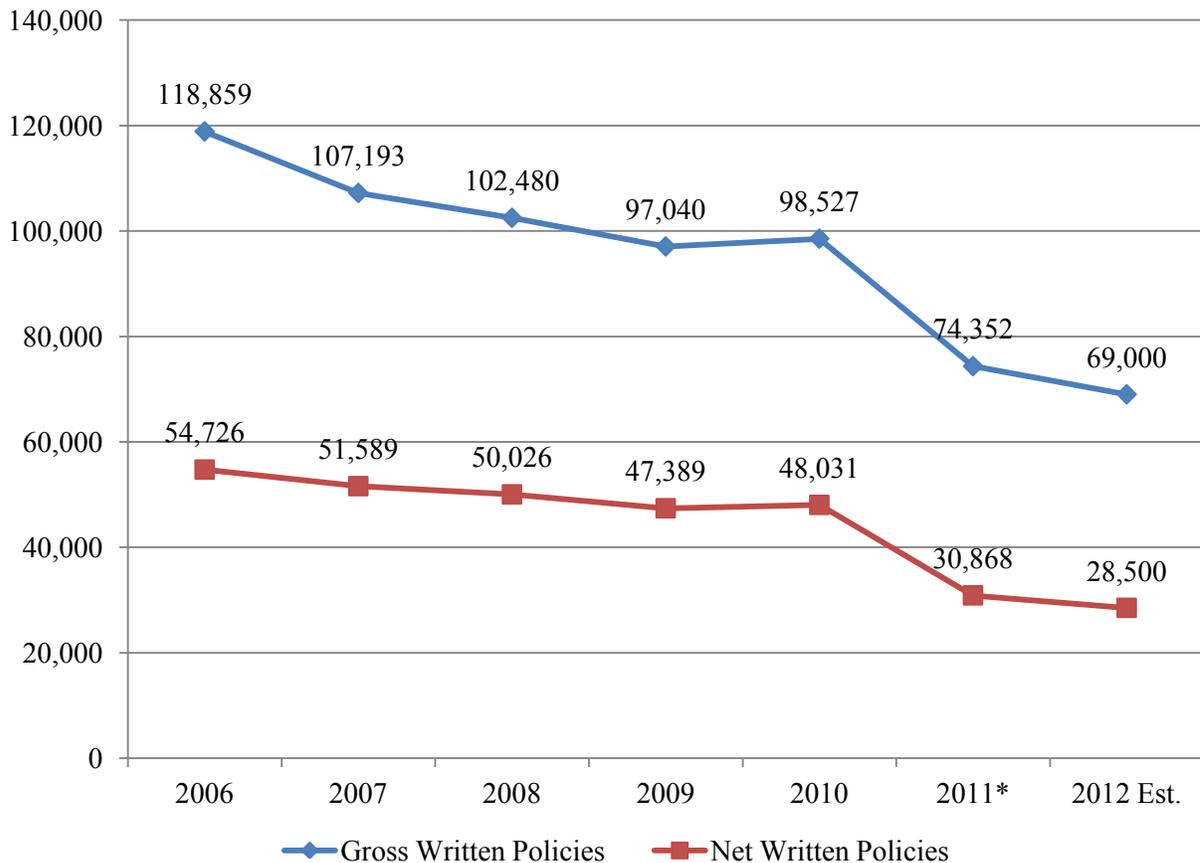
* Year-end adjustments may significantly alter the results. All calendar 2011 numbers are subject to change.

Source: Maryland Automobile Insurance Fund

The number of claims settled by the Uninsured Division has fluctuated fairly substantially from year-to-year with changes of more than 30% compared to the prior year in calendar 2009 and 2010. In calendar 2011, the number of claims settled increased despite the decrease in claims overall. MAIF explained that, because the volume of claims and personnel is limited, short-term changes in personnel play a role in claims resolution.

MAIF’s Insured Division business has historically been counter-cyclical, growing when the private market tightens. Economic declines have typically resulted in the tightening of the market and MAIF’s business growing. Despite this historic tendency and the economic downturn, MAIF’s business has declined in most years since calendar 2006, as shown in **Exhibit 2**. The decrease in gross and net written policies, although ongoing, was of relatively small magnitudes (decreases of less than 10.0%) from calendar 2007 to 2009. After a slight increase in calendar 2010, MAIF experienced a substantial decline in the number of gross and net written policies in calendar 2011, 24.5 and 35.7%, respectively. Although not definitive, MAIF indicates that potential causes for this decrease are the current economic conditions and the calendar 2011 rate increases. **MAIF should comment on why the current trend is different from the historic counter-cyclical policy trend and how this might affect the long-term outlook for MAIF’s services.**

