GO Committee #3
January 23, 2012

MEMORANDUM

January 19, 2012

TO: Government Operations and Fiscal Policy Committee

FROM: Jacob Sesker, Senior Legislative Analyst JS

SUBJECT: Mid-year Review—Risk Management

Background

The Risk Management Division of the Department of Finance is charged with administering the self-insurance program established under §20-37 of the County Code. Finance administers the program, but ultimately most cost control measures must be implemented by participating departments and agencies.

This year, as in many past years, the Committee will have a mid-year review in advance of its work on the subsequent fiscal year's operating budget. The Self-Insurance Internal Service Fund is substantial[1]; consequently, the Committee has used the mid-year briefing to become familiar with risk management issues prior to beginning Committee worksessions on the operating budget.

Highlights and Issues

1. *Fund balance*: In the FY11 operating budget, the County began a three-year plan to restore fund balance to the policy level (actuarial confidence level of 80-85 percent). Finance projects that the policy level will be achieved by FY14 with no increase in agency contributions.

2. *Workers' Compensation (WC)*: In FY11, the number of claims involving lost time from work fell by 22%.

    a. *Medical Expenses*: The County has established a network of medical providers and a pharmacy network. The combined savings associated with these initiatives is roughly

[1] In the FY12 approved budget, the Fund has revenues of $56,922,810 and expenditures of $49,264,680.

$1.5 million annually. However, Maryland WC law allows injured employees to seek treatment with any provider they choose and allows them to change providers at will. If the County and employee unions were to agree that injured union members must be treated by providers in the network, Finance estimates that such an agreement would save $1 million annually.

b. *Indemnity benefits*: Indemnity benefits include Temporary Total Disability and Permanent Partial Disability. The County has a light duty program, which provides for alternative duty assignments for up to six months. Light duty programs are an important tool for controlling the length of disability. Some of the other agencies have weak or ineffective light duty programs. Finance recommends requiring all agencies participating in the self insurance program to establish light duty programs.

3. *Agency and departmental WC trends*: WC costs per $100 of payroll have steadily increased in recent years. Within County government, the cost for FY12 is estimated to be $3.05 per $100 of payroll. Much of that cost is attributable to the WC costs at Fire and Rescue Service ($7.93 per $100) and Police ($4.51 per $100).

4. *Self Insured Liability and Property Claims*: Several bus fires have driven up the cost of property claims. The County is evaluating recovering all or some of those losses from the bus manufacturer. Damage to County and agency structures and equipment has been costly, in part due to extreme weather and an earthquake. Self-insured property losses increased from an average annual cost of $900,000 from FY02 to FY09 to an average annual cost of $1.7 million from FY10 to FY12.[2]

Attachment: © 1 Mid-year Risk Management Update from Finance Director

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[2] Total property damages were much higher, with the largest losses covered by commercial insurance.

DEPARTMENT OF FINANCE

Isiah Leggett
County Executive

MEMORANDUM

Joseph F. Beach
Director

January 23, 2012

TO: Nancy Navarro, Chair
Government Operations and Fiscal Policy Committee

FROM: Joseph F. Beach, Director
Department of Finance

SUBJECT: Mid-year Risk Management Update

I am pleased to provide information in reference to the GO Committee's annual review of the County's risk management program. Terry Fleming and I look forward to presenting the update and responding to your questions at the meeting scheduled for January 23, 2012.

FY11 Financial Results and FY12 Projections. The balance sheet and income statement are attached. Observations on the fund balance follow:

- FY11 claims payments exceeded actuarial projections by about $5 million, resulting in a fund balance of ($6.23 million).
- Actuarial projections are based on a 55 percent statistical confidence level. The County's policy is to fund claims to an actuarial confidence level of 80-85 percent, using the difference as a fund balance to account for the fluctuation in claim payments from year to year.
- The fund balance should be $12.8 million based on the June 30, 2011, actuarial analysis.
- In the FY11 budget, the County began a three-year plan to restore fund balance to the policy level.
- Based on current projections and considering the current fiscal position, the policy level will be achieved by FY14 with no increase in agency contributions.

