

Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE

House Bill 1008
Economic Matters

(Delegate Davis)

Injured Workers' Insurance Fund - Status and Renaming

The bill changes the status of the Injured Workers' Insurance Fund's (IWIF) from that of a State agency to a statutorily created not-for-profit, mutual insurer. To reflect its new status, IWIF is renamed the Chesapeake Employers' Mutual Insurance Company.

The company retains its public purpose as the insurer of last resort and must continue to guarantee the availability of workers' compensation insurance in the State. Moreover, the bill does not affect IWIF's core functions. However, the bill specifies that the company is not a unit of State government and, unless as specifically identified in law, is not subject to any law that affects governmental units.

Fiscal Summary

State Effect: The bill does not directly affect governmental operations. The State Retirement Agency (SRA) can handle transferring IWIF to a participating governmental unit (PGU) with existing resources. The Maryland Insurance Administration (MIA) can continue to regulate the company with existing resources.

Injured Workers' Insurance Fund Effect: Changing IWIF's status to that of a statutorily created not-for-profit, mutual insurer means that IWIF gains autonomy from State personnel, procurement, and other laws applicable to State governmental units. This change is not expected to materially affect its finances.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: The company may only operate as a workers' compensation insurer and is prohibited from converting to a stock company or consolidating with a stock company or other mutual insurers. In general, the company will continue to be regulated by the Maryland Insurance Commissioner as IWIF is under current law. With a few exceptions, the company would be regulated similar to other insurers in the State.

The company's assets, similar to those of IWIF, will consist of all revenue received by the company, including premiums for insurance that the company issues, earnings from third-party administrative and related activities, and investment and interest income.

If the company is placed in a conservatorship or receivership, or becomes insolvent, the State has no liability to the policyholders, persons receiving workers' compensation benefits, or the company's creditors. The bill establishes that the State has no interest in the assets of the company and may not borrow or appropriate from the company's revenues or assets. The assets of the company are held by the company in trust for the policyholders, injured workers, and the company's creditors.

Employees of the company are not employees of the State and are not subject to any law or regulation governing State employment or compensation. Employees that have served, as of September 30, 2010, in an eligible capacity for at least five years will continue to be members of the State's retirement or pension systems. Employees hired on or after October 1, 2010, may not be members of the State retirement or pension systems. However, employees with less than five years of eligible service by October 1, 2010, may choose to remain members of the retirement or pension systems, but they must do so by December 31, 2010. Employees who elect not to remain in the systems will have their accumulated contributions returned to them. The company must continue to pay contributions for all employees that remain in the system beginning in fiscal 2012.

IWIF employees hired on or before October 1, 2010, may not be removed from employment unless (1) there is cause for removal; (2) written charges are filed; and (3) the employee has an opportunity for an administrative hearing. This does not apply to employees who are laid off due to a lack of work.

The bill makes technical changes to the methods by which the company can pursue the collection of debts from delinquent policyholders and cancel a policy due to nonpayment or as a result of noncompliance. Nonetheless, the company must abide by statutory guidelines related to the collection of debts and cancellation of policies. (*See Insurance Article § 19-406.*)

The bill stipulates that, for all intents and purposes, the company is the successor of IWIF. As of the bill's October 1, 2010 effective date, all functions, powers, duties, equipment,

assets, liabilities, and employees of IWIF are transferred to the company. This transfer includes the IWIF headquarters in Towson. The bill specifies that, in consideration for these transfers and to extinguish any claim the State has or may have against the assets or property of IWIF or the company, the company will transfer \$20 million to the State's general fund, as specified in the Budget Reconciliation and Financing Act of 2010 (SB 141/HB 151). Finally, the bill allows the company to operate under the IWIF name for up to one year after the effective date of the bill.

Current Law:

Role of IWIF in the State (Unchanged by the Bill)

IWIF must serve as a competitive insurer in the marketplace for workers' compensation insurance, guarantee the availability of such insurance in the State, serve as the insurer of last resort, and engage only in the business of workers' compensation insurance. IWIF operates as a third-party administrator in the State and is subject to State insurance law provisions related to such entities.

Regulation of IWIF and Rate Making Practices (Unchanged by the Bill)

IWIF must submit a detailed package of information to the Governor that includes the schedule of premium rates that IWIF will charge for the next calendar year. The board of IWIF, which is appointed by the Governor, has the authority to determine the schedule of premium rates based on the rating system that, in the opinion of the board:

- most accurately measures the level of hazard for each policyholder on the basis of the number of injuries that occur in the enterprises of the policyholder;
- encourages the prevention of injuries; and
- ensures the solvency of IWIF from year to year.

Chapter 336 of 2009 specified that IWIF must operate in a manner similar to an authorized domestic workers' compensation insurer and is subject to additional regulation by MIA. IWIF is regulated in a manner similar to most other insurers in the State; however, IWIF is not required to pay a premium tax, or join the National Council on Compensation Insurance (NCCI) and adhere to the policy forms filed by NCCI. Chapter 336 also required the Insurance Commissioner to, at least once every five years, study IWIF's rate making practices to ensure that the agency produces actuarially sound rates. IWIF's board must adopt a schedule of premium rates in accordance with sound actuarial practices and must ensure that the rates are not excessive, inadequate, or unfairly discriminatory.

Employment with IWIF (Changed by the Bill)

Employees of IWIF are considered State employees and are members of the State employees' retirement and pension systems. The board establishes compensation rates for IWIF employees; to the extent practicable, the board must set compensation levels in accordance with the State pay plan. In general, IWIF employees are considered special appointments and may not be removed unless (1) there is cause for removal; (2) written charges are filed; and (3) the employee has an opportunity for an administrative hearing. This does not apply to employees who are laid off due to a lack of work.