**Exhibit 2
Policies
Insured Division
Calendar 2006-2012**

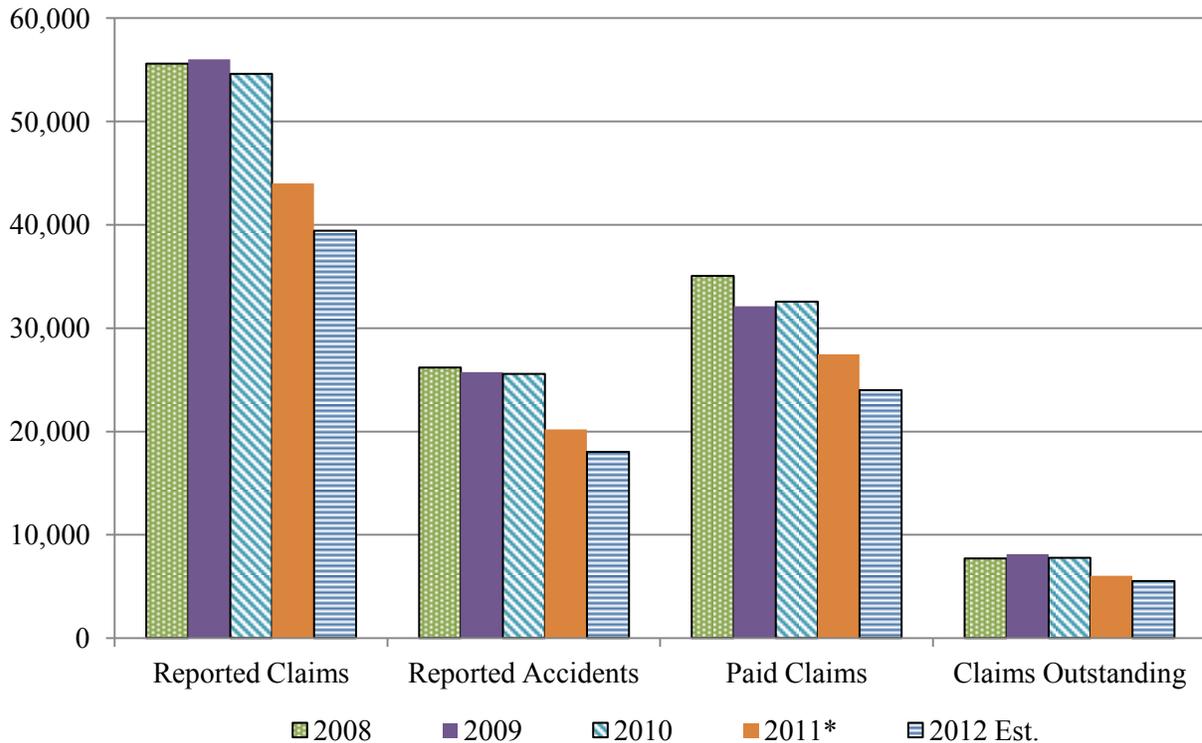


* Year-end adjustments may significantly alter the results. All calendar 2011 numbers are subject to change.

Source: Maryland Automobile Insurance Fund

Following a slight increase in calendar 2009, the number of claims reported in the Insured Division decreased in calendar 2010 and 2011, falling by 2.5 and 19.4%, respectively, as shown in **Exhibit 3**. The number of accidents reported also decreased in fiscal 2011. Although claims and accident reporting is based on external factors, both are ultimately impacted by the substantial decrease in the number of MAIF policies in recent years. The number of paid claims increased in calendar 2010, despite a decrease in the overall number of claims, which MAIF attributes to maintaining personnel in this area. However, both paid claims and claims outstanding, decreased in calendar 2011.

**Exhibit 3
Claims Activity
Insured Division
Calendar 2008-2012**



* Year-end adjustments may significantly alter the results. All calendar 2011 numbers are subject to change.

Source: Maryland Automobile Insurance Fund

Calendar 2012 Budget

MAIF, a nonbudgeted fund agency, submits its budget to the General Assembly for informational purposes only. An analysis is typically prepared in alternate years. As shown in **Exhibit 4**, the calendar 2012 budget increases by \$3.3 million, or 7.3%, compared to calendar 2011. The budget for the Insured Division is expected to increase by \$3.2 million, while the Uninsured Division budget is expected to increase by \$106,490.

Exhibit 4
Proposed Budget
Maryland Automobile Insurance Fund
(\$ in Thousands)

How Much It Grows:	Nonbudgeted Fund	Total
2011 Actual	\$45,547	\$45,547
2012 Proposed Budget	48,877	48,877
Amount Change	\$3,330	\$3,330
Percent Change	7.3%	7.3%

Where It Goes:

Personnel Expenses

Merit increase of 3.5%.....	\$800
Employee retirement.....	328
Employee and retiree health insurance.....	207
Annualization of salary plan revisions.....	172
Social Security contributions.....	36
Overtime.....	-33
Workers' compensation premium assessment.....	-41
Salaries of temporary positions.....	-144
18.9 positions eliminated in calendar 2012.....	-452
Other fringe benefit adjustments.....	3

