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Governor

ANTHONY G. BROWN
Lt. Governor

THERESE M. GOLDSMITH
Commissioner

KAREN STAKEM HORNIG
Deputy Commissioner

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October 1, 2012

The Honorable Martin O'Malley
Governor
State House
Annapolis, Maryland 21401

Thomas V. Mike Miller, Jr.
President of the Senate
8808 Old Branch Avenue
Clinton, Maryland 20735

Michael E. Busch
Speaker of the House
State House, H-101
Annapolis, Maryland

Edward J. Kasemeyer, Chair
Senate Budget and Taxation Committee
5205 East Drive, Suite H
Arbutus, Maryland 21227

Thomas M. Middleton, Chair
Senate Finance Committee
P. O. Box 1735
Waldorf, Maryland 20604

Norman H. Conway, Chair
House Appropriations Committee
House Office Building, Room 121
6 Bladen Street
Annapolis, Maryland 21401

Dereck E. Davis, Chair
House Economic Matters Committee
House Office Building, Room 231
6 Bladen Street
Annapolis, Maryland 21401

Thomas J. Phelan, CPA
President and Chief Executive Officer
Injured Workers' Insurance Fund
8722 Loch Raven Boulevard
Towson, Maryland 21286

RE: Report on Fair Value of State of Maryland Support of the Injured Workers' Insurance Fund

Pursuant to Section 7(d)(2), Chapter 570, Laws of Maryland 2012, and in accordance with § 2–1246 of the State Government Article, the Maryland Insurance Administration hereby submits the Report on Fair Value of State of Maryland Support of the Injured Workers' Insurance Fund prepared by Invotex Group. Appended to the Report is a written comment received from T. Eloise Foster, Secretary, Department of Budget & Management.

Should you have questions regarding this Report, please do not hesitate to contact me.

Sincerely,
Signature on file with original
Therese M. Goldsmith
Insurance Commissioner

TMG:tlw
Enclosure

cc: Committee Members
Sarah T. Albert, Department of Legislative Services (5 copies)

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September 27, 2012

Ms. Therese M. Goldsmith
Insurance Commissioner
Maryland Insurance Administration
200 St. Paul Street, Suite 2700
Baltimore, Maryland 21202

Re: Report on Fair Value of State of Maryland Support of IWIF

Dear Commissioner Goldsmith:

On behalf of Invotex Group, I am pleased to submit our Report relating to Fair Value of State of Maryland's Support of the Injured Workers' Insurance Fund (IWIF). An executive summary section is included, which summarizes our key findings and conclusions.

In performing our work, we consulted extensively with the management team of IWIF, the Maryland Insurance Administration ("MIA") as well as officials from the Department of Budget and Management and the State Treasurers' Office. We gratefully acknowledge their cooperation and the courtesies extended to us in the course of our work.

We appreciate this opportunity to have served you and the Maryland Insurance Administration. I will be glad to discuss our study and the resulting findings and conclusions with you and your staff at your convenience.

Sincerely,

Lester C. Schott
Managing Director

Report on:

Fair Value of State of Maryland Support of IWIF for the Maryland Insurance Administration

September 27, 2012

INVOTEX® GROUP

CONTENTS

ABBREVIATIONS AND ACRONYMS **1**

I. EXECUTIVE SUMMARY **2**

II. ASSIGNMENT **5**

III. BACKGROUND REGARDING IWIF **7**

IV. APPROACH AND METHODOLOGY **12**

V. FACTORS TO CONSIDER **14**

1. Start–up Funding: *Paragraph (1)(i)* 15
2. Real Estate: *Paragraph (1)(ii)* 16
3. Tax Exemptions: *Paragraphs (1)(iii),(iv),(v), (2)(iii)* 18
4. State Self-Insured Workers' Compensation Program: *Paragraph (3)(i)* 20
5. $6 million Transfer in 2011: *Paragraph (3)(ii)* 26
6. Additional Costs Incurred as Insurer of Last Resort: *Paragraph (2)(i)* 26
7. The Nonprofit Mission: *Paragraph (2)(ii)* 28
8. Risk Based Capital: *Paragraph (2)(vi)* 29
9. Other Financial Contributions or Financial Benefits: *Paragraph (1)(vi)*.... 33
10. Residual vs. Competitive Business: *Paragraph (2)(iii),(iv),(v)* 36

VI. COMPETITIVE BUSINESS FINANCIAL BENEFIT MODEL ...**42**

1. Estimation of the fair value of IWIF's participation in the competitive market 43
2. Estimation of the portion of the fair value of IWIF's competitive business resulting from benefits that IWIF received from the State........................... 47

VII. CONCLUSION **51**

VIII. EXHIBITS

Exhibit 1. Senate Bill 745 Section 7

Exhibit 2. Timeline of Key Law Changes

Exhibit 3. MD Workers' Compensation Market Share by Premiums

Exhibit 4. Annual Rates of Return
Exhibit 5. Fair Value of Initial Funding
Exhibit 6. Tax Rates
Exhibit 7. Fair Value of Exempt Taxes
Exhibit 8. Incremental Investment Income Earned for State
Exhibit 9. Competitive Business Valuation Model
Exhibit 10. IWIF 2011 Broker Satisfaction Report
Exhibit 11. MIA 2011 Report on Workers' Compensation Insurance

ABBREVIATIONS AND ACRONYMS

ACL	Authorized Control Level
BRFA	Budget Reconciliation and Financing Act
Commission	State Industrial Accident Commission
IWIF	Injured Workers' Insurance Fund
DBM	Department of Budget and Management
FASB ASC	Financial Accounting Standards Board Accounting Standards Codification
Fund	State Accident Fund or Injured Workers' Insurance Fund
MIA	Maryland Insurance Administration
OLA	Office of Legislative Audits
NAIC	National Association of Insurance Commissioners
RBC	Risk Based Capital
SAF	State Accident Fund
SB 745	Senate Bill 745
SHA	State Highway Administration
SIAC	State Industrial Accident Commission
SSAP	Statement of Statutory Accounting Principles
STO	State Treasurer's Office

I. EXECUTIVE SUMMARY

Invotex was engaged by the Maryland Insurance Administration to conduct a study to determine the fair value of any financial contribution made by the State of Maryland to the Injured Workers' Insurance Fund ("IWIF") and the fair value of any financial benefit IWIF has received from the State since its inception in 1914. This study was mandated by Senate Bill 745, 2012 State of Maryland Legislative Session, which was signed into law on May 22, 2012 (Chapter 570, Laws of Maryland 2012).

Our methodology and approach focused on the following major elements:

- Understand the impact of the historical landmarks in IWIF's evolution;
- Consider the specific factors identified by Senate Bill 745, and determine which of the factors resulted in a financial contribution made by the State to IWIF, or a financial benefit IWIF received from the State;
- Consider any financial benefits IWIF may have provided to the State; and
- Analyze and determine the fair value of the financial contributions and financial benefits received by IWIF, net of the financial benefits received by the State.

We note that while IWIF has existed for nearly a century it has slowly evolved from primarily an insurer of last resort, providing a source of workers' compensation insurance for those employers and businesses in the State which could not obtain this coverage in the commercial market, to a competitive insurer with the largest workers' compensation insurance market share in the State, commanding a 23% market share. This evolution was made possible by numerous law changes that organizationally removed IWIF from State government, and fundamentally changed the manner in which IWIF conducted its business. Most significant of these were the changes that occurred in the early 1990's that completely removed IWIF from the State budget, and required IWIF to develop a marketing plan. By the mid-1990's IWIF made a number of changes to its business operations and processes to enable it to compete in the competitive market.

A factor that we considered, as stated in Senate Bill 745, was that because IWIF only began advertising and paying commissions to licensed insurance producers beginning in 1996, IWIF's entire book of business was considered the residual market through 1995. We

concluded that IWIF's entire book of business through 1996 should be considered attributable to the residual market. We noted that subsequent to a 1990 law change that completely removed IWIF from the state budget process, and required IWIF to market its services, IWIF's operating philosophy, its systems, its insurance products and the manner in which it interacted with its policyholders all underwent significant changes. A commission program for agents and brokers was established in 1996, and in 1997, IWIF began paying significant amounts of commissions to agents and brokers. As a result of the changes made that were in place by 1997, enabling it to operate in a manner similar to private carriers, we considered the pre-1997 business to be all residual market business.[1]

Through our review of the numerous factors to be considered in this study, we noted several instances where the State made a direct financial contribution to IWIF (e.g., providing the Fund with start-up money). In addition to these direct financial contributions, there have also been other forms of support provided to IWIF by the State, some direct and some indirect. From this support, IWIF received a financial benefit. The most significant of these are the tax exemptions provided to IWIF. It is clear that IWIF did not receive a financial benefit equivalent to the total amount of the tax exemptions permitted, as this benefit was passed on to its policyholders in the form of lower premium rates. The fact that IWIF's risk based capital levels were below regulatory minimums at the time it became subject to Maryland Insurance Administration ("MIA") regulation is a further indication that prior profits were not accumulated in IWIF's surplus; therefore, IWIF did not receive a financial benefit pre-1997 when it primarily served the residual market. However, a significant financial benefit to IWIF was that the tax exemptions and other forms of State support positioned it to compete in the competitive market at an advantage to private carriers at the time IWIF was transforming from a residual market insurer to a competitive insurer.

To quantify the value of the financial benefit received from the State by IWIF as a result of the tax exemptions, its association with the State, and other indirect forms of support that in and of themselves are not precisely quantifiable, we constructed a "Competitive Business

[1] We recognize that pre-1997, IWIF revenues included some business that would not be considered residual, so therefore would be considered competitive. Throughout its existence, IWIF wrote workers' compensation insurance for anyone that requested them to do so. However, it was not until 1997 that (a) IWIF began actively soliciting competitive business and (b) stopped passing financial benefits received from the State to its policyholders. Based on the changes that occurred in the early 1990's, as explained in this Report, that transformed IWIF into a competitive insurer in 1997, we have considered the pre-1997 business to be residual market business.