FY11 Claim Results and Trends.

Workers' Compensation. Workers' compensation (WC) costs represent approximately 91 percent of all claims processed by the Self Insurance Fund. Observations on WC claims follow:

- For FY11, there was a significant reduction (22 percent) in the number of claims involving lost time from work—typically the most expensive claims.

- There was no concomitant reduction in claims costs; however, there may be a longer term savings for FY11 as those claims mature. Claim payments made in a given fiscal year include payments for claims that occurred in all prior years for those employees still treating for injuries or still disabled from work. Consequently, a reduction in the number of claims must be a multi-year trend to recognize lower annual costs. If the reduction in lost time claims continues, costs will be lower over time.
- Workers' compensation claims can remain open for many years, especially the claims involving the public safety presumption (heart and lung diseases and some forms of cancer) and claims involving severe trauma. In FY11, we closed the last remaining open claim for the first year of our Self Insurance Program—1978.
- Currently, there are 173 open claims that occurred prior to the year 2000, for which we expect to pay at least $7.1 million.

The two primary cost centers for WC claims are medical expenses and indemnity benefits. Indemnity benefits consist of wage replacement benefits (Temporary Total Disability, or TTD) and benefits for permanent injuries (Permanent Partial Disability, or PPD).

Medical Expenses. Medical benefits are the most costly component of WC claims. Observations on medical provider fees and prescription costs follow:

- Workers' compensation laws require an employer to pay medical bills related to the injury or illness as long as the employee requires care.
- Additionally, although the County has established a network of medical providers, the Maryland WC law allows injured employees to seek treatment with any provider they choose, and they can change providers at will.
- The provider network saves the County about $1 million per year, but only about 50 percent of injured employee doctor visits are within the network.
- Claims outside the network are subject to a fee schedule established by the Maryland Workers' Compensation Commission (Commission).
- The rates were revised higher in 2008 and are now tied to Medicare reimbursement rates, plus an annual percentage increase based on the cost of living. Medical costs for the Self Insurance Program increased about 10 percent after the change.
- We are waiting to learn if the proposed reduction in Medicare reimbursement rates by the federal government will have any effect on the WC fee schedule in Maryland.
- Prescriptions under WC programs tend to cost 50-70 percent more than group health pharmacy programs.
- The County has established a pharmacy network that saves about $500,000 per year.
- The Commission has established a fee schedule for prescriptions that will be effective during 2012.
- The fee schedule for prescriptions provides discounts below the average wholesale price of drugs, but the discount is not as much as the County currently realizes. However, the new fee schedule will help to alleviate the practice of physicians dispensing prescription drugs during office visits at a very high cost.

Below is a list of the highest-cost medical services, representing 88 percent of all medical bills paid for the past four fiscal years.

Description	Paid FY08	Paid FY09	Paid FY10	Paid FY11	Total	% of Total
Treating Physician	2,780,054	2,580,868	2,411,275	2,223,847	9,996,044	22.4%
Hosp Inpatient	582,961	1,528,338	2,598,007	1,436,334	6,145,640	13.8%
Hosp Outpatient	2,061,618	1,529,021	1,123,436	1,242,722	5,956,797	13.3%
Phys Therapy	1,529,391	1,408,276	1,643,817	1,641,851	6,223,335	13.9%
Prescriptions	1,361,895	1,432,291	1,576,935	1,859,534	6,230,655	14.0%
Diagnostic	497,709	629,475	599,780	532,338	2,259,302	5.1%
Ortho Surgery	455,534	836,270	653,134	896,454	2,841,392	6.4%
						88.9%

Temporary Total Disability (TTD).