Insurance Related Expenses

Public service announcements targeting uninsured motorists.....	494
Implementation costs of new policy administration system.....	75
Maryland Insurance Administration examination fees.....	-54
Volume declines resulting in reductions in postage, premium tax payments, underwriting, and other insurance services.....	-251

Other Changes

Planned employee incentive compensation payments.....	1,686
Updating software licenses.....	398
Printer rental and printer cartridges.....	53
Updates to system and batteries for uninterrupted power supply.....	50
Telephone upgrades.....	41
Snow removal and lawn care.....	39
Building consultant assisting in the determination to renovate building or move.....	36
Insurance premiums.....	21

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Where It Goes:

Legislative relations	-55
Calendar 2011 expenses for equipment and furniture purchases, equipment rentals, and technical and special fees that were not expended	-65
Payments made in advance in 2011 for software maintenance.....	-73
Other changes.....	60
Total	\$3,330

Note: Numbers may not sum to total due to rounding. 2011 actual is actual data through September 30, 2011, and estimates from October 1 through December 31. The Maryland Automobile Insurance Fund operates on a calendar-year basis.

Volume Related Changes

MAIF adjusts the number of positions each year based on anticipated needs primarily through attrition. In calendar 2012, MAIF anticipates eliminating 17.9 regular positions from the Insured Division and 1 position from the Uninsured Division largely due to the ongoing decline in policies. These deletions are expected to reduce expenditures in calendar 2012 by \$451,888.

Other expenditures of MAIF are also impacted by the number of policies. Consistent with the requirements on all insurance companies, MAIF must pay a 2% tax on premiums. The anticipation of further declines in policies written by MAIF reduces premium tax payment expenditures in calendar 2012 (\$83,333) compared to calendar 2011. In addition, underwriting and other insurance services decrease (\$103,982) as a result of declining needs for these services. MAIF also attributes a decrease of \$64,141 in postage to volume declines.

Personnel

Calendar 2012 expenditures include increases for personnel totaling \$1.3 million, which is offset by savings related to the eliminated positions. Regular earnings increases reflect:

- a 3.5% merit increase for all employees (\$800,179); and
- the annualization of salary plan revisions provided to some employees in November 2011 (\$172,099).

Salaries are also impacted by the end of the temporary salary reduction and furlough plan (in effect through June 30, 2011) and the removal for the one-time employee bonus provided to all State employees in fiscal 2012 (paid in MAIF in calendar 2011). Other substantial personnel increases involve employee retirement expenditures (\$327,610) and health insurance (\$206,599).

Incentive Compensation

Slightly more than half (50.7%) of the increase in MAIF’s calendar 2012 budget is attributable to an incentive compensation payment plan that has been approved by MAIF’s Board of Trustees, an increase of \$1.7 million. These incentive payments are based on collective performance of the agency and are typically tied to specific goals. **MAIF should comment on how it sets goals that must be achieved to allow incentive compensation to be received by employees.**

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 the following two triggers occur: (1) the surplus of the Insured Division falls below 25% of the three-year average of net direct written premiums; and (2) MAIF experiences an operating loss. The last assessment occurred more than 20 years ago, in 1989.

The assessment threshold varies from year to year as a result of changes in the three-year average of net direct written premiums. Within the last decade, the threshold has varied quite substantially, reaching \$57.6 million in calendar 2004 and falling in each year since that time to an estimated threshold of \$23.7 million in calendar 2012.

Despite rate increases in January 2011 (4.25%) to account for the increase in mandatory minimum coverage and in February 2011 (13.7%), the ongoing decreases in policies written by MAIF has led to reductions in the direct written premiums in calendar 2011 (22.0%) and calendar 2012 (2.1%), as shown in **Exhibit 5**. As a result, the three-year average of direct written premiums and the assessment threshold are expected to continue to decline through calendar 2012.

Exhibit 5
Maryland Automobile Insurance Fund
Assessment Threshold
Calendar 2010-2012

	<u>Direct Written Premium</u>	<u>Three-year Average</u>	<u>Assessment Threshold</u>
2008	116,636,349		
2009	109,168,500		
2010	111,904,499	112,569,783	28,142,446
2011	87,304,866	102,792,622	25,698,155
Est. 2012	85,500,000	94,903,122	23,725,780

Note: The Maryland Automobile Insurance Fund operates on a calendar year basis for its financial statements in accordance with State regulations for insurance companies.

Source: Maryland Automobile Insurance Fund

MAIF Insured Division Financial Statement

Exhibit 6 presents the financial statement for the Insured Division of MAIF. In calendar 2011, the Insured Division’s income fell to \$115.9 million, a decrease of \$13.6 million compared to calendar 2010. Calendar 2012 income decreases by an additional \$10.6 million.