Financial Benefit Model." A major assumption in the Model is the start date of January 1, 1997, as this is the year IWIF began operating as a competitive insurer in earnest, e.g., fully began its marketing efforts, including paying commissions. We used an Asset Valuation Approach, based on the value of IWIF's assets less the value of its liabilities, to estimate the financial benefit IWIF received from the State related to the post-1997 competitive business. Although the Model start date is January 1, 1997, we recognize that IWIF had in place the components required to generate future cash flows, including an established customer base. The value of that customer base, along with all of IWIF's assets, is estimated by the Model, and is based the expected future cash flows that will be derived from IWIF's tangible (e.g., building, equipment) and intangible (e.g., customer base, goodwill) assets. The Model is more fully described in Section VI of this Report.

We also noted that IWIF has provided financial benefits to the State, the most significant of these being investment income that was generated during a period when IWIF invested State monies on deposit with the Fund.

In our final analysis, considering the direct financial contributions from the State since 1914, the financial benefits IWIF received for tax exemptions and other State support since 1997, and the financial benefits IWIF provided to the State, we estimated the fair value of the net financial benefit to IWIF to be approximately $44.5 million, as follows:

Summary of Fair Value of Net Benefits Received by IWIF

	Financial Benefits and Contributions	
	IWIF Received from State	**State Received from IWIF**
Start-up Funding	900,000	-
Unreimbursed Operating Expenses	1,100,000	-
Benefit from State on Competitive Business	57,100,000	-
Incremental Investment Income Earned for State	-	10,800,000
Benefit from $ 6MM Transfer *	-	3,800,000
Total	**$59,100,000**	**$14,600,000**
Fair Value of Net Benefits to IWIF	**$44,500,000**	

** After deduction of $2.2 million IWIF paid to State (See Section V.5 of report)*

II. ASSIGNMENT

Invotex was engaged by the MIA to conduct a study to determine the fair value of any financial contribution made by the State of Maryland to IWIF and the fair value of any financial benefit IWIF has received from the State since its inception in 1914. This study was mandated by Senate Bill 745, 2012 State of Maryland Legislative Session, which was signed into law on May 22, 2012 (Chapter 570, Laws of Maryland 2012).[2]

The Legislation required that specific factors be considered in performing the study, as follows:

- The fair value of funds, including start-up funding, provided by the State to IWIF at any time;
- The fair value of real estate or other assets transferred or otherwise provided to IWIF, net of amounts paid for the real estate or other assets by IWIF out of its revenues;
- The fair value of property taxes or transfer taxes on IWIF owned property that would have been paid if IWIF had not been a State agency;
- The fair value of sales and excise taxes that would have been paid to the State if IWIF had not been a State agency;
- The fair value of premium taxes not paid to the State by IWIF due to its tax exempt status prior to June 1, 2011;
- The fair value of any other direct contribution made by the State to IWIF, and any other financial benefit IWIF received from the State.

In determining the fair value of the items listed above, the study was to take into consideration:

- Additional costs IWIF incurred because it is the insurer of last resort and was thus required to provide workers' compensation insurance to businesses regardless of the degree of risk;
- That IWIF is a nonprofit entity with profits passed on to its policyholders;
- Whether the benefit of taxes not paid was passed on to policyholders since IWIF was not subject to those taxes;

[2] An excerpt of Senate Bill 745 requiring that this study be performed can be found at **Exhibit 1.**

- That because IWIF only began advertising and paying commissions to licensed insurance producers beginning in 1996, IWIF's entire book of business was considered the residual market through 1995;
- That effective October 1, 2009, IWIF was statutorily required to serve as a competitive insurer in the marketplace, in addition to guaranteeing the availability of workers' compensation insurance in the State, serving as the workers' compensation insurer of last resort, and engaging only in the business of workers' compensation insurance in accordance with State law; and
- That effective 2003, IWIF was required to be subject to risk based capital standards.

The study was also required to consider:

- Any subsidy that IWIF provided to the State in connection with the State self-insured workers' compensation program; and
- That IWIF was required to transfer $6,000,000 to the General Fund on or before June 30, 2012, as provided by Section 20 of Chapter 397 of the Acts of the General Assembly of 2011, less the amount received by the State on or before June 30, 2012, as a result of the imposition of a premium tax on IWIF under Section 6-101 of the Insurance Article.

As one can see from the preceding list, there were a number of moving parts to be considered in this study. On the surface, it might appear that this is a simple number crunching exercise. For example, the present value of tax exemptions that were available to IWIF because it was a State agency could be calculated and summarized. However, the answer to the question: "What is the fair value of any financial contribution made by the State to IWIF and the fair value of any financial benefit IWIF has received from the State since its inception in 1914?" cannot be answered this simply, without considering IWIF's past and its evolution from solely an insurer of last resort to a competitive insurer, and the role it has played in providing a source of mandated workers' compensation insurance to Maryland employers since 1914. The Legislature, in Senate Bill 745, suggested that a number of factors be considered which are specifically identified in Senate Bill 745, to determine the fair value of the State's financial contributions and fair value of financial benefits provided to IWIF.

In performing our work, we consulted extensively with the management team of IWIF, the MIA, as well as officials from the Department of Budget and Management and the State Treasurers' Office. We gratefully acknowledge their cooperation and the courtesies extended to us in the course of our work.

III. BACKGROUND REGARDING IWIF

In order to address the factors to be considered in determining the fair value of any financial contribution made by the State of Maryland to IWIF and the fair value of any financial benefit IWIF has received from the State since its inception in 1914, it is necessary to first understand certain information about IWIF - its legislative history, its organizational structure in State government, and the resultant changes in its operating characteristics - which chronicles IWIF's evolution from a unit of State government primarily focused on providing a source of required workers' compensation insurance coverage to businesses and employers who could not obtain coverage elsewhere, to that of a competitive insurer with the largest share of the workers' compensation insurance market in the State.

In 1914, Chapter 800, Laws of Maryland 1914, known as the Workmen's Compensation Act, created the State Industrial Accident Commission ("SIAC"). The responsibilities of the SIAC were to administer Maryland's workers' compensation law and to adjudicate claims for compensation arising under the law. As part of this law the State Accident Fund ("SAF" renamed the Injured Workers' Insurance Fund or IWIF in 1990) was created as part of the SIAC. The SAF was created for the purpose of providing a source of workers' compensation insurance coverage to Maryland employers that were unable to obtain coverage from private insurers, or who chose not to do so. In this capacity, SAF functioned as the workers' compensation insurer of last resort for Maryland employers.

In 1916, a funding mechanism was established by Chapter 597, Laws of Maryland 1916. The law required that the SIAC, effective for the year ending December 31, 1917, was to assess the workers' compensation insurance industry for the cost of administering the Commission. The expense for operating the SAF, as part of the Commission, was included in this assessment. The Commission then authorized a transfer to the State general fund to reimburse the State for the expenses of the SIAC and the SAF. Prior to this, the SAF expenses were paid with State general funds.

In 1941, the Maryland General Assembly created the "Commissioners of the State Accident Fund" as a separate agency, and as a result, the SAF was no longer part of SIAC (Chapter 504, Laws of Maryland 1941). The law continued to require the Fund to reimburse the State for all expenses. Chapter 98, Laws of Maryland 1970, accomplished a major reorganization in State Government and the State Accident Fund was placed in the new State Department of Personnel. The Fund remained subject to the State personnel, budget, procurement and other State agency

rules and the same mechanism for the Fund to reimburse the State for its operating expenses continued to apply.

In 1987, the SAF was removed from the State Department of Personnel and made independent of all State agencies (Chapters 584 and 585, Laws of Maryland 1987). The law also exempted the Fund from all personnel, budget, procurement and other State agency rules.

In 1990, Chapter 71, Laws of Maryland 1990 (the "1990 Law") changed the name of the Fund to the Injured Workers' Insurance Fund ("IWIF"). Additionally, the 1990 Law completely removed IWIF from the State budget. Up to this point, IWIF received an appropriation and reimbursed the State for operating expenses paid by the State on IWIF's behalf. Of even greater significance is that the legislation required IWIF to develop and implement a plan by which services provided by the Fund would be made known to employers in the State, and permitted IWIF to develop a promotional pamphlet to be included in the mailings of business personal property tax billings by local jurisdictions. As discussed further below, the 1990 Law marked the beginning of fundamental changes in the manner in which IWIF conducted its business, from that of a residual market insurer to that of a competitive carrier. These changes, which included changes in its operating philosophy, policies, systems and commissions for agents and brokers, were in place by 1997.

In 2000, IWIF was made a member of the Property and Casualty Insurance Guaranty Corporation. The Maryland State Treasurer was removed as the custodian of the Fund's investments and IWIF became subject to MIA regulation and examination. Additionally, IWIF was required to meet risk based capital requirements (Chapter 567, Laws of Maryland 2000). The risk based capital requirements were amended in 2002 and again in 2003 to provide for a phase in of the requirements and to exempt IWIF from one component of the risk based capital calculation (the excessive growth penalty).

Legislation enacted by the Maryland General Assembly in 2011 required the Fund to pay Premium Tax, a two percent tax on the direct premiums written in Maryland that is imposed on insurance companies (Chapter 397 Laws of Maryland 2011), and in 2012 legislation was enacted to convert IWIF to the Chesapeake Employers Insurance Company, a private, nonprofit, and non-stock workers' compensation insurer (Chapter 570 Laws of Maryland 2012). The 2012 legislation makes the renamed Company independent from State government, effective October 1, 2013.