Final Disposition of IWIF (Unchanged by the Bill)

If the General Assembly repeals the statute that created IWIF, IWIF's assets must be distributed as determined by the General Assembly, or as justice requires with regard to existing obligations for compensation. Chapter 22 of 2002 required that IWIF become a member of the Property and Casualty Insurance Guaranty Corporation (PCIGC) like other insurers in the State. If an insurer in the State becomes insolvent, PCIGC assess its members to cover claims. A 1968 Opinion of the Attorney General indicates that assets of a State insurance fund belong exclusively to the policyholders; thus, the State may not convert IWIF's assets for general State purposes.

Background: IWIF administers workers' compensation for the State and provides workers' compensation insurance to firms unable to procure insurance in the private market. IWIF was established in 1914 as the State Accident Fund, part of the State Industrial Accident Commission. In 1941, it became a separate agency and took its current name in 1990. IWIF only writes policies in Maryland and is the exclusive residual workers' compensation insurer in the State. IWIF cannot decline businesses that seek coverage and must adjust rates in response to changing market conditions. In Maryland, IWIF is a major insurer with approximately one-third share of the market.

An October 2009 report by Conning Research and Consulting, a firm specializing in insurance industry analysis, found that workers' compensation state funds, such as IWIF, have achieved a significant share of the overall insured market countrywide. The report found that state funds write approximately 25% of the workers' compensation policies nationwide and that the market share of these funds is increasing in many of the states in which they write (about 25 states). Numerous state funds have mutualized in recent years, including state funds in Kentucky, Rhode Island, and Texas.

The Budget Reconciliation and Financing Act of 2010 (SB 151/HB 141) proposes balance transfers totaling \$26.5 million from IWIF to the State's general fund in fiscal 2010. The largest is a transfer of \$20 million from IWIF's reserve fund. Assets in IWIF's reserve fund represent a utilization of reserves the quasi-governmental unit has accumulated through the course of its operations as a provider of workers' compensation insurance in the State; these

assets are not State monies previously disbursed to IWIF. IWIF held reserves worth \$287.6 million as of December 2009. The remaining \$6.5 million in transfers are from special fund reserves capitalized with State funds. These funds are used by IWIF to pay operating costs and actuarial liability claims the State may incur under its self-insured workers' compensation program that IWIF administers on behalf of the State.

IWIF's operations are solely financed by premiums and investments, but its start-up capital and the majority of its plant assets, such as the various parcels of land constituting its current office location in Towson, were provided by the State. IWIF's December 31, 2009 balance sheet includes real estate assets valued at \$10.3 million. However, the State Department of Assessments and Taxation valued IWIF's headquarters property at \$15.2 million in January 2008. By controlling operating expenses IWIF has accumulated its reserves in order to maintain rate stability. In 2008, IWIF reduced rates by 5%, even as its premiums written totals fell, due to reserve increases.

State Fiscal Effect: In recent years, the General Assembly has enacted legislation that regulates IWIF in a manner more similar to that of a private insurer than a State agency. In particular, Chapter 336 of 2009 subjects IWIF to greater regulation under the State's insurance statute and increases MIA's oversight of IWIF. Chapter 336 also required IWIF to pay an annual assessment to MIA, which is a requirement of private insurers. This bill does not affect the requirement that IWIF pay the MIA assessment.

From the standpoint of State revenues, an important issue related to IWIF is whether or not it must pay the premium tax, which is required of private insurers in the State. Under current law, IWIF is not subject to the premium tax; this is unchanged by the bill.

Currently, the State does not have access to the reserves of IWIF unless (1) the State receives approval from IWIF to transfer assets from IWIF's reserves; or (2) the State repeals the statute that created IWIF. Under the bill, the company is subject to these same provisions; thus, the State continues to have no right to IWIF's reserves unless the agency is eliminated by the General Assembly.

Although the bill changes the status of IWIF and its employees, it does not directly affect government operations. The bill does not result in a material increase or decrease in State revenues or expenditures. However, by shifting unfunded pensions liability and closing eligibility for new hires, PGU contribution rates may increase.

Additional Comments: The State Retirement Agency advises that provisions that allow employees of the newly created company to remain in the State's retirement and pension systems may violate the Internal Revenue Service's Revenue Ruling 89-49 of 1989, which specifies that a plan is not considered a government plan merely because the sponsoring organization has a relationship with a governmental unit. SRA advises that five factors are

used in determining whether an employer can participate in a State government plan. The factors include:

- the degree of government control over the employer's day-to-day operations;
- whether the employer was created by statute;
- the organization's source of funding;
- how the organization's governing body is selected; and
- whether the employer's employees are considered government employees other than for retirement purposes.

Thus, SRA advises that IWIF employees may not remain in the State pension or retirement systems and would either vest their service (for employees with at least five years of eligibility service) or withdraw from the systems.

Legislative Services advises that the bill specifies that the new company must continue to pay for all employees remaining in the system beginning in fiscal 2012, several months after the conversion.

Additional Information

Prior Introductions: None.

Cross File: SB 507 (Senator Middleton – Finance) is identified as a cross file, but it is not identical.

Information Source(s): Injured Workers' Insurance Fund Maryland, Maryland Insurance Administration, Maryland State Retirement Agency, Department of Budget and Management, Workers' Compensation Commission, Department of Legislative Services

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