The vast majority of income in the Insured Division is the result of earned premium. Because premium is earned over time, rate increases take a year to be fully included in earned premium. However, the rapid decline in policies (35.7% in net written policies) in calendar 2011 more than offset rate increases in that year, resulting in a decrease in earned premiums of \$12.4 million in calendar 2011 with a further decline of \$10.6 million anticipated for calendar 2012. Investment income is expected to remain relatively stable due to improved market conditions from calendar 2010 to 2012.

**Exhibit 6
Maryland Automobile Insurance Fund
Insured Division**

	<u>Actual 2010</u>	<u>Actual 2011</u>	<u>Estimated 2012</u>
Earned Premium	\$111,931,923	\$99,538,051	\$88,200,000
Investment Income	17,400,250	16,218,656	17,000,000
Other Income	126,818	95,586	100,000
Income	\$129,458,991	\$115,852,293	\$105,300,000
Claims Incurred	\$88,283,435	\$62,703,691	\$54,300,000
Claim Expenses Incurred	28,215,586	27,556,594	25,600,000
Other Expenses	26,835,375	24,139,416	24,000,000
Expenditures	\$143,334,396	\$114,399,701	\$103,900,000
Net Gain (Loss)	-\$13,875,405	\$1,452,592	\$1,400,000
Beginning Surplus	\$128,749,019	\$124,271,479	\$118,967,098
Net Income	-13,875,405	1,452,592	1,400,000
Change to Non-admitted Assets	9,397,865	-6,775,157	0
Release of Over Recoupment	0	18,184	0
Ending Surplus	\$124,271,479	\$118,967,098	\$120,367,098
Assessment Threshold	\$28,142,446	\$25,698,155	\$23,725,780
Ratio of Surplus to Assessment Threshold	4.42	4.63	5.07

Note: The Maryland Automobile Insurance Fund operates on a calendar year basis for its financial statements in accordance with State regulations for insurance companies.

Source: Maryland Automobile Insurance Fund

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Total expenditures decrease in both calendar 2011 and 2012 compared to calendar 2010, with a decrease of \$28.9 million in calendar 2011. Reductions in the number of claims resulted in a decrease in claims incurred of \$25.6 million in calendar 2011 with an additional decrease expected in calendar 2012. MAIF attributes a decrease in other expenses of \$2.7 million in calendar 2011 compared to calendar 2010 to the reduction in policies. Other expenses are expected to remain relatively stable in calendar 2012.

Expenditures decreased by more than income, allowing MAIF to experience a net gain in calendar 2011 of \$1.5 million even though income fell. The calendar 2011 net gain is the first net gain in the Insured Division since calendar 2007. However, despite the modest net gain, the Insured Division surplus decreased by \$5.3 million, compared to calendar 2010, as a result of a change in non-admitted assets (essentially an unrealized gain or loss) of -\$6.8 million in calendar 2011.

In calendar 2012, MAIF anticipates a similar net operating gain of \$1.4 million, which would result in a slight increase in the surplus. However, the actual ending surplus would ultimately be impacted by any positive or negative change to non-admitted assets.

MAIF's surplus to assessment ratio is expected to increase in both calendar 2011 and 2012, reaching 5.07 in calendar 2012. Reductions in the assessment threshold due to declines in direct written premium allowed the ratio to increase in calendar 2011 even as the surplus fell.

MAIF Active Vehicle Analysis

Exhibit 7 provides information on the distribution of vehicles insured by MAIF by territory. This distribution may impact the number and value of expected claims. As in recent years, inner and outer Prince George's County have the highest share of the vehicles insured by MAIF, a combined 35.6% in calendar 2011, a slight increase over calendar 2010.

**Exhibit 7
Active Vehicle Analysis
Insured Division
Calendar 2008-2011**

<u>Territory</u>	<u>2008</u>	<u>Dist %</u>	<u>2009</u>	<u>Dist %</u>	<u>2010</u>	<u>Dist %</u>	<u>2011</u>	<u>Dist %</u>
Baltimore City	5,111	7.2%	4,783	9.7%	5,019	7.1%	2,768	5.6%
Inner Baltimore County	4,015	5.7%	3,798	7.7%	3,773	5.3%	2,373	4.8%
Outer Baltimore County	2,376	3.4%	2,147	4.4%	2,142	3.0%	1,447	2.9%
Inner Montgomery County	3,204	4.5%	2,939	6.0%	2,702	3.8%	1,765	3.6%
Outer Montgomery County	3,330	4.7%	3,107	6.3%	2,751	3.9%	1,824	3.7%
Inner Prince George's County	18,599	26.4%	17,959	36.5%	18,486	26.2%	12,812	26.0%
Outer Prince George's County	6,746	9.6%	6,643	13.5%	6,517	9.2%	4,726	9.6%
Eastern Shore	4,767	6.8%	5,006	10.2%	5,164	7.3%	4,180	8.5%
Rest of the State	26,132	37.1%	24,290	49.4%	23,974	34.0%	17,307	35.2%
Total Vehicles	74,280	105.3%	70,672	143.6%	70,528	100.0%	49,202	100.0%

Source: Maryland Automobile Insurance Fund

Baltimore City's share of vehicles insured by MAIF decreased by 21.1%, to 5.6%, in calendar 2011 compared to calendar 2010, after having increased slightly in that year. While Baltimore City's share of vehicles has generally declined in recent years, the Eastern Shore's share has increased, reaching 8.5% in calendar 2011, an increase of 16.4% compared to calendar 2010.