A timeline of the key law changes that have affected IWIF can be found at **Exhibit 2.**

While IWIF has existed for nearly a century, it has undergone a slow but steady evolution to where it is today. For much of its existence, IWIF functioned primarily as the insurer of last resort, providing a source of workers' compensation insurance, a coverage required by law, for those employers and businesses in the State that could not obtain this coverage in the commercial market. Additionally, IWIF's mission was to provide this coverage at the lowest possible cost. The 1916 Annual Report of the State Accident Fund stated:

> "By developing a strong State Accident Fund the employers of Maryland will be enabled to secure Compensation Insurance at a minimum cost, as all State fund rates are relieved from the usual load of agents' and brokers' commissions, dividends to stock holders and State taxation."

The 1926 and the 1927 Annual Reports of the State Accident Fund conveyed a similar mission:

> "The State Accident Fund is accomplishing one of the main purposes for its creation that of writing compensation insurance for employers in Maryland at practically cost and there is no doubt that a large amount of premium has been saved to the employer who has insured with this Fund" (*Annual Report of the State Accident Fund,* 1926).

> "One of the purposes for the creation of the State Accident Fund was that it should endeavor to write compensation insurance for the employers in the State of Maryland at as near cost as possible. Of course, it is difficult to accurately estimate the cost of a year's business in advance, but it seems that the purpose above mentioned has been accomplished to as fine a point as it is practical to do so" (*Annual Report of the State Accident Fund,* 1927).

In the 1980s and early 1990s the Fund routinely referred to providing insurance at the lowest possible cost:

> "In short, this was another successful year for the State Accident Fund, and we feel we have met again our goal of providing to you our policyholders full workers' compensation insurance at the lowest possible cost" *(Annual Report of the State Accident Fund,* 1983).

> "In conclusion, we feel that the Fund has continued to meet its goal of providing workmen's compensation insurance at the lowest possible cost" (*Annual Report of the State Accident Fund,* 1987).

> "Since 1914, our motivation has never changed: the provision of the best possible customer service, at the lowest possible cost" (*Annual Report of the Injured Workers' Insurance Fund,* 1991).

Beginning in the early 1990s, after the enactment of the 1990 Law, a fundamental change in IWIF's operating philosophy began to occur. IWIF's stated goal of providing insurance at, or as near, cost as possible changed to that of providing the employers of Maryland *"a guaranteed source of* ***affordable*** *workers' compensation insurance"* (*Annual Report of the Injured Workers' Insurance Fund (1992); (1993); (1994)*). While the change is subtle, it is significant, as it coincided with the time when IWIF began marketing, paying commissions and otherwise conducting its business in a manner similar to other private insurers. It marked the beginning of the transformation of IWIF from an entity focused only on the residual market to an entity focused on competing in the marketplace as well. The 1996 Annual Report provides additional evidence of this. In that Report, the Chairman of the Board commented that *"to retain our dominant position, we undertook a number of other initiatives which expand our visibility in the marketplace…there are numerous innovative,* ***competitive*** *products on the drawing board for next year…"* (*Annual Report of the Injured Workers' Insurance Fund* 1992, 1993, etc.).

We are also aware that around the time the State Accident Fund became an independent agency and was renamed the Injured Workers' Insurance Fund, its financial condition was weak. Observers of IWIF, which included other workers' compensation insurers in the Maryland market, were concerned that IWIF was not financially sound. Industry observers were concerned that if IWIF was made a member of the Property and Casualty Insurance Guaranty Corporation and subsequently became insolvent, the Maryland workers' compensation insurance industry would be subject to huge assessments to pay the claims of IWIF's policyholders. In 2000 when IWIF first became subject to MIA regulation and examination, and was required to meet risk based capital requirements, IWIF's surplus level triggered increased regulatory scrutiny by MIA as required by the risk based capital standards. This is an indication that up until the time that IWIF transformed into a competitive insurer, a level of surplus sufficient to meet regulatory solvency requirements was not accumulated nor

were profits accumulated in its surplus; rather, as will be more fully discussed later in this Report, IWIF as a nonprofit entity passed on any profits and the benefits of tax exemptions to its residual market policyholders in the form of lower premium rates. It has been only since this transformation that IWIF has accumulated profits and grown its surplus. This surplus growth is vitally important in order to protect IWIF policyholders and provide an adequate cushion against the various risks inherent in, or affecting, the insurance business (e.g., adverse claim development, extreme economic conditions).

The events occurring since the early 1990s changed the way IWIF does business: from a unit of State government providing mandated workers' compensation for those who could not purchase it elsewhere, to a competitive insurer with the largest workers' compensation insurance market share in the State, commanding a 23% market share.[3]

[3] Market share in 2011, see **Exhibit 3** for market share data for the period 2001 to 2011.

IV. APPROACH AND METHODOLOGY

During the course of our study, we reviewed volumes of documents, including the following:

- Claims administration agreements from 1949 and 1990
- Consultant reports (e.g., Morgan Stanley report on Pinnacol Assurance)
- Financial statements and reports dating back to 1914
- Historical premium levels by rating tiers
- IWIF administrative expense allocations
- IWIF Annual Reports dating back to 1914
- IWIF Budget Book excerpts
- IWIF premium rate making analyses
- Legislation and its related history
- Legislative Auditor audit reports
- Memoranda prepared by IWIF
- MIA examination work papers and reports
- Public information on other state funds
- Public information on residual market shares
- Rates of return on investments
- Risk based capital trends
- Task Force reports (e.g., Governor's 1980 Task Force on the Study of IWIF)

Additionally and as required by Senate Bill 745, we consulted extensively with IWIF management and the MIA, and met with officials from the State Department of Budget and Management, and the State Treasurer's Office.

To answer the questions posed by the Maryland General Assembly, specifically, "What is the fair value of any financial contribution made by the State to IWIF and the fair value of any financial benefit IWIF has received from the State since its inception in 1914?" first requires a definition of the term "fair value." The Legislature did not define this term in Senate Bill 745. "Fair value" can have varied definitions depending on if it is used in valuation, accounting, or legal literature.

"Fair value" is generally used more frequently in legal settings, such as court determinations or regulations, or in recent accounting literature, than in valuation texts. In legal settings, the

definition varies by state and type of matter. In accounting literature, FASB ASC 820[4] defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."[5] FASB ASC 820 further discusses that "fair value should be measured using consistently applied valuation techniques based upon market, income, or cost (asset) approaches. Each of these approaches includes different measurement techniques that rely on judgment and assumptions, including assumptions about risk."[6]

In the context of this Report, we have considered the above guidance, along with knowledge of other standard definitions of value. Therefore, as explained more fully throughout this Report, we estimated the "fair value" of the contributions made and benefits received to the party that received the benefits (i.e., IWIF or the State), rather than what might be considered the value to the contributor. We also considered standard valuation techniques and standard present value calculations, including actual rates of returns realized and relevant risk factors.

Our methodology and approach focused on the following major elements:

- Understand the impact of the historical landmarks in IWIF's evolution;
- Consider appropriate factors in determining fair value of financial contributions and benefits IWIF received from the State;
- Consider benefits IWIF may have provided to the State; and
- Analyze and determine the fair value of the financial benefits received by IWIF, net of the financial benefits received by the State.

[4] Financial Accounting Standards Board Accounting Standards Codification.
[5] Guide to Business Valuations, February 2010, Volume 1, section 201.8.
[6] Guide to Business Valuations, February 2010, Volume 1, section 201.10.

V. FACTORS TO CONSIDER

As stated above, Senate Bill 745 identified specific factors that were to be considered by the study in determining the financial contribution made by the State of Maryland to IWIF and the fair value of any financial benefit IWIF has received from the State since its inception in 1914. In this section of our Report, we will discuss our consideration of these factors, as well as our analysis and conclusion regarding financial contribution or financial benefit. The *italicized* references in each of the following sections refer to the specific paragraphs of Section 7, Sub-Section (b), of Senate Bill 745.

For benefits received by either IWIF or the State, we have calculated the present value as of June 30, 2012. In those instance where complete financial data was not available through June 30, 2012, such as in the competitive business financial benefit model in Section VI of this Report, we performed our calculations as of December 31, 2011, then updated this to the present value as of June 30, 2012.

To calculate the present value, we utilized annual rates of return on investments obtained from several sources:

- For the period from 1987 to 2011, during which IWIF directed the investment of their funds, we estimated annual rates of return based upon IWIF's annual financial statements.[7]
- Prior to 1987, the State Treasurer's Office ("STO") was responsible for making investment decisions regarding IWIF's funds. We were advised by the STO that IWIF's funds were invested in the same manner as the State's general funds.
    - Therefore, for the period from 1975 to 1987, we used the State general funds interest rate that was provided to us by the STO.
    - For the period from 1914 to 1975, the State general fund interest rate was not available. For this period, the STO provided us with the average three-month U.S. Treasury Bill rate, which they advised us tracked the State general fund rate closely.
- Annual projected earnings were compounded annually.

The annual rates of return that we utilized in our calculations can be found in **Exhibit 4**.

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[7] We compared IWIF's average rate of return for the fifthteen year perio from 1997 to 2011 to that of peer companies. IWIF's average rate of 5.74% was slightly higher than that of the peer group average of 5.20%.

1. **Start–up Funding:** *Paragraph (1)(i)*

Initial Surplus Funding: As previously noted, Chapter 800 Laws of Maryland 1914, created the SAF, as a unit within the SIAC. While the SAF was a part of the SIAC, the SIAC's responsibilities were broader, as the SIAC was responsible for administering the workers' compensation laws in the State, conducting hearings, etc., responsibilities similar to those of the State Workers' Compensation Commission today. In the enabling legislation, State funds were appropriated to the SIAC to cover operating expenses and to maintain a solvent SAF. The first annual report of the SIAC, covering the fiscal year November 1, 1914 to October 31, 1915, indicates that the SAF received $15,000 in start-up funding for the purpose of establishing an initial adequate reserve to pay workers' compensation claims. IWIF has represented that these initial start-up funds were never paid back to the State, and our analysis of financial records and Annual Reports of the SIAC, SAF and later IWIF confirm this. We calculated the fair value of the $15,000 start-up funding as of June 30, 2012 to be approximately $900,000. The calculation details can be found in **Exhibit 5**.