- Employees unable to work as a result of a work-related injury or illness are entitled to receive TTD weekly benefits equal to two-thirds of their average weekly wage not to exceed 100% of the state average weekly wage, or $965.00 for 2012.
- This wage replacement benefit is payable until the employee returns to work or reaches Maximum Medical Improvement.
- The County and other agencies in the self insurance program have bargained for or have personnel regulations that require a supplemental salary payment on top of the weekly TTD benefit amount up to the employee's regular take-home pay.
- This supplemental salary payment is for 12-18 months, depending on the agency and agreements.
- Controlling TTD is challenging in some cases, since some employees may select providers who allow them to stay out of work.
- Providing alternative or light duty assignments is an important tool to help control the length of disability.
- The County's program provides for alternative duty assignments for up to six months.
- Some of the other agencies have weak or ineffective light duty programs, leading to extended periods of disability and TTD payments.
- Substantial funds could be saved by the self insurance program if other agencies embraced alternative duty programs.

Permanent Partial Disability (PPD).

- Permanent Partial Disability claims are the second largest component of workers' compensation claims.
- Permanent Partial Disability benefits are awarded to an injured employee when their medical condition has reached a plateau referred to as Maximum Medical Improvement.
- This is a condition where no further curative treatment is needed and in the overwhelming majority of claims the employee has returned to regular job duties.
- An injured employee's attorney normally files for a hearing before the Commission for a determination on whether or not the employee has suffered any PPD as a result of the injury or illness.

- Under Maryland WC law, injured employees' attorneys are not paid unless there is such a finding. Consequently, a hearing is requested in virtually every claim when the employee is represented by counsel.
- Our experience has been that the Commission will issue an award in virtually every case, which leads to some counterintuitive situations as explained below.

For example, we have claims for employees who have incurred minor soft tissue injuries, lost no time for work, and have had one or two doctor visits. The Commission has found that these employees have suffered permanent partial disabilities and made awards for tens of thousands of dollars. In other cases, the Commission has found employees 50 percent or more disabled (making the claim cost $200,000 or more), yet the employees are performing their regular job duties with no apparent restrictions.

The charts below report claims frequency and cost per $100 payroll for the participating agencies and for the County, including County departments with the highest WC claims activity.

Agency and Departmental WC Trends. The following two charts show the number of lost time claims for the three largest agencies in the self insurance fund and for the County departments with the highest frequency.

- For FY11, the numbers in the two charts show a significant reduction from prior years.
- As the charts indicate, there can be sizeable fluctuation in claims frequency from year-to-year.
- As mentioned above, continued lower frequency will eventually lead to lower costs.

Lost Time Claims

Year	All Agencies	County	MCPS	MNCPPC
FY05	856	499	224	76
FY06	962	535	270	92
FY07	910	547	237	73
FY08	1033	601	269	98
FY09	1025	605	237	102
FY10	1074	632	256	120
FY11	845	480	245	88

Montgomery County Departments
Lost Time Claims

Year	FRS	Police	DOT	DGS	DOC&R
FY05	228	138	47	14	33
FY06	197	157	70	18	44
FY07	231	150	66	21	24
FY08	201	165	71	17	37
FY09	244	154	69	29	26
FY10	246	143	105	25	30
FY11	182	133	77	11	45

The next two charts show the cost of WC per $100 of payroll for the larger County departments and for all of the agencies participating in the County's self insurance fund.

Montgomery County Departments Incurred WC Cost per $100 Payroll

Department	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Fire & Rescue Services	4.99	5.68	6.36	7.05	6.48	5.54	6.40	6.84	7.93	7.93
Police	2.25	2.93	3.35	4.23	3.91	3.70	4.59	4.56	5.02	4.51
DPW&T	1.73	1.74	1.80	2.20	2.28	2.48	*			
Liquor Control	2.74	2.78	2.99	3.67	3.23	2.68	2.80	2.73	2.80	2.39
Correction & Rehab	1.90	1.80	2.21	2.75	2.70	3.28	3.21	2.88	3.14	2.89
Transportation						*	3.21	3.11	3.26	3.62
General Services						*	2.11	2.12	2.96	2.70
All Other	0.33	0.34	0.39	0.53	0.39	0.32	0.32	0.38	0.41	0.47