Issues

1. Uninsured Division Surplus Not Sufficient to Cover Transfer

Section 22 of the Budget Reconciliation and Financing Act of 2011 authorized the transfer of \$4.0 million from MAIF to the general fund on or before June 30, 2012, contingent on the enactment of Senate Bill 993 of 2011. As discussed in Issue 2, Senate Bill 993, which became Chapter 312 of 2011, altered the requirements of employee compensation for MAIF.

The interpretation of the final language, as enacted, requires these funds to be transferred from the Uninsured Division of MAIF rather than be treated as an operating expense which would be shared between the two divisions. Transferring the funds from the Uninsured Division only is consistent with previous advice letters provided by the Office of Attorney General (OAG) which have stated that while a transfer from the Insured Division is not clearly unconstitutional, litigation would likely result and this litigation would have an outcome that is difficult to predict. In addition, OAG has advised that such a transfer could potentially open up the State to a responsibility for MAIF's liabilities in the event of a future fiscal collapse of MAIF.

Funds have been transferred from the Uninsured Division two other times within the last decade (\$20.0 million in 2002 and \$7.0 million in 2009). Absent the transfer during the 2011 session, MAIF anticipated the Uninsured Division had a surplus in calendar 2010 (through November 30) of \$2.9 million, which was expected to increase to nearly \$3.0 million in calendar 2011. MAIF's actual calendar 2010 ending surplus was \$2.5 million.

Uninsured Division Financial Statement

Exhibit 8 presents the financial statement for the Uninsured Division of MAIF. MAIF's total income (\$4.0 million) is \$50,286 higher than calendar 2010. MAIF is able to collect expenses from the responsible uninsured party. These collections have been impacted by the economy in recent years, resulting in lower collections. Collections on notes and judgments increase in calendar 2011 compared to 2010 but remain below levels seen in the recent past. The calendar 2009 and 2011 transfers from MAIF reduced the investment income during this period. The Uninsured Division's largest income source is revenue received from the Motor Vehicle Administration uninsured motorist fine, which is indexed each year based on the Consumer Price Index – All Urban Consumers – Medical Care. MAIF's share reached \$2.8 million in calendar 2011, and is projected to reach \$2.9 million in calendar 2012.

Exhibit 8
Maryland Automobile Insurance Fund
Uninsured Division

	<u>Actual</u> <u>2010</u>	<u>Actual</u> <u>2011</u>	<u>Estimated</u> <u>2012</u>
MVA Fines	\$2,735,538	\$2,825,811	\$2,935,000
Collections on Notes and Judgments	944,502	966,263	969,000
Investment Income	230,992	169,244	85,000
Income	\$3,911,032	\$3,961,318	\$3,989,000
Claims Incurred	905,641	680,012	734,000
Claims Expenses Incurred	1,531,274	1,101,310	1,108,000
Collection Expenses	468,043	551,868	497,000
Administrative Expenses	1,190,849	968,416	939,000
Expenditures	\$4,095,807	\$3,301,606	\$3,278,000
Net Gain	-\$184,775	\$659,712	\$711,000
Beginning Surplus	\$2,535,051	\$2,468,701	-\$915,511
Net Income	-184,775	659,712	711,000
Unrealized Gain (Losses)	118,425	-43,964	0
Extraordinary Transfer	0	-4,000,000	0
Ending Surplus	\$2,468,701	-\$915,551	-\$204,511

MVA: Motor Vehicle Administration

Note: The Maryland Automobile Insurance Fund operates on a calendar year basis for its financial statements in accordance with State regulations for insurance companies

Source: Maryland Automobile Insurance Fund

MAIF's calendar 2011 expenditures were \$794,201 less than calendar 2010. Calendar 2012 expenditures decrease by less than \$25,000 compared to calendar 2011. Claims and claims expenses incurred decreased by a combined \$655,593 in calendar 2011 due to a decrease in claims activity, accounting for the majority of the decrease in total expenditures. Administrative expenditures decreased by \$22,433, primarily due to changes in assignments of personnel.

MAIF's net income in calendar 2011 was partially offset by a slight unrealized loss. As a result, with a beginning balance of only \$2.5 million, a net income of \$659,712, and a small unrealized loss, the transfer results in a surplus below \$0.0. MAIF anticipates an ending surplus of a -\$915,511. A negative surplus is expected to continue in calendar 2012.