Initial Operating Expenses: In 1916, legislation was passed that created a funding mechanism by which the workers' compensation insurance industry was assessed to fund the operations of the SIAC, including the SAF, from 1917 and forward. Carriers were assessed their pro-rata share of the SIAC operating expenses based on the ratio that each carrier's insured payroll bore to the total insured payroll in the State, similar to the funding mechanism in place for the State Workers' Compensation Commission today. The collection of the assessment provided funds for the SIAC to reimburse the State for its operating expenses. In this regard, the State initially appropriated and paid the operating expenses of the SIAC and SAF, and was then reimbursed by the SIAC. From 1917 forward, the State no longer funded the SAF's operating expenses. However, for the period from November 1, 1914 to December 31, 1916, the State was not paid back for the operating expenses of the SAF. We determined, from the Annual Reports of the early years of the SIAC, that the SAF's operating expenses during this period totaled $21,478. We calculated the fair value of the unreimbursed operating expenses as of June 30, 2012 to be approximately $1,100,000. The calculation details can be found in **Exhibit 5.**

Conclusion: The start-up funding provided by the State to SAF in 1914 and the unreimbursed operating expenses of SAF that were paid by the State during the period from November 1, 1914 to December 31, 1916 represent direct financial contributions to IWIF. The fair value of these amounts as of June 30, 2012 total $2,000,000.

2. **Real Estate:** *Paragraph (1)(ii)*

IWIF's building, parking lots and parking garage are located on five separate parcels of real estate. In addition, in 2009, IWIF acquired three undeveloped lots adjacent to the IWIF property. The history of these parcels is described in the following table:

Parcel Number	Purchase Year & Price	Appraisal Values & Related or Non Related Party Transaction	Source of Acquisition Funding
681	1982 $45,000	$45,000 Non Related Party	IWIF
953	1984 $955,000	$580,000 to $955,000 Non Related Party	IWIF
675	1984 $115,000	$75,000 to $126,000 Non Related Party	IWIF
1178	1999 $200,000	$132,000 Related Party	IWIF
757	2003 $11,600	No appraised value Related Party	IWIF
3; 129; 543	2009 $997,000	No appraised value Non Related Party	IWIF

Prior to 2001, the real estate and buildings occupied by IWIF were titled in the name of the State. On May 1, 2001, title to most of these properties was transferred from the State to IWIF. Later, it was determined that two of the parcels that were intended to be transferred were erroneously not transferred (parcels 675 and 681). Title to the two parcels that were erroneously not transferred in 2001 was transferred to IWIF on November 7, 2005.

Even though each of the parcels purchased prior to 2001 were originally titled in the name of the State, IWIF claimed that IWIF did directly purchase each of these parcels. Based upon examination of documentation provided by IWIF, including correspondence, accounting ledger pages, IWIF checks, and financial statements, we have concluded that in each case IWIF funds were used to purchase the property.

Further, we analyzed each purchase to determine whether or not the price paid by IWIF for the property represented a fair market value or whether the State provided the property to IWIF at a price other than fair market value. As noted above, six of the parcels (all but two) were purchased directly from parties independent of the State. Therefore, a fair market value transaction is assumed. Further, of these six properties, (a) one parcel (681) included documentation listing an appraised value equal to the purchase price and correspondence approving the purchase, (b) two parcels (953 and 675) included documentation providing appraised values that included values at or in excess of the purchase price and independent approval of the price by the Department of General Services, and (c) three parcels (3, 129, and 534) were purchased in 2009, after IWIF was independent of the State budget process.

The remaining two parcels (1178 and 757) were purchased by IWIF from the State Highway Administration ("SHA"). For parcel 1178, IWIF paid $200,000, even though the appraised value was only $132,000. This appeared to result from a negotiated agreement between IWIF and the SHA. The SHA owned and used the property adjacent to the IWIF office for salt storage, and IWIF wanted the property for a parking lot. The SHA wanted $280,000 to cover the cost of a move and relocating the salt dome. IWIF wanted to pay $100,000 to $125,000. The negotiated agreement of $200,000 was approved by the Board of Public Works.

The final parcel, 757, was a small "sliver of land" also owned by the SHA, which IWIF wanted for a driveway. No appraisal was performed, but the parties agreed to a purchase price of $11,600.

Conclusion: The real estate owned by IWIF was acquired at fair value, utilizing IWIF funds. Since IWIF paid fair value or otherwise reasonable prices at the time of the purchase, there was no financial benefit received by IWIF from the State.

3. **Tax Exemptions:** *Paragraphs (1)(iii),(iv),(v), (2)(iii)*

As a State agency, IWIF has been exempt from paying various State taxes. The most significant of these is premium tax, a tax based on an insurer's direct insurance premiums written in the State, in lieu of a State income tax. As previously noted, effective June 1, 2011, IWIF became subject to premium taxation, and paid $2,176,252 for premiums written during the period June 1, 2011 to December 31, 2011.

Being a State agency also exempted IWIF from State sales tax on its otherwise taxable purchases of goods. Additionally, IWIF was exempt from property taxes and transfer taxes on the property that it owns.

The tax exemptions provided to IWIF are not accidental or an oversight, as the issue of tax exemption vs. taxing the Fund has been addressed by State governmental task forces and study groups, and considered by the Maryland General Assembly at numerous times during IWIF's existence. For example, in 1950, the State Fiscal Research Bureau studied the SAF, and recommended that the Fund be subjected to premium tax, stating that:

- The State Accident Fund is theoretically in competition with private carriers and because of the fact that the private carriers must pay premium taxes, the Fund is very often charged with having an unfair advantage.
- Naturally, premium taxes are included in the rate structure of the premium rate calculated by private carriers. The payment of premium taxes by the State Accident Fund will also require the absorption of these taxes in the Fund's rate structure. This would make the State Fund premium rates more responsive to comparison with rates charged by private carriers.

The issue was taken up again by a 1999 Governor's Task Force Study of the Injured Workers' Insurance Fund. In its Report, the Task Force commented that:

> "IWIF should retain its exemption from the premium tax (assuming it remains the insurer of last resort). IWIF is exempt from the 2% premium tax imposed upon other insurers. The Task Force determined that IWIF, as an insurer of last resort, is writing the business that other workers' compensation carriers will not write,

> and therefore the exemption from the premium tax offsets the risk no other insurer will accept by insuring these employers. It is crucial to the business climate of Maryland that the business owners in the State be able to obtain this coverage at a reasonable price. To implement the premium tax would increase the rates offered by IWIF by at least 2%, the rate of the premium tax. The membership agreed unanimously that IWIF should maintain its exemption from premium tax. The Task Force believes that the industry sentiment that IWIF's exemption from premium tax creates an unleveled playing field is diminished by the substantial risk the Fund undertakes by writing the business that other carriers will not."

It is clear that IWIF did not include taxes in their premium rates. In this regard, we reviewed the base rate level and classification premium rates developed by the Fund's consulting actuary for the period 2004 to 2012. Beginning in 2012, the premium rates included a 2% expense factor for taxes. Prior to this the rate development did not include an expense factor for taxes.

In this regard, IWIF did not receive a financial benefit equivalent to the amount of its tax exemptions. As noted above, IWIF's premium rates did not include expense factors for taxes. Rather, IWIF's policyholders benefited, as IWIF was able to charge lower rates than it would otherwise have been able to do. The issue of subjecting IWIF to taxes was considered throughout IWIF's existence, and, until 2011, the Legislature resisted subjecting IWIF to taxes, since it would inevitably raise rates. However, the tax exemptions did provide IWIF with a competitive edge, as it transformed from a residual market insurer to a competitive insurer.

Conclusion: The amount of taxes IWIF would have paid had they not been a State agency is substantial. For example, the present value of premium taxes that would have been paid total of approximately $281,100,000 as of December 31, 2011. Similarly, we calculated the present value of sales tax IWIF would have paid to be approximately $2,000,000 as of December 31, 2011.[8] We did not separately compute the present value of the property tax exemptions. Tax assessments for the IWIF properties were only available for the last few years. However, this would not have altered our conclusion, as explained below.

IWIF did not include an expense factor for taxes in its premium rate development, therefore, IWIF did not retain a direct financial benefit from the State as a result of these tax exemptions. Rather the financial benefit inured to the benefit of its policyholders, who for many years of IWIF's existence were almost entirely employers and businesses in Maryland who had no other options for workers' compensation insurance. By not being subject to taxes, IWIF was able to charge these policyholders lower rates. However, the tax exemptions did provide IWIF with a competitive edge as it transformed from a residual market insurer to a competitive insurer. We quantify the financial benefit IWIF received in the competitive market due in large part to the tax exemptions, in Section VI of this Report.

4. **State Self-Insured Workers' Compensation Program:** *Paragraph (3)(i)*

Since the execution of a contract between the SAF and the State in 1949, IWIF has been responsible for administering the State of Maryland's self-insured workers' compensation program. The initial contract was in the form of a Policy of Insurance issued to the State. Payment terms were as follows:

- Premium for one year's insurance based on the estimated cost of insurance was deposited with SAF,
- The policy automatically renewed and continued in force after the expiration of the original one year for succeeding annual periods,
- The State was liable for the same renewal deposit premium thereon for each succeeding annual period until the expiration of three years from the effective date of the policy,

[8] Tax rates, their effective periods and the fair value calculation can be found at **Exhibit 6** and **Exhibit 7**.