*FY09 County reorganization

Agency Incurred Cost Per $100 Payroll

Agency	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Montgomery County	1.16	1.32	1.50	1.93	2.64	2.35	2.55	2.81	3.16	3.05
MCPS	0.55	0.55	0.56	0.61	0.51	0.45	0.50	0.52	0.53	0.60
Montgomery College	0.15	0.14	0.15	0.17	0.15	0.12	0.15	0.16	0.16	0.19
M-NCPPC	1.61	1.62	1.54	1.70	1.52	1.95	2.12	2.30	2.22	2.67
City of Gaithersburg	1.19	0.81	0.93	0.99	0.83	0.74	0.91	0.97	1.03	1.02
MC Revenue Authority	0.98	0.97	1.27	1.69	1.18	1.06	0.99	1.04	1.03	1.18
HOC	0.38	0.34	0.85	1.08	1.21	0.59	0.70	0.72	0.83	1.49
Rockville Housing	0.34	0.34	1.36	0.29	0.29	0.33	0.42	2.02	1.27	0.84
Town of Somerset	1.46	1.41	1.37	1.28	1.31	1.09	1.06	1.51	1.42	1.53
Bethesda Urban Partn.	0.82	0.76	0.71	0.56	0.41	0.51	0.47	0.30	0.24	0.25
Friendship Heights				0.46	0.41	0.40	0.37	0.86	0.86	0.86
All Agencies Combined	0.94	1.01	1.08	1.28	1.18	1.23	1.19	1.27	1.24	1.29

Workers' Compensation Recommendations. The following changes may help manage the increasing cost of WC claims. Please note that the first two recommendations would require collective bargaining.

1. Require that employees who treat for work-related injuries or illnesses may receive disability leave only if they select the treating physician from the provider network and participate in the pharmacy network.
   - If employees choose not to participate in the networks, they will not be eligible for disability leave and will be paid wage replacement benefits in accordance with the Maryland WC law.
   - This requirement would save a minimum of $1 million per year based on current provider network penetration.
   - Montgomery County Public Schools is currently the only agency using this process.
2. Reduce the period that disability leave can be paid from current levels to a hard cap of 12 months.
3. Require all agencies participating in the self insurance program to establish alternative duty programs to return injured employees to work as soon as possible.

Self Insured Liability and Property Claims. Observations on liability and property claims follow:

- Self insured claims for automobile liability and general liability have been static for many years.
- There are infrequent claims for the two types which expose the County to damages above the limits set by the Local Government Tort Claims Act—automobile accidents that occur outside the State of Maryland and general liability claims involving constitutional violations.
- In FY10 and FY11, there was a significant increase in the number and cost of claims for damage to County vehicles over prior years.
- Historically, vehicle losses occur primarily in the Police Department; however, in the same period there have been several bus fires that have driven up costs. We are evaluating the possibility of recovering some or all of the losses from the bus manufacturer.
- With respect to damage to County and agency structures and equipment, FY10 through FY12 year-to-date have presented challenges due to severe weather conditions and an earthquake.
- Self insured property losses during this period have spiked from an average of $900,000 per year for FY02-FY09, to $1.7 million for FY10-FY12 YTD.
- Total property damages were actually much higher; fortunately, the larger losses were covered by commercial insurance above the $250,000 policy deductible.

Commercial Insurance. Observations on commercial insurance follow:

- The self insurance program purchases commercial insurance to cover exposures that are not easily predictable and may lead to losses not economically feasible to self insure.
- These policies include commercial property, excess liability, blanket crime, and fiduciary liability.
- Commercial insurance rates continue to be competitive.
- All policies were renewed for FY11 with premium rates that were either static or lower.
- As mentioned above, there have been several large weather-related property insurance claims filed in the past 30 months resulting in significant payments by the commercial insurance company. Although market conditions remain favorable, adverse claims experience may lead to higher premiums at renewal on July 1, 2012.

Please let me know if the Committee has questions or would like additional information.