Impact on Claims

MAIF indicates that the negative surplus will not impact its ability to pay claims to those rightfully entitled to claims because these are paid over a period of time, not necessarily the year in which the claim is reported and the liability incurred. Over time, MAIF believes the surplus will again build. **MAIF should comment on the impact of the negative surplus on its operations and the long-term future of the division.**

2. Annual Report on the Reasonableness of the Surplus of the Insured Division

The 2008 *Joint Chairmen's Report* (JCR) requested that MAIF and the Maryland Insurance Administration (MIA) submit a report on the following 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 the surplus if it is determined to be excessive. In October 2008, MAIF and MIA submitted a response to this request which outlined a formal review process to determine whether MAIF's surplus is excessive. A memorandum of understanding between MIA and MAIF formalized the review process in November 2009.

Using information provided by MAIF, MIA evaluates MAIF's surplus based on the following factors:

- the ratio of the surplus to the assessment trigger;
- the surplus as measured by Risk Based Capital (RBC);
- the ratio of premium to surplus;
- external economic factors;
- trends in the automobile insurance industry both nationally and in Maryland; and
- 24-month financial projections.

The 2009 and 2010 JCR requested that MIA annually submit to the budget committees the report on the surplus of the Insured Division of MAIF concurrent with the submission to the Presiding Officers and the Chair and Vice Chair of the Senate Finance and House Economic Matters committees.

Findings

On January 7, 2011, MIA published the report for calendar 2009; the calendar 2010 report has not been submitted as of this writing. The MIA report regarding calendar 2009 noted the unusual decline in policies discussed previously.

In calendar 2009, MAIF's surplus to assessment ratio was 4.36, an increase from calendar 2008 when this ratio was 4.18. However, MIA explained that the improved ratio occurred as a result of a reduction in net direct written premiums, which allowed the ratio to improve despite the decline in the division's surplus.

MIA explained, as described in statute, it is the policy of the State to encourage insurance companies to maintain a surplus above the minimum required levels. MAIF continues to do so, in the surplus as measured by RBC. In fact, in calendar 2009, MAIF maintained the sixth highest ratio compared to the top 10 private automobile insurance writers. MIA's analysis of the premium to surplus ratio is that the ratio is healthy. MIA also described the impact of the economic downturn on the market in the whole, which has resulted in declines in direct written premiums, underwriting losses, and declines in net investment gains.

MIA requested that MAIF produce multiple scenarios of operating conditions (a baseline and a stressed scenario). Under the stressed scenario, MAIF estimated its surplus could fall in calendar 2011 to the level an assessment would be required.

MIA concluded that MAIF's surplus is not excessive. However, MIA noted that it could not determine an amount that it would consider to be excessive. MIA recommended that because MAIF cannot control its premium volume, as the insurer of last resort, MAIF, in consultation with MIA, should conduct a comprehensive analysis through an independent expert. The analysis would examine operations and factors that impact operating outcomes with a goal of establishing a range within which its surplus would be reasonable, neither excessive nor deficient. MAIF reports that undertaking such an analysis at this time is not economically feasible. **DLS recommends committee narrative requesting a copy of the annual report on the reasonableness of the Insured Division. DLS also recommends committee narrative requesting that MAIF and MIA submit a report on an analysis of the point at which MAIF's surplus would be deficient.**

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: The response to the 2008 *Joint Chairmen's Report (JCR)* request by the Maryland Automobile Insurance Fund (MAIF) and the Maryland Insurance Administration (MIA) indicated that MIA will annually produce a report on the reasonableness of the surplus of the Insured Division of MAIF. The first of these annual reports was submitted on July 16, 2009, to the budget committees in response to the 2009 JCR. The committees request that MIA continue to submit this report (for calendar 2011 and 2012) 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 Matters committees.

Information Request	Author	Due Date
Calendar 2011 and 2012 annual reports on the reasonableness 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.

2. Adopt the following narrative:

Point at Which the Insured Divisions Surplus Would Be Deficient: In the calendar 2009 report of the reasonableness of the surplus of the Insured Division by the Maryland Insurance Administration (MIA) released in January 2011, MIA stated that the Maryland Automobile Insurance Fund (MAIF) should, in consultation with MIA, conduct a comprehensive analysis of its operations and the various factors that impact its operating results, with a goal of establishing a range within which its surplus would be reasonable, neither excessive nor deficient. Given the ongoing decline of the Insured Division surplus, the committees request MAIF and MIA undertake this analysis.

Information Request	Authors	Due Date
Report on an analysis of the point at which the Insured Division's surplus would be deficient	MAIF MIA	December 1, 2012

Updates

1. Strategic Consulting Expenditures

In November 2009, the Office of Legislative Audits (OLA) released a fiscal compliance audit for MAIF. The audit contained five findings, including two policy issues. One of these findings was that certain expenditures of MAIF should be disclosed to the legislative budget committees as part of the annual budget submission process. In the discussion of this finding, OLA indicated that some expenditures of MAIF appeared to be inconsistent with the mission of a State-created entity designated as an insurer of last resort and were more consistent with a private insurer. The expenditures over which the audit expressed concern included:

- strategic consulting;
- marketing;
- public relations;
- advertising; and
- producer appreciation events.