- After the three-year term, the amount of the deposit premium was to be determined in accordance with the accident experience of the State for the three years,
- Thereafter the said deposit premium was to be determined annually from the experience of the entire (all years) period of coverage under this policy,
- If at any time during the first three years, 'incurred losses' plus `administrative costs' equaled or exceeded 90% of the deposit premium for such current period or year, the State was required to make an additional 'interim deposit' in the amount determined by SAF.

An endorsement to the policy was executed in 1956, which clarified that the administrative cost of the workers' compensation insurance coverage provided by the State Accident Fund would be determined based on 12-1/2% of the total incurred losses each year, beginning July 1, 1956. The administrative charge was subject to review at the end of a three-year period to determine whether the 12-1/2% was the proper administrative charge to be made. In addition, the State Accident Fund was to bill the Board of Public Works annually for a deposit covering the estimate for incurred losses, plus administrative expenses.

A 1988 Legislative Auditor's report discussed the terms of the 1949 policy. The Legislative Auditor commented that the annual premiums charged to the State were based upon estimated claims payments and administrative expenses for the current year of coverage, and did not take into consideration estimated amounts on incurred but unsettled claims that will be paid in future years. The Legislative Auditor also commented that if terminated, the State would remain liable for unpaid claims and administrative expenses at the termination date. The Auditor recommended that due to the reorganization of the SAF effective July 1, 1988, which separated the SAF from the State Department of Personnel, the policy be renegotiated to clarify the financial responsibilities of each party.

In response to the recommendation of the Legislative Auditor, the current claims administration agreement, dated July 1, 1990, clarified IWIF's role as that of a claims administrator for the State ("the 1990 State Agreement"). The 1990 State Agreement also specified the services to be performed and the terms of payment. The 1990 State Agreement requires IWIF to provide to the State the same level of service and standards of service that are provided to private employers that insure with IWIF. The

State is to pay its proportionate share of IWIF's administrative costs, and the costs IWIF incurred in developing and administering a risk management/safety program for the State. The State's proportionate share of the administrative costs are calculated as the ratio of the actual incurred losses from the next preceding calendar year to the actual incurred losses of all insureds of the Fund, including the State. Administrative costs are defined as the annual operating costs of the Fund minus costs associated with underwriting/auditing and the risk management/safety program.

As part of our review of IWIF's administration of the State self-insured workers' compensation program, we met with officials from the State Treasurer's Office and the Department of Budget and Management, we requested that IWIF provide its analysis of the benefits IWIF provides to the State pursuant to the 1990 State Agreement, and we reviewed a January 19, 2011 MIA examination report on the claims administration agreement. Our discussions with State officials, while informative and helpful, were inconclusive on whether the State receives a subsidy in connection with IWIF's administration of the workers' compensation program. The officials stated that they believe there are benefits provided by IWIF to the State; however, they struggled with whether the fees are fair and reasonable. It was pointed out that due to the fee allocation methodology in the 1990 State Agreement, as the insured book of IWIF's business decreases, the State's share of the allocated costs increases. Conversely, as IWIF's insured book of business increases, the State benefits. Additionally, all those interviewed agreed that the contract should be renegotiated or put out on bid to test whether or not the rates charged by IWIF are market rates, and otherwise fair and reasonable.

The MIA examination report concluded that the State was receiving substantial value from the contract with IWIF. The report stated that the fees appeared to be "fair and reasonable" in relation to the services provided. To the extent MIA could compare the fees to the fees paid by other self-insured jurisdictions to their administrators, the State appeared to be charged a reasonable and competitive amount. MIA also noted that there were significant benefits to IWIF in maintaining the agreement, as it can achieve economies of scale, and spread its indirect costs and overhead over a larger volume of business.

The ability to spread costs over a larger book of business is a significant consideration. Providing claims administrative services below cost, or at a minimum without a profit

margin loaded into the fees, is not unprecedented for nonprofit insurers with both large blocks of insured and administrative services only business. In our experience we have witnessed this on numerous occasions. For example, CareFirst of Maryland, Inc., a nonprofit health service plan, reported in its 2011 Annual Statement losses from its administrative services only business totaling $9.6 million and $47.7 million for the years ended 2011 and 2010, respectively.

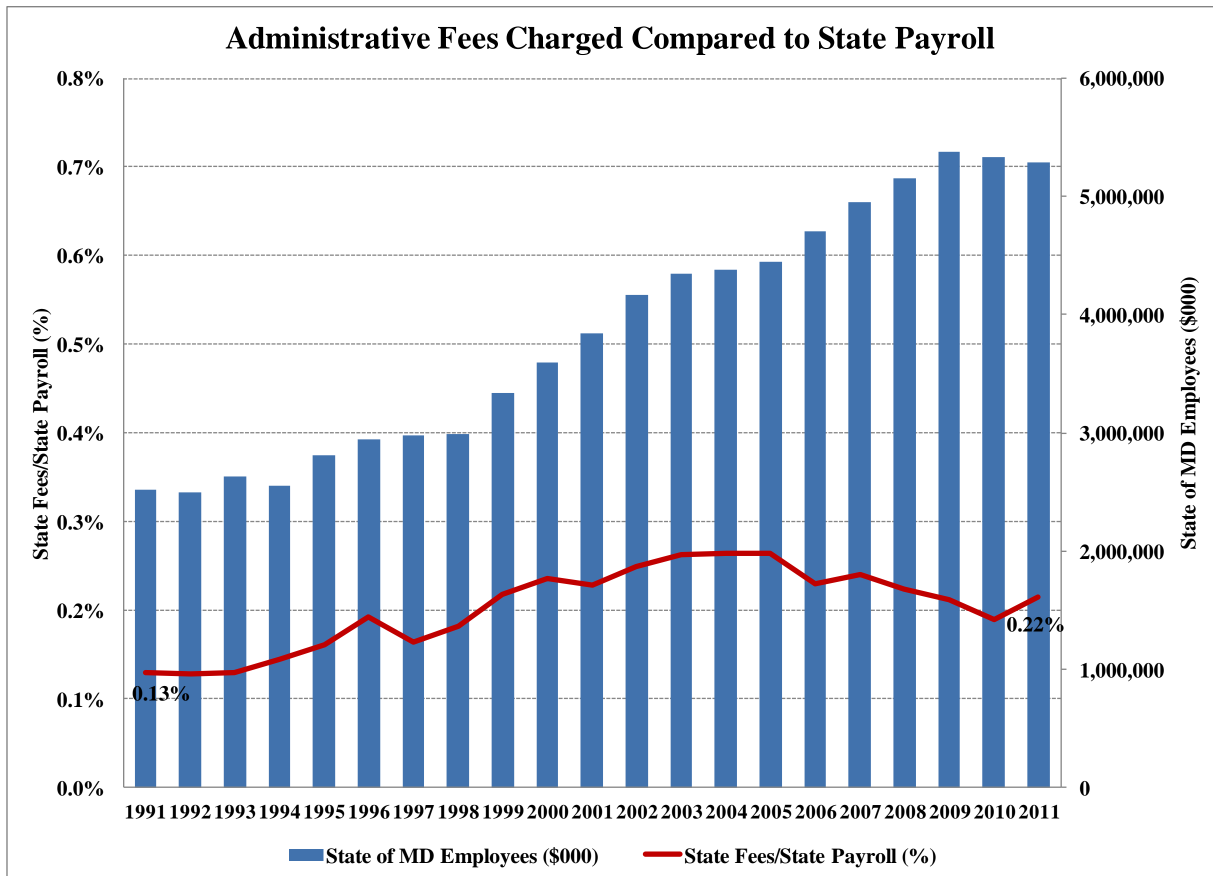
The MIA examination report also stated that based on a review of a cost allocation model used by IWIF to bid on claims administration services for other entities, the expense allocation methodology in the agreement appeared to save the State approximately $2 million in fiscal year 2010. It is not clear from this statement whether the allocation methodology used by IWIF for bidding on services for other entities is appropriate for the State contract. For example, the array of services IWIF provides to the State appears to be much more comprehensive than those provided to other self-insured entities. The MIA also noted that IWIF may provide some additional services to the State, beyond those identified in the agreement.

IWIF management has stated that it provides substantial benefit to the State through its administration of the program. IWIF notes that it is a cost sharing arrangement without a profit margin. In this regard, IWIF estimates the present value of a subsidy to the State, as a result of not loading in any profit and assuming a 4% margin, to be in the range of $10 to $15 million for the period 1949 to 2011. IWIF also contends that the State has not been charged for the cost of loss control services that IWIF estimates exceeds $1 million since July 1, 2009. As previously noted, it is not unusual for nonprofit entities to enter into administrative services contracts at or below cost, and IWIF presumably recognized certain benefits existed when they executed the current agreement with the State in 1990. As such, we did not consider the lack of a profit margin further.

An additional consideration is the quality of services provided and the impact the quality of services has on claim costs. IWIF has performed claims administration services for the State since 1949; it is familiar with the State's book of business and State of Maryland requirements. Further, the fact that IWIF's risk management programs may have served to reduce the State's cost of claims should be considered.

We also noted that in Senate Bill 140, 2010 legislative session, (the fiscal year 2011 Budget Bill) the State, in a cost cutting measure, reduced the payment to IWIF under the administrative services agreement by $500,000. We were advised by officials from DBM that the reduction was a negotiated amount between officials from DBM and management of IWIF. Reductions in fees between parties to a contract are not unusual, and presumably the parties would consider the benefits they derive from the contract in negotiating the reduction. Accordingly, we did not consider the reduction to be a financial benefit to the State that should be considered separately.

