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Injured Patients and Families Compensation Fund

Office of the Commissioner of Insurance

March 2013

Report Highlights

The Fund provides secondary medical malpractice insurance to approximately 14,000 health care providers.

The Fund has experienced significant fluctuations in annual total claims payments.

The Fund's financial position has improved significantly.

A target range for net asset balances and a process to evaluate them should be established.

OCI needs to improve the Fund's financial reporting process.

The Injured Patients and Families Compensation Fund provides participating physicians and other health care providers in Wisconsin with secondary medical malpractice insurance to cover claims that exceed the coverage limits of their primary insurance. Statutes require most health care providers that operate or have permanent practices in Wisconsin to maintain primary malpractice coverage of $1.0 million for each incident and $3.0 million per policy year, and to participate in the Fund by paying assessments that help to fund claims greater than these amounts.

There is no limit to the compensation the Fund will pay on behalf of participating providers for economic damages, such as medical costs and loss of income. Noneconomic damages, which include compensation for suffering, mental distress, and loss of companionship and affections, are currently limited by statutes to $750,000.

The Fund is governed by a 13-member Board of Governors. The Office of the Commissioner of Insurance (OCI) has statutory responsibility for administering the Fund.

Statutes require the Legislative Audit Bureau to perform a financial audit of the Fund at least once every three years. In completing our audit, we reviewed the Fund's internal controls; assessed the fair presentation of its financial statements; and evaluated compliance with certain statutory provisions. We also reviewed the financial status of the Fund and followed up on prior audit recommendations. Our audit report contains our unqualified opinion on the Fund's financial statements and related notes as of and for the years ended June 30, 2012, June 30, 2011, and June 30, 2010.

Annual Assessment Rates

Assessment rates have regularly increased over the last four years, with average annual increases ranging from 5.0 percent to 9.9 percent. Physicians are assessed rates for fiscal year (FY) 2012-13 coverage that range from $1,534 for general practice physicians to $10,125 for obstetric and neurological surgeons.

Key Facts and Findings

Since its inception, the Fund has paid $807.8 million for 660 claims.

The Fund reported a net asset balance of

Claim Payments

The Fund has paid $807.8 million for 660 claims from its inception in 1975 through June 30, 2012. Thirty-six of the claims have been for amounts of $5.0 million or more and represent 41.7 percent of the total claim payments. The largest claim was $34.3 million paid in FY 2007-08 for an incident that occurred in FY 2003-04.

A small number of large-value claims can significantly affect the Fund's operations and cash flow. For example, annual total claim payments of $50.3 million in FY 2007-08 and $65.7 million in FY 2008-09 represent the two largest years of payments since the Fund's inception. In contrast, annual total claim payments in FY 2011-12 were negative because unused funds in two future medical expense accounts totaling $1.9 million reverted back to the Fund upon the death of two claimants.

$361.3 million as of June 30, 2012.

The Fund accumulated $1.0 billion in cash and investments as of June 30, 2012.

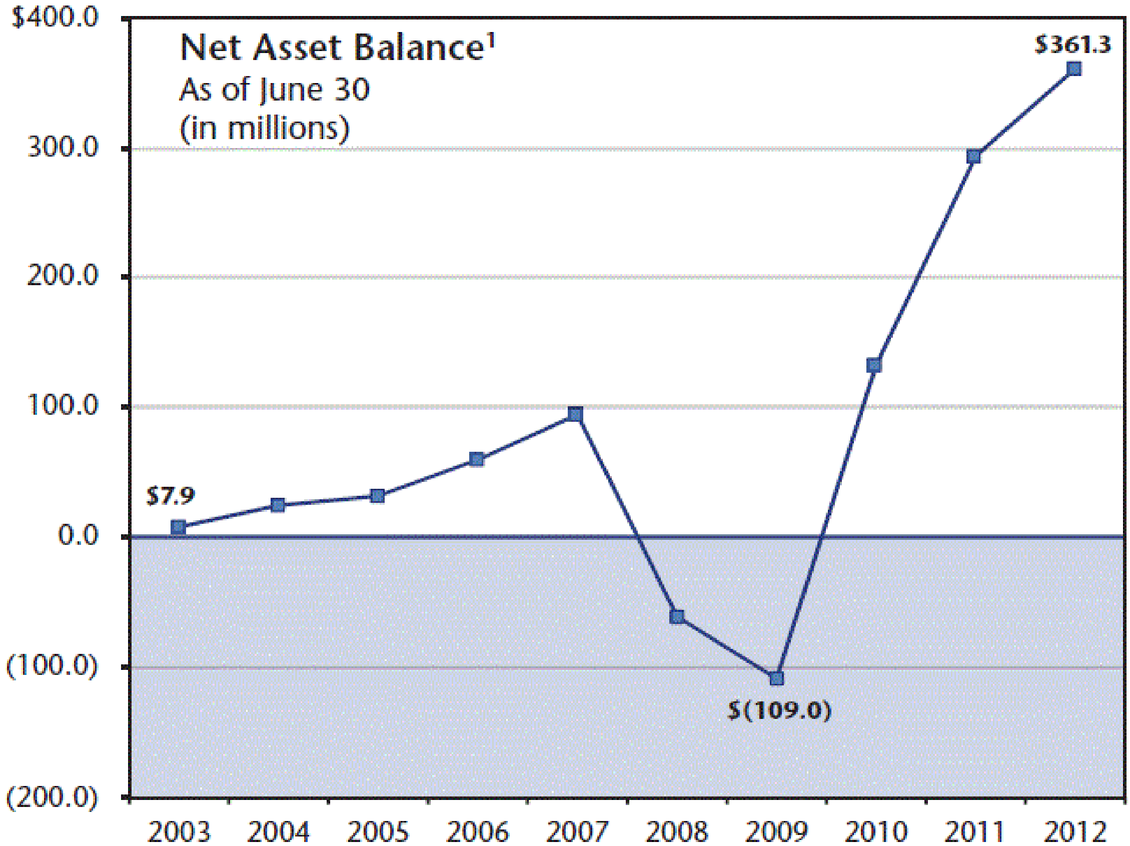
The Wisconsin Supreme Court ruled that a $200 million transfer from the Fund to the State was unconstitutional.