JFB/dtf

List of Attachments
SIF Balance Sheet & Income Statement

cc: Joseph Adler, Director, Office of Human Resources
Terry Fleming, Risk Management
Kurt Wolfe, MCPS
Lynda von Bargen, Montgomery College
Wanda Wesley-Major, MNCPPC

FY13 RM Balance Sheet & Income Statement

October 12, 2011

	FY06	FY07	FY 08	FY09	FY10	FY11	FY12	FY12
BALANCE SHEET	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	BUDGET	PROJECTED
ASSETS								
CASH & INVESTMENT	94,411,741	96,579,845	96,052,685	89,870,769	88,983,647	96,847,361	105,705,990	108,714,791
CASH-RESTRIC	0	0	0					
OTHER ASSETS	300,000	273,533	300,000	300,000	278,106	196,867	300,000	300,000
TOTAL	94,711,741	96,853,378	96,352,685	90,170,769	89,261,753	97,044,227	106,005,990	109,014,791
LIABILITIES & EQUITY								
CLAIMS PAYABLES	79,710,000	75,499,000	80,831,000	88,141,000	94,833,000	102,026,000	99,869,000	105,821,000
OTHER LIABILITIES	1,133,584	1,032,776	1,200,000	1,264,321	1,419,743	1,247,316	1,200,000	1,200,000
CONTRIB CAPITAL	0	0	0					
EQUITY/FUND BAL	13,868,157	20,321,602	14,321,685	765,448	(6,990,990)	(6,229,089)	4,936,990	1,993,791
TOTAL	94,711,741	96,853,378	96,352,685	90,170,769	89,261,753	97,044,227	106,005,990	109,014,791
INCOME STATEMENT								
REVENUES								
CONTRIBUTIONS	48,099,083	32,310,240	31,253,956	32,061,588	39,666,206	51,656,201	55,672,810	55,672,810
RECOVERED LOSSES	879,494	574,701	507,978	513,560	622,730	634,766	900,000	900,000
INVESTMENT INCOME	4,782,807	6,138,902	5,182,510	1,740,521	218,318	28,748	250,000	250,000
INVEST INC-ESCROW								
G F TRANSFER			68,480	24,030				
MISC INCOME	(822)	311	489,825	224,286	223,733	447,147	100,000	100,000
	53,760,562	39,024,154	37,502,749	34,563,985	40,730,987	52,766,862	56,922,810	56,922,810
EXPENSES								
CLAIMS EXPENSE	20,336,586	26,834,168	25,897,416	29,242,713	29,128,614	32,418,783	31,134,000	30,905,000
RESERVE/IBNR ADJUSTMENT	8,823,000	(4,211,000)	5,332,000	7,310,000	6,692,000	7,193,000	3,226,000	3,795,000
MISC ADJUSTMENT	33,005	0						
OTHER INSUR COSTS	7,793,231	7,800,440	9,813,739	9,035,810	10,094,856	9,891,471	11,090,170	11,090,170
COUNTY ATTORNEY	1,715,757	1,737,920	1,941,843	2,044,281	2,195,938	2,068,954	2,513,070	2,513,070
GEN'L & ADMIN	294,871	409,181	517,668	487,418	376,017	432,753	400,450	396,690
PREMIUM REFUND								
MEDICAL PROGRAM								
INTEREST EXPENSE								
UNEMPLOYMENT								
INTEREST EXP-ESCROW								
LOSS ON INVESTMENT								
TOTAL	38,996,450	32,570,709	43,502,666	48,120,222	48,487,425	52,004,961	49,264,680	48,699,930
NET INCOME (LOSS)	14,764,112	6,453,445	(5,999,917)	(13,556,237)	(7,756,438)	761,901	7,658,130	8,222,880
BEGINNING BALANCES								
OTHER CHANGES								
EQUITY/FUND BAL	(895,955)	13,868,157	20,321,602	14,321,685	765,448	(6,990,990)	2,721,140	(6,229,089)
ESCROW FUND								
ENDING BALANCES								
EQUITY/FUND BAL	13,868,157	20,321,602	14,321,685	765,448	(6,990,990)	(6,229,089)	4,936,990	1,993,791

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