We compared the administrative fees charged to the State to the covered State employees' payroll for the period 1991 to 2011. We noted that while the State payroll has increased by 129 percent, administrative fees charged to the State have increased by only 67 percent during the same period. Therefore, based on this comparison, it does not appear that the fees charged are increasing at an unusually fast rate, or that fees have become a disproportionately higher percentage of covered payroll since the inception of the claims administration agreement.



Conclusion: A summary of the benefits that the Agreement provides to both the State and IWIF are listed below:

Benefits to State:

- IWIF provides services e.g., safety management program, beyond those identified in the Agreement,
- The State benefits from IWIF's knowledge and experience in adjudicating State claims,
- IWIF does not include a profit margin in the fees charged to the State,
- The quality and effectiveness provided by IWIF in negotiating and settling claims may serve to reduce claim cost.

Benefits to IWIF:

- IWIF achieves economies of scale, and can spread its indirect costs and overhead over a larger book of business,
- IWIF can allocate more administrative costs to the State when its commercial market share is decreasing, thus keeping premium rates lower.

The current Claims Administration Agreement provides financial benefits to both the State and IWIF. Whether the State is receiving excess value compared to costs paid from the contract versus possibly overpaying for the services provided is not clear, or easily determinable. As noted above, the contract has not been rebid or renegotiated since its inception in 1990. Difficulty ascertaining the reasonableness of the fees charged to the State is further compounded by the lack of comparability of the services received by the State and provided by IWIF, to the services provided by administrators in other states to their self-insured plans.

An additional factor to consider is the quality of services provided and the impact the quality of services has on claim costs. IWIF has performed claims administration services for the State since 1949; it is familiar with the State's book of business and State of Maryland requirements. Further, the fact that IWIF's risk management programs may have served to reduce the State's cost of claims should be considered. We believe that the contract should be viewed as an exchange for services at a negotiated price, under which both parties to the agreement benefited. As such we did not include a net financial benefit to either the State or to IWIF in our conclusions.

5. **$6 million Transfer in 2011:** *Paragraph (3)(ii)*

The 2011 Budget Reconciliation and Financing Act (BRFA) required IWIF to transfer $6.0 million to the State. The Bill also provided that IWIF was to be given a credit against the $6.0 million in the amount of the premium taxes it would be required to pay for 2011 (effective June 1, 2011 IWIF was subject to premium tax). For the period June 1, 2011 to December 31, 2011, IWIF owed and paid the State premium taxes totaling $2,176,252. In June 2012, IWIF paid the balance of the $6.0 million amount, totaling $3,823,748, to the State. The $6.0 million was an estimate of IWIF's 2011 premium taxes, presumably based upon premium volume from several years prior. However, by 2011, IWIF's premium volume had decreased. Therefore, the balance of the total $6.0 million paid, less the actual premium tax liability ($2,176,252) for 2011, did not represent an amount paid for premium taxes.

Conclusion: The balance of the $6.0 million, less the premium tax liability for 2011 ($2,176,252), represents a financial benefit received by the State as a result of its association with IWIF. The $3,800,000 (rounded) is an offset to any calculated financial benefit IWIF has received from the State.

6. **Additional Costs Incurred as Insurer of Last Resort:** *Paragraph (2)(i)*

IWIF's primary purpose for most of its existence has been to serve the residual market as the insurer of last resort. While residual market business is inherently riskier, IWIF charged actuarially developed rates for this business. Therefore, IWIF did not incur additional costs as the insurer of last resort.

However, this is not to imply that IWIF does not provide a significant financial benefit to the State of Maryland by acting as the residual market insurer. IWIF has functioned in this role throughout its existence. By its very nature this business is inherently riskier than the non-residual market. Dock workers, construction workers and bridge painters are more susceptible to serious work-related injuries than office workers. A mechanism must exist to serve this market, and provide a source for a mandated insurance coverage, and IWIF is that mechanism. If there was not a source for

workers' compensation insurance for riskier business, such as those that may have been declined by private carriers because of their adverse claims history, or due to the nature of their business which may result in greater claims, these Maryland employers, many of which are small employers and employers in high-risk professions, may leave the State or simply go out of business.

While it will be further discussed in the risk based capital section of this Report, it bears mentioning here that until IWIF transitioned from a residual market insurer to that of a residual market and a competitive insurer, it did not accumulate a level of surplus sufficient to meet regulatory minimums. If IWIF were to fail financially, the source for workers' compensation insurance for the residual market would disappear, absent other action. As such, to continue to provide this significant financial benefit to the State of Maryland by serving the residual market, and to offset the significantly increased risks associated with this business, it is important that IWIF maintain an adequate level of surplus.

This was taken into consideration in our Competitive Business Financial Benefit Model in Section VI of this Report.

Conclusion: Serving as the insurer of last resort does not result in additional costs to IWIF, as actuarially sound rates are developed and charged to residual market policyholders.

However, IWIF provides a significant financial benefit to the State of Maryland by acting as the residual market insurer. A mechanism must exist to serve the residual market, and provide a source for a mandated insurance coverage, and IWIF is that mechanism. Otherwise, Maryland employers in the residual market would not have a source for workers' compensation insurance, and may leave the State or simply go out of business. This role in the Maryland workers' compensation market was a significant consideration in the development of the Competitive Business Financial Benefit Model, which is discussed in Section VI of this Report.

7. **The Nonprofit Mission:** *Paragraph (2)(ii)*

As previously noted in the Background section of this Report, throughout most of its existence IWIF's mission, as a nonprofit entity, has been to provide workers' compensation insurance at the lowest possible cost. "Profits" (and savings derived from cost benefits provided by the State, such as tax exemptions) were passed on to policyholders in the form of lower premium rates.

IWIF also has, at various times in its existence, passed on profits that accumulated in surplus to its policyholders in the form of policyholder dividends. In this regard:

- In 1920 there was reference to a $2,000 dividend and in 1921 there was a reference to a $30,000 dividend in the Annual Report of the SIAC. At the time, SAF's surplus was approximately $385,000.
- During the period 1950 to 1961, SAF paid dividends of approximately $860,000. Annual Reports at the time described the dividends as a return of excess surplus to the policyholders. Surplus, which stood at $2.6 million in 1950, had dropped to $1.7 million by 1961, or by approximately the amount of the policyholder dividends.
- A $9,000,000 policyholder dividend was declared in 1980. The dividend was recorded as appropriated retained earnings in the financial statements. According to the September 26, 1980 board minutes, a cash dividend was appropriate based on the "operating results for fiscal year 1980" and "the overall strong financial position of the Fund".
- A $10,000,000 policyholder dividend was declared by IWIF in 1997. According to the IWIF Annual Report, the dividend was to share the financial success of the company with the 80% of IWIF policyholders who had "excellent safety records" (See Annual Report of IWIF 1997).
- IWIF also created a participating dividend plan at the policy level in 1997. The plan is based on the experience of the policyholder after an 18 month evaluation period and paid at 22 months. Based on the loss ratio for that period, the policy may have been eligible for a dividend. The participating plan was suspended in November 2010. During the period 1999 to the present, the dividends paid or credited under this program totaled approximately $27.4 million.

Conclusion: Throughout its existence, IWIF has "passed its profits on to policyholders," by maintaining its premiums at the lowest possible cost and by paying dividends when the Fund was successful, or when surplus was considered excessive.

It bears noting, however, that the dividend program initiated in 1997 coincided with the changes in IWIF's operations that occurred around that time. It is significant that the participating dividends were paid to those policyholders with the best loss experience, presumably those policyholders that would be able to obtain workers' compensation insurance in the private market. This is an example of how IWIF designed its insurance products post-1997 to make them more appealing to attract and retain competitive business. Additionally, IWIF's ability to pay dividends to this block of policyholders points to a competitive advantage that IWIF had as a result of the tax exemptions granted to it. The financial benefit of this advantage is taken into consideration and quantified in Section VI of this Report, "Competitive Business Financial Benefit Model."

8. **Risk Based Capital:** *Paragraph (2)(vi)*

Legislation in 2000 (Chapter 567, Laws of Maryland 2000) effective October 1, 2000 subjected IWIF to MIA regulation and required IWIF to meet risk based capital ("RBC") requirements. RBC is a method of measuring the minimum amount of capitalization appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. IWIF's RBC is calculated by applying factors to various asset, premium and reserve items. The factor is higher for those items with greater underlying risk and lower for less risky items. The adequacy of an insurance company's actual capital can then be measured by a comparison to its RBC as determined by the formula.

Accompanying the RBC formula itself is a model law developed by the NAIC and adopted in a substantially similar form by many states, including Maryland.

The critical part of the model law and the enabling statute is that it drives regulatory action; as the reporting entity's capital and surplus falls through successively decreasing threshold levels, increasing levels of regulatory intervention are triggered. If an entity's capital and surplus falls below the lowest threshold, the statute would

require the insurance commissioner to take over control of the company. Those thresholds are as follows:

- Company Action Level RBC = 200% of Authorized Control Level ("ACL") RBC; the company must submit a plan that identifies the matters that contributed to the action level event, propose corrective action, provide certain financial projections, including supporting assumptions, and identify the quality and/or problems associated with various aspects of the company's business.
- Regulatory Action Level RBC = 150% of ACL RBC; in addition to the filing of a plan, the regulator may examine the company and/or its plan to the extent necessary, and can issue corrective orders.
- Authorized Control Level RBC = amount as determined pursuant to the RBC formula and instructions; in addition to the preceding levels of regulatory action, the regulator may, if deemed to be in the best interests of policyholders, cause the company to be placed under regulatory control provided that the Authorized Control Level event alone is sufficient grounds to do so.
- Mandatory Control Level RBC = 70% of ACL RBC; provides that the regulator shall place the company under regulatory control and that the Mandatory Control Level alone is sufficient grounds to do so.

