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An Audit:

Injured Patients and Families Compensation Fund

Office of the Commissioner of Insurance

March 2010

Report Highlights

The Fund's financial position has declined significantly.

A 2008 actuarial audit concluded the Fund's loss liability estimates were reasonable, although conservative.

OCI implemented a new provider system, at an estimated cost of $1.4 million.

Key Facts and Findings

The Fund provides secondary medical malpractice insurance to more than 13,400 health care providers.

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.

The Fund has paid more than $770.8 million in claims from its inception through December 31, 2009. There is no limit to the compensation it 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.

Statutes require the Legislative Audit Bureau to perform financial audits of the Fund at least once every three years. Our audit report contains our unqualified opinion on the Fund's financial statements and related notes as of and for the years ending June 30, 2009, 2008, and 2007. In light of ongoing interest in the Fund's financial position, we also reviewed changes in provider assessments, annual claim payments, and the Fund's accumulated cash and investments; recent legislation and court decisions affecting the Fund; and the results of an actuarial audit completed in 2008. In addition, we reviewed the status of the implementation of the Fund's new computer system for maintaining the accounts of participating providers.

Financial Position

Since its creation in 1975, the Fund has received more provider assessments and investment income than it has paid out in claims and administrative

Since its inception, the Fund has paid more than $770.8 million for 651 claims.

The Fund reported a negative balance in the amount of -$109.0 million as of June 30, 2009.

The Fund accumulated $635.8 million in investments as of June 30, 2009.

As required by 2007 Wisconsin Act 20, $200.0 million was transferred from the Fund to the Medical Assistance Trust Fund during the 2007-09 biennium.

expenses. As a result, it accumulated $635.8 million in investments as of June 30, 2009.

However, the Fund's financial position is also significantly affected by its loss liabilities, which 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. Both the uncertainty and the long-term nature of medical malpractice claims make it difficult to predict the size and timing of claims that will be settled and paid from the Fund. The Board of Governors, which manages the Fund, relies on a consulting actuarial firm to estimate the Fund's loss liabilities.

For several years, the Fund had reported a positive financial position because estimated loss liabilities were less than the cash and investments available to pay them. However, its financial balance has declined significantly over the last two years. The 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.

In 2007 Wisconsin Act 20, the Legislature directed that $200.0 million be transferred from the Fund to the Medical Assistance Trust Fund in the 2007-09 biennium.

The transfer took place in two stages: $71.5 million was transferred in October 2007, and the remaining $128.5 million was transferred in July 2008. Because the Fund did not have sufficient cash and investments to readily liquidate without incurring a loss, the transfer caused its cash balance to become negative. The Fund had a negative cash bal ance in the amount of -$76.8 million as of June 30, 2009, and incurred interest expenses totaling /nobr>$2.5 million through June 30, 2009.

The Wisconsin Medical Society filed a lawsuit in October 2007 challenging the constitutionality of the transfer. The lawsuit was dismissed in December 2008, but an appeal is currently pending before the Wisconsin Supreme Court.

Audited Net Asset Balance[1]
As of June 30

Year	Amount (in millions)
2000	$ 27.2
2001	28.4
2002	6.6
2003	7.9
2004	24.6
2005	31.7
2006	59.8
2007	94.4
2008	(61.5)
2009	(109.0)

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

The Fund's financial position also has been affected by the recent downturn and instability in the economy and the investment markets. The Fund incurred $9.2 million in realized and unrealized losses from the collapse of Washington Mutual Bank and Lehman Brothers Holdings, Inc., in 2008. The Fund also realized losses of $7.7 million from the sale of investments in Ford Motor Company and General Motors Corporation as the State of Wisconsin Investment Board—the entity that manages its investments—reduced the Fund's exposure to the auto industry.

The Fund has experienced a steady increase in annual claim payments over the last four years. The fiscal year (FY) 2008-09 total of $65.7 million in annual claim payments was the largest since the Fund's inception. The FY 2007-08 total of $50.5 million in annual claim payments was the second-largest. These amounts include deposits in accounts to fund the payment of future medical expenses.

In June 2008, the Fund paid its largest claim to date, which was $34.3 million. The next-largest claim payment to date, which was $18.0 million, was paid in December 1990.

At least part of the increase in claim payments over the last four years can be attributed to a 2005 Wisconsin Supreme Court ruling that a $350,000 inflation-adjusted limit on noneconomic damages in medical malpractice cases violates equal protection guarantees in the Wisconsin Constitution. A new limit of $750,000 was enacted on April 6, 2006, but because of the Court's 2005 decision there were no limits on the recovery of noneconomic damages for incidents that occurred from January 1, 1991, through April 5, 2006.

The Fund's consulting actuary projects deterioration in the Fund's financial position over the next several years without fee increases. In response, the Board increased rates by 9.9 percent effective July 1, 2009.

Actuarial Audits

Estimating the Fund's loss liabilities is challenging because:

- claims that exceed the primary medical malpractice insurance thresholds established in statute typically are infrequent and involve severe cases;
- a medical malpractice claim may be filed years after an incident;
- there is no limit on the amount of economic losses the Fund may be required to pay;
- legislation and court decisions can significantly affect the Fund's liabilities; and
- the methodology and assumptions used by an actuary can significantly affect the result of an analysis.

Estimates of the Fund's loss liabilities have been regularly reduced over the last several years as claim experience was more favorable than expected. We recommended in past audits that the Fund obtain regular and comprehensive reviews of its actuaries' methods and assumptions for estimating loss liabilities. Such actuarial reviews or audits are fairly common for critical and complex actuarial analyses, such as those completed for the

Fund. Two actuarial audits completed

Two actuarial audits completed by two different actuarial firms—the first in July 2005 and the second in September 2008—concluded that the Fund's loss liabilities were reasonable, although conservative. Both firms also recommended improvements to the process for estimating the Fund's loss liabilities.

The 2005 actuarial audit recommended that the analysis of the consulting actuary include an explicit loss liability risk margin to represent the risk that actual losses could be higher than predicted, and consider a lower investment return assumption. In 2007, we recommended that the next actuarial audit again evaluate these areas and that the Board of Governors report the results of the audit to the Legislature. However, the 2008 actuarial audit did not evaluate the appropriateness of either the explicit loss liability risk margin or the investment return assumption.

The 2008 actuarial audit recommended that the actuary use a second method to estimate losses for recent years and reevaluate the effect on its analyses of a 1997 increase in the statutory threshold for Fund coverage to $1.0 million for each incident. The actuary implemented the recommendations and believes its current analyses are correspondingly less conservative than in the past.

Provider System

As discussed in past audit reports, a continuing challenge for the Fund had been the decreasing effectiveness of an aging computer system that maintained the accounts of participating health care providers. The provider system, which was developed in the early 1990s, was not able to accommodate the increasing demands of the Fund's operations.

In response to the critical nature of the provider system and the seriousness of noted concerns, the Office of the Commissioner of Insurance (OCI) began to develop and implement a new provider system in FY 2005-06.

The new system was implemented in March 2010. Costs for the new system total $1.4 million and were paid by the Fund.

As part of our next audit of the Fund, we will assess whether the new provider system adequately addresses past concerns.

Recommendation

Our recommendation again addresses the need for the Fund's Board of Governors to:

- require the next actuarial audit to evaluate the appropriateness of the Fund's explicit loss liability risk margin and its investment return assumption, and convey that information in its annual report to the Legislature ***(p. 19)***.

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