In August 2011, the State transferred $233.7 million to the Fund from the General Fund.

Financial Position

The Fund's financial position is represented by its net asset balance, which is the difference between its assets and liabilities. The Fund's net asset balance was $361.3 million as of June 30, 2012.

The Fund's loss liabilities are based on estimates of what it may be required to pay for malpractice incidents that have occurred but may not yet have been settled or even reported. The Board of Governors relies on a consulting actuarial firm to estimate the Fund's liabilities.



[1]Represents the Fund's assets less its liabilities.

Estimating the Fund's loss liabilities is challenging because of the long-term nature, infrequency, and severity of claims covered by the Fund as a secondary medical malpractice insurer and the absence of a limit on the amount of economic damages that the Fund may be required to pay.

Legislation and court decisions have also contributed to the uncertainty in estimating the Fund's loss liabilities. Estimates of the Fund's loss liabilities have been regularly reduced over the last several years as claims experience has been more favorable than expected.

The Fund's financial position also has been significantly affected over the last five years by a $200 million transfer from the Fund to the State's Medical Assistance Trust Fund required by 2007 Wisconsin Act 20.

Largely due to the $200 million transfer, the Fund's net asset balance declined 215.5 percent from $94.4 million as of June 30, 2007, to -$109.0 million as of June 30, 2009.

The Fund's net asset balance increased significantly in FY 2009-10 in anticipation of the return of the funds as the result of a July 2010 Wisconsin Supreme Court ruling that the transfer was unconstitutional. The Dane County Circuit Court subsequently issued an order in July 2011 that required the State to also pay the Fund $33.7 million for the Fund's estimated lost investment earnings, interest expense paid by the Fund, and attorney fees to be paid to the Wisconsin Medical Society. In August 2011, the State transferred $233.7 million to the Fund from the General Fund.

The Fund's financial position also has been affected by the economy and investment markets over the last five years. At least part of the decline in the Fund's net asset balance in FY 2008-09 was the result of negative investment earnings associated with the recession that began in 2008.

As the investment markets have improved in recent years, the Fund has experienced increases in its investment earnings, which totaled $54.1 million in FY 2010-11 and $67.5 million in FY 2011-12.

Due to the significant increase in the Fund's net asset balance in recent years, it will be important for the Board of Governors to establish formal parameters for assessing the overall sufficiency or reasonableness of the Fund's net asset balance. Such parameters will help the Board make future decisions about the Fund's financial operations and communicate information about the Fund's financial position.

Actuarial Audits

In response to our prior audit recommendations, the Fund now contracts for actuarial audits every three years to evaluate the reasonableness of the actuarial methodology and assumptions used in developing estimates of the Fund's loss liabilities.

All three actuarial audits completed to date have concluded that the Fund's loss liabilities were reasonable, although conservative. The most recent actuarial audit, which was completed in December 2011, concluded that the Fund's 5.5 percent investment rate assumption was aggressive. In December 2011, the Board of Governors approved a reduction in the investment rate assumption to 5.0 percent and, in September 2012, approved a further reduction to 4.5 percent.

Need for Improvements in Financial Reporting

Accurate financial reporting is important to help ensure that interested parties have confidence in the Fund's financial operations and the Board of Governors has the best information available to make key decisions regarding the Fund's future financial operations. However, OCI has not established adequate procedures and controls to ensure the accuracy of the Fund's financial statements. As a result, we again identified financial statement errors as part of our audit and we report a material weakness in the Fund's internal controls over financial reporting.

Recommendations

We include recommendations for the Office of the Commissioner of Insurance to:

- work with the Board of Governors to establish a target range of minimum and maximum net asset balances for the Fund and to establish a process to evaluate the appropriateness of the targets on an annual basis *(**p. 19**);* and
- reassess the Fund's current financial reporting process and take steps to establish and document clear procedures for completing and verifying the accuracy of the Fund's financial statements, including:
  - comparing actual results of the Fund's financial activities to expectations;
  - reconciling and verifying key account balances to supporting or corroborating sources of information;
  - reviewing the continued accuracy of formulas and links in spreadsheets; and
  - establishing checklists to document that critical steps are completed *(**p. 22**);*

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