With legislation that was passed and became effective in 2009, new provisions of the NAIC RBC Model Law relating to a trend test were adopted by Maryland. Under the prior formula, a Company Action Level event was not triggered until the RBC ratio (total adjusted capital divided by authorized control level RBC) fell below 200%. With the addition of the new trend test, a Company Action Level event could also be triggered at higher RBC ratios, i.e., between 200% and 300%, if the company was also experiencing a negative trend, defined as a combined ratio of greater than 120%. IWIF's combined ratio is historically in excess of 120%. Therefore, a Company Action Level event would be triggered at 300% of ACL RBC in IWIF's case.

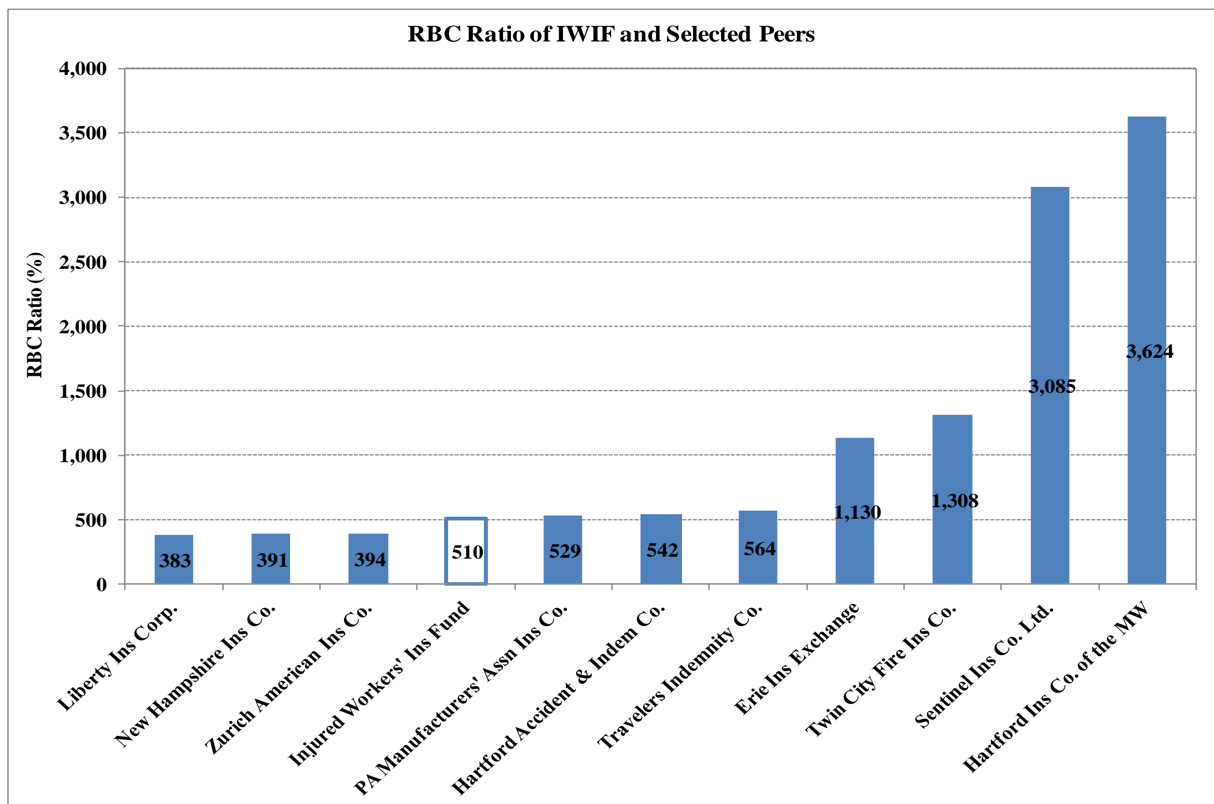
IWIF's initial RBC filing in 2000 disclosed that its RBC ratio was 262%, above the regulatory action triggers. However, as a result of an MIA examination as of December 31, 2000, several adjustments to IWIF's financial position were necessary. The effect of these adjustments placed IWIF's RBC ratio at 159%, a level below its Company Action Level requirement.

At the time of the 2001 RBC filing, IWIF's RBC ratio stood at 166%, and when the 2002 RBC filing was due, IWIF's RBC ratio was at 95%, which was below the Authorized Control Level. Had it not been for relief granted to IWIF through legislative action in the 2002 Session of the Maryland General Assembly, IWIF would have been subject to being placed under regulatory control by the MIA.

Since this low in 2002, through premium rate increases and stabilization in the insurance market followed by a decrease in premium volume, which had the effect of reducing RBC requirements, IWIF's RBC ratio, has increased to 510% as of December 31, 2011. While a study of the adequacy of surplus is beyond the scope of this project, there are a few points worth mentioning:

- In 2000 when IWIF first became subject to MIA regulation and examination, and was required to meet RBC requirements, IWIF's surplus level triggered increased regulatory scrutiny by MIA.

- While IWIF is currently above all regulatory RBC action levels, its RBC ratio is below that of many of their competitors in the Maryland workers' compensation insurance market, and other state funds.



- There are certain risks that do not necessarily lend themselves to modeling as part of a standard, industry-wide format and which therefore may not be adequately reflected in RBC, if at all. For example, the following risks are currently not captured in the RBC formula: catastrophe risk, operational risk and diversification risk. The need for surplus in excess of regulatory trigger points is emphasized in Maryland law. Section 4-302 of the Insurance Article, Annotated Code of Maryland states that "in order to safeguard the solvency of the insurance business in the State, an insurer should maintain an amount of capital in excess of the minimum RBC levels …and, additional capital is used and is useful in the insurance business and helps secure an insurer against various risks inherent in, or affecting, the insurance business and not accounted for or only partially measured by the risk based capital requirements…"

- The MIA, in a report dated March 5, 2012, prior to the passage of Senate Bill 745, concluded that IWIF's surplus would be adequate in the near future if $50 million were transferred from IWIF to the State general fund, and that IWIF should continue to meet regulatory surplus minimums. However, the MIA noted that IWIF's long-term needs have not been thoroughly analyzed. Based on the above, IWIF's ability to stay above RBC regulatory triggers in order to absorb estimated potential losses under plausible adverse scenarios is critical.

Conclusion: Since being made subject to risk based capital standards, the accumulation of an adequate level of surplus has been a significant concern for IWIF. IWIF's inability to meet the minimum risk based capital standards when they were first imposed upon them in 2000 is further indication that up until the time that IWIF transformed into a competitive insurer, a level of surplus sufficient to meet regulatory solvency requirements was not accumulated. As evidenced by the inadequate level of surplus at that time, it is clear that IWIF did not retain, but rather passed on any financial benefits from its relationship with the State to its policyholders. We considered the need to meet risk based capital minimums in our selection of the appropriate discount factor to be utilized in our competitive business financial benefit model, which is discussed in the next section of this Report.

9. Other Financial Contributions or Financial Benefits: *Paragraph (1)(vi)*

As previously noted, during the course of our review we consulted extensively with the management team of IWIF, the Maryland Insurance Administration ("MIA") as well as officials from the Department of Budget and Management and the State Treasurers' Office. We requested and were provided access to an extensive volume of documentation by the aforementioned. As a result of this review, we did not discover any direct financial contributions made by the State to IWIF other than those previously discussed in this Report. However, through our discussions with State officials and IWIF, we identified several instances where IWIF may have received a financial benefit, by way of its association with, or support by, the State. We also identified instances where IWIF may have provided a financial benefit to the State. These are as follows:

- Incremental Investment Income Earned for the State: Pursuant to a provision in the aforementioned 1990 claims administration agreement between the State and IWIF, the State, on a monthly basis was to pay IWIF one-twelfth of the projected annual claims and administrative expenses. However, the State also had the option to voluntarily deposit funds with IWIF to fund the future costs of incurred losses. Under this agreement, the amounts provided by the State to IWIF were deposited in an account for the benefit of the State and the State received interest earned on the average daily net balance in the account. The rate of interest credited to the State was to be the same as that earned by IWIF. An MIA examination covering the period January 1, 2000 to December 31, 2000 raised issues with the comingling of funds. In its report dated August 1, 2001, the MIA recommended that IWIF ensure its compliance with all terms of the contract, including the requirement to maintain the State's deposits in a "special account." In response, the State contract was amended in November 2001 and current and future deposits were to be placed in a special account "as directed and approved by the Treasurer, for the benefit of the State" with IWIF as custodian. IWIF subsequently invested the State's funds in securities as directed by the Treasurer. Thus, the State no longer benefited from IWIF's return on investments. However during the period from 1990 to 2000 the State voluntarily deposited significant amounts of money with IWIF. For example, in 2000, the State's average deposits with IWIF totaled approximately $114 million, while the monthly average claims cost and administrative expenses allocable to the State totaled $3.8 million. During 1990 to 2000, when the

State's funds were comingled and invested with IWIF's funds, the State received the benefit of a significantly higher rate of return than otherwise would have been earned had the State Treasurer invested the funds in a manner similar to other State investments. We calculated the present value of the financial benefit to the State to be approximately $10,800,000. Our calculation of this amount can be found on **Exhibit 8.**

- Benefit to IWIF from participation in the State's health benefits provided for its employees and retirees: IWIF reimburses the State for the employer's share of the cost of health insurance for its employees and retirees. DBM stated to us that IWIF benefits from the superior purchasing power of the State by being included in the State's health benefits program. However, no evidence was provided on savings provided to IWIF, or how much more a comparable health benefits program would have cost IWIF on a stand-alone basis. Additionally, IWIF as a stand-alone entity would not be required to offer a health benefits package equivalent to what the State offers its employees. Further, IWIF would always have had the option of passing any increased cost on to its employees, thus keeping the employer's (IWIF) cost the same, or possibly even less. We concluded that there is no financial benefit to IWIF.