OLA noted that the law does not prohibit these types of expenditures, but OLA was concerned about the appropriateness. The audit noted that MAIF believes that these types of expenditures are appropriate and a necessary part of its business. OLA recommended that MAIF report detailed budget and expenditure data for these items to the budget committees.

During the 2010 session, MAIF provided information on the planned expenditures for nearly all of these expenditure types; however, MAIF explained that it had 140 contracts totaling approximately \$10.0 million it considered to be strategic consulting expenditures ranging from investment advisors to services associated with underwriting and claims adjustment. Due to concern regarding the difference in value provided in the audit about MAIF's strategic consulting expenditures and the amount provided by MAIF, committee narrative in the 2010 JCR requested that MAIF and OLA work together to develop a uniform understanding of strategic consulting expenditures. The narrative also requested MAIF submit reports containing the definition and detail on the strategic consulting expenditures in calendar 2009, 2010, and 2011. Although MAIF believed that no discrepancy in the definition of the term existed, a report was submitted in August 2010 containing a definition.

Definition of Strategic Consulting

OLA and MAIF held a meeting in May 2010 to define the term. The definition was based on three principles: (1) a business understanding of strategic consulting; (2) the need for transparency;

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and (3) the existing budget infrastructure and object codes. The report explained that writings on strategic consulting focus on the nature of the vendor, the forward looking nature of the contract, problem solving advice of the contract, and the relationship to the core business or dollar value to the contracting agency. MAIF believed that the term should not be defined too narrowly to ensure that the General Assembly has access to needed information on spending of the agency.

MAIF and OLA have as a result jointly defined strategic consulting as “[c]ontracts with third party vendors who, in whole or in part, provide support, analysis, or advice to MAIF on its core insurance and governmental operations, including but not limited to, support, analysis, and advice on investment, underwriting and claims processes, information services and essential building functions.” MAIF and OLA explicitly do not include marketing, public relations, advertising, lobbying services, or producer appreciation events as strategic consulting expenditures because these items are already reported in the existing budget structure.

Strategic Consulting and Other Expenditures

As requested in the 2010 JCR, MAIF provided detail on these and other expenditures for calendar 2010 and 2011. MAIF provided this information upon request for calendar 2012. **Exhibit 9** provides a comparison of MAIF expenditures in these areas from calendar 2009 to 2012.

Exhibit 9
Comparison of Strategic Consulting and Other Related Expenditures
Calendar 2009-2012

	<u>2009</u> <u>Actual</u>	<u>2010</u> <u>Actual</u>	<u>2011</u> <u>Projected</u>	<u>2012</u> <u>Budget</u>	<u>Difference</u>
Strategic Consulting Services	\$5,724,961	\$6,327,175	\$6,414,784	\$6,742,322	\$327,538
Marketing, Public Relations, or Advertising Services	\$42,988				
Conferences and Events		\$650	\$2,500	\$0	-\$2,500
Outreach Media Expense		0	7,023	501,500	494,477
Outreach Materials		8,787	12,293	9,100	-\$3,193
Outreach Miscellaneous		2,962	4,130	8,250	4,120
Total Marketing, Public Relations, and Advertising	\$42,988	\$12,399	\$25,946	\$518,850	\$492,904
Outside Lobbying Services	\$73,975	\$32,760	\$95,304	\$40,000	-\$55,304
Total Strategic Consulting and Other Expenditures	\$5,841,924	\$6,372,334	\$6,536,034	\$7,301,172	\$765,138

Source: Maryland Automobile Insurance Fund

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As shown in Exhibit 9, MAIF's expenditures for strategic consulting have increased from calendar 2009. The calendar 2012 budget for these expenditures of \$6.7 million, an increase of \$327,538 compared to the calendar 2011 projected budget. Under the definition agreed upon by MAIF and OLA, these expenditures include purchases of computer software and other computer related contracts, underwriting, legal research, independent auditors, and investment services.

Advertising and marketing expenditures were relatively low during this time period; however, in calendar 2012, marketing expenditures increase by \$492,904 due to a planned campaign targeting uninsured motorists. Lobbying services have fluctuated substantially between these years but decrease in calendar 2012 to \$40,000.

2. Employee Compensation Changes

Chapter 312 of 2011 altered the requirements related to employee compensation in MAIF. Prior to this legislation, employee compensation was expected, when possible, to be in accordance with the State pay plan. In addition, the executive director of MAIF was required to submit changes in the salary plans, including increases or decreases in salary ranges other than those associated with routine classification and promotions or general salary increases, to the Secretary of the Department of Budget and Management (DBM) 45 days before the effective date of the change. The Secretary of DBM was required to review the proposed changes and determine, at least 15 days before the change, whether the changes would have an adverse effect on comparable State jobs. If the Secretary of DBM failed to respond to the proposed changes, the failure to respond was deemed to be a statement that the proposed change does not have an adverse effect. MAIF employees, as State employees, were also subject to the temporary salary reductions and employee furloughs.

Under Chapter 312, MAIF's executive director is now required to not only determine, but also administer employee compensation in MAIF. The legislation also removes the requirements for the review of proposed employee compensation changes by the Secretary of DBM and that employee compensation be consistent with the State pay plan. The legislation also explicitly states that MAIF employees are not subject to any law, regulation, or executive order regarding State employee compensation including furloughs and salary reductions.

Employee Compensation Changes

As part of the new authority granted to MAIF under Chapter 312, MAIF made several adjustments to employee compensation. A committee of the Board of Trustees was formed to examine the change, and the committee obtained an independent market study. As a result of the market study, the Board of Trustees authorized a market adjustment to the salaries of 53 employees of MAIF. MAIF indicates that this adjustment will provide these employees, in total, an additional \$196,355.

MAIF also implemented a 4.0% merit increase for employees effective mid July 2011. Employees will benefit from the full 4.0% increase in calendar 2012, for a cumulative \$727,000 increase. MAIF has also planned a 3.5% merit increase for calendar 2012, an increase of \$800,179.

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Initially, as was the case with other Executive Branch employees, MAIF implemented the \$750 bonus provided to employees, incrementally in bi-weekly pay checks. However, MAIF later awarded the amounts that had yet to be paid in a lump-sum payment.

As part of the new requirement that the executive director of MAIF administer the employee compensation, MAIF awarded a contract to a private payroll company. Previously, pay checks for MAIF's employees were paid through the Maryland Comptroller's Office.

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

<u>Object/Fund</u>		<u>CY 2010 Actual</u>	<u>CY 2011 Projected</u>	<u>CY 2012 Estimated</u>	<u>CY11-CY12 Amount Change</u>	<u>Percent Change</u>
Positions						
01	Regular	388.00	374.7	355.8	-18.9	-5.0%
02	Contractual	2.00	1.4	1.6	0.2	14.3%
	Total Positions	390.00	376.1	357.4	-18.7	-5.0%
Object						
01	Salaries, Wages & Fringe Benefits	\$32,557,872	\$32,960,600	\$33,836,336	\$875,736	2.7%
02	Tech & Special Fees	\$5,712,172	\$5,068,282	\$6,936,563	\$1,868,281	36.9%
03	Communications	\$1,243,575	\$1,329,542	\$1,309,792	-\$19,750	-1.5%
04	Travel	\$118,575	\$143,248	\$144,219	\$971	0.7%
06	Fuel & Utilities	\$382,245	\$364,327	\$369,000	\$4,673	1.3%
07	Motor Vehicle Operations & Main	\$374,686	\$415,954	\$406,590	-\$9,364	-2.3%
08	Contractual Services	\$4,133,745	\$3,537,167	\$3,652,316	\$115,149	3.3%
09	Supplies & Materials	\$286,265	\$319,201	\$360,197	\$40,996	12.8%
10	Equipment Replacement	\$1,822	\$24,152	\$11,545	-\$12,607	-52.2%
11	Equipment Additional	\$275,542	\$1,063,389	\$1,479,554	\$416,165	39.1%
13	Fixed Charges	\$318,517	\$277,553	\$298,997	\$21,444	7.7%
14	Land & Structures	\$64,000	\$43,239	\$72,000	\$28,761	66.5%
	Total Objects	\$45,469,016	45,546,654	48,877,109	\$3,330,455	7.3%
Funds						
07	Nonbudgeted Fund	\$45,469,016	\$45,546,654	\$48,877,109	\$3,330,455	7.3%
	Total Funds	\$45,469,016	\$45,546,654	\$48,877,109	\$3,330,455	7.3%

Note: 2011 actuals are actual through September 30, 2011, and estimates from October 1 to December 31, 2011.

**Calendar Summary
Maryland Automobile Insurance Fund**

<u>Program/Unit</u>	<u>CY10 Actual</u>	<u>CY11 Projected</u>	<u>CY12 Estimated</u>	<u>CY11-CY12 Change</u>	<u>%Change</u>
42 Insured Division	\$43,141,541	\$43,130,091	\$46,354,056	\$3,223,965	7.5%
47 Uninsured Division	2,327,474	2,416,563	2,523,053	106,490	4.4%
Expenditures Total	\$45,469,015	\$45,546,654	\$48,877,109	\$3,330,455	7.3%
Nonbudgeted Fund	\$45,469,015	\$45,546,654	\$48,877,109	\$3,330,455	7.3%
Appropriations Total	\$45,469,015	\$45,546,654	\$48,877,109	\$3,330,455	7.3%

Note: 2011 actuals are actual through September 30, 2011, and estimates from October 1 to December 31, 2011.