- The value of IWIF's policyholders' perception that IWIF would be supported by the State if IWIF experienced financial difficulty: While this may have been a consideration in attracting and retaining policyholders, thus providing IWIF a competitive advantage, we believe it is adequately taken into consideration in our financial benefit calculation.

- Value of legal protections from its association with the State: As a unit of State government IWIF received immunity from certain types of lawsuits. The State and units of State government are generally immune from tort actions. However, the State has waived its immunity from losses up to $200,000 per claim. The State, through the State Insurance Trust Fund administered by the STO, bills IWIF for this liability coverage. For fiscal year 2012, the State billed IWIF approximately $18,000 for the cost of this coverage. Officials from the STO and DBM believe that the limited sovereign immunity protection afforded IWIF is a financial benefit, as absent this protection, IWIF would have to obtain coverage with higher limits at substantially increased cost.

However, we determined that IWIF has in fact obtained such coverage for the last eleven years. In this regard, IWIF has obtained general liability coverage and umbrella coverage that provides protection up to $15 million per occurrence, at a cost of approximately $26,000 for the 2012/2013 policy year. In addition, neither the STO nor IWIF could recall IWIF ever having filed a tort claim. Since IWIF has obtained and paid liability insurance we concluded that this was not a significant measurable financial benefit to IWIF.

- Value of surety bond the State Treasurer maintained to secure the funds of IWIF: The STO stated that when the State Treasurer was custodian of IWIF's investments, the STO maintained a bond to secure the funds. IWIF was not charged for this; thus, it represented a savings to IWIF. We do not believe the incremental cost to the State for the additional bonding, or the cost IWIF would have incurred had they separately procured a bond would have been significant; as a result we did not pursue this further.

- Value to State to obtain reinsurance by virtue of its relationship with IWIF that it could not otherwise obtain: The State pays its proportionate share of the reinsurance coverage (i.e., insurance obtained by an insurer to protect itself from financial loss due to catastrophic events); however, IWIF contends that the State, as a self-insured plan, could not otherwise obtain "reinsurance." This may be technically true, as only an insurer can reinsure. However, similar coverage can be obtained by self-insured plans (referred to as "stop loss" insurance). Additionally, no evidence was provided that indicated that the cost to the State by obtaining reinsurance through IWIF was less than the State would have paid, had they obtained similar coverage on their own. As such, we did not consider this further in our analysis.

- Value for servicing Bethlehem Steel, USL&H and Black Lung: Bethlehem Steel was a self-insured entity. IWIF stepped in and took over management of the workers' compensation claims when Bethlehem Steel was in bankruptcy. Ultimately, a memorandum of understanding was executed under which IWIF is paid for administering the claims. Regarding the US Long Shore and Harborworkers and Black Lung coverage (coal miners), these were instances where IWIF stepped in and provided coverage when other carriers exited these markets. However, IWIF is, by law, required to be the insurer of last resort,

and in all of the instances above, there is no direct financial benefit IWIF provided to the State. Therefore, we did not consider these further in our analysis.

10. Residual vs. Competitive Business: *Paragraph (2)(iii),(iv),(v)*

Fundamental changes in IWIF's mission, and in the manner in which it conducted business, began with the passage of Chapter 71, Laws of Maryland 1990. The 1990 legislation accomplished a number of things: the name of the Fund was changed to the Injured Workers' Insurance Fund, IWIF was completely removed from the State budget process, and most significant to IWIF's future was the requirement for IWIF to develop and implement a plan by which services provided by the Fund would be made known to employers in the State (otherwise known as a marketing plan). IWIF immediately began to implement the requirements. In its 1990 Annual Report IWIF stated that a marketing unit was created that year. At the time, the idea was to try to make people "aware" of IWIF.

Beginning in the early 1990's there were significant differences in how IWIF did business and how other carriers did business. For example, IWIF customers had to make a premium "deposit" with the Fund. The deposit amount was subsequently adjusted based on the businesses' reported payrolls. Additionally, IWIF did not use industry standard class codes and had continuous policies (i.e., there was no policy term). Both of these features made it impossible to use agents who were unfamiliar with IWIF's unique practices. Regardless, brokers and agents would have had no incentive to refer employers to IWIF, as they did not earn commissions for the referrals, or for writing or assisting in writing the policy. Most agents and brokers write or place numerous types of insurance coverage for employers and businesses (e.g., liability, auto, etc.). If the agents and brokers could have placed the coverage with other carriers, and earn a commission, they likely would have done so. In addition, IWIF's own service levels at the time were not perceived to be at the same level as private carriers (as many of their employees did not have any commercial insurance background). Finally, IWIF had antiquated systems and processes. To address these concerns, IWIF hired a consulting firm to perform a reengineering project in the mid-1990's.

We also note that in the 1996 Annual Report of IWIF, the Chairman of the Board commented that "to retain our dominant position, we undertook a number of other initiatives which expand our visibility in the marketplace…there are numerous innovative, competitive products on the drawing board for next year…"

By January 1997 the following changes had been accomplished:

- IWIF amended its internal policy to permit the payment of agent and broker commissions;
- Insurance policy terms were changed from "continuous" to annual; and
- IWIF converted to industry recognized National Council on Compensation Insurance (NCCI) rate classifications.

By 1997, the changes were in place. IWIF paid a significant amount of commissions to agents and brokers in 1997 and beyond, and IWIF was a more competitive player in the marketplace.

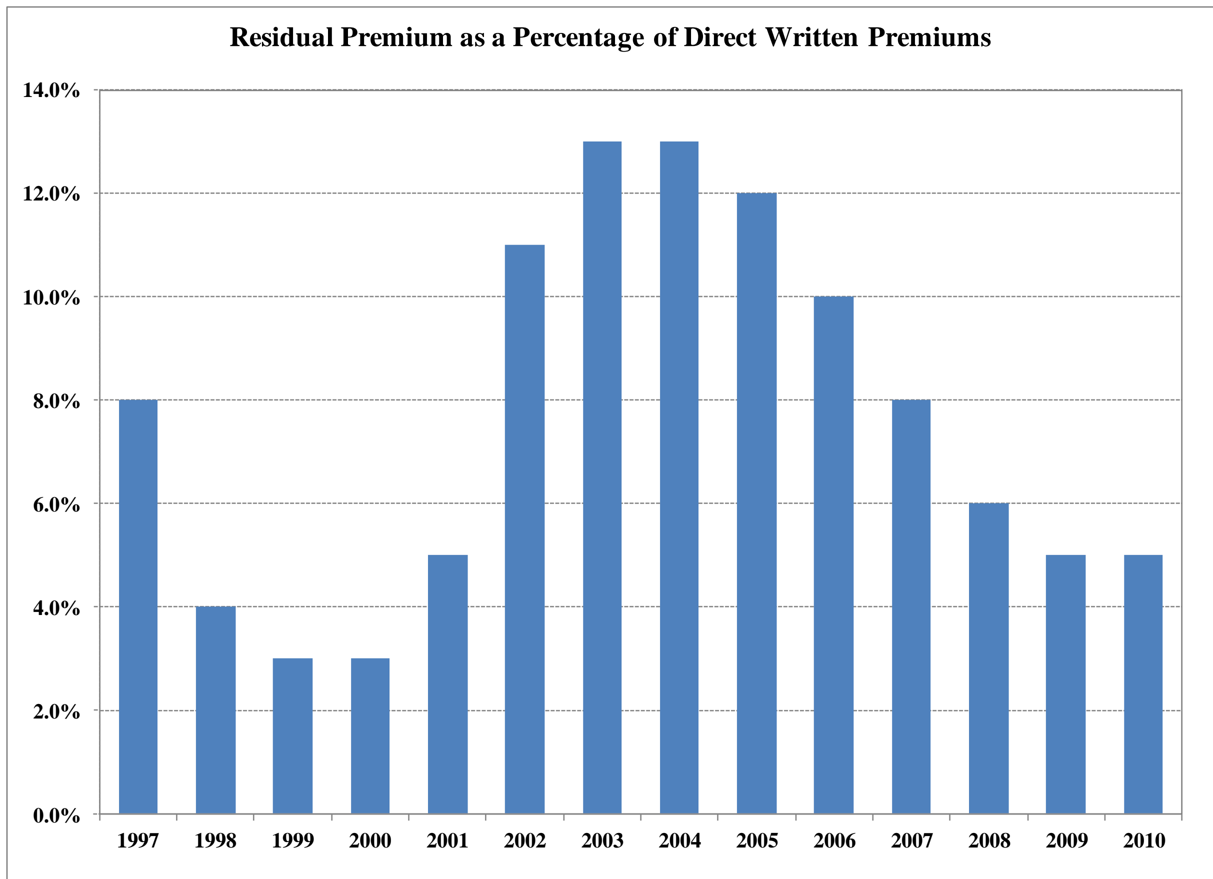
In this regard, in 1997 the national residual workers' compensation market was approximately 8% of the entire workers' compensation market based upon NCCI averages (discussed further below). At that time, IWIF held approximately 17% of the total Maryland workers' compensation market. Between 1997 and 2011, the approximate residual percentage of the national market varied between 3% and 13% and averaged 7%. During that same period, in which IWIF was a participant in the competitive market as well as the residual market, IWIF's workers' compensation market share increased from 17% in 1997 to 23% in 2011.[9]

A precise determination of the exact amount of IWIF's business that is residual versus competitive is not possible. We requested IWIF to provide us with its analysis of residual versus competitive business; however, IWIF was not able to fulfill this request. In this regard, IWIF does not maintain documentation supporting whether its business is from the residual or competitive markets. For example, IWIF's customers do not have to produce declinations from other carriers in order for IWIF to write a policy, as does the Maryland Automobile Insurance Fund ("MAIF"). IWIF's mandate is different as it serves as both an insurer of last resort and a competitive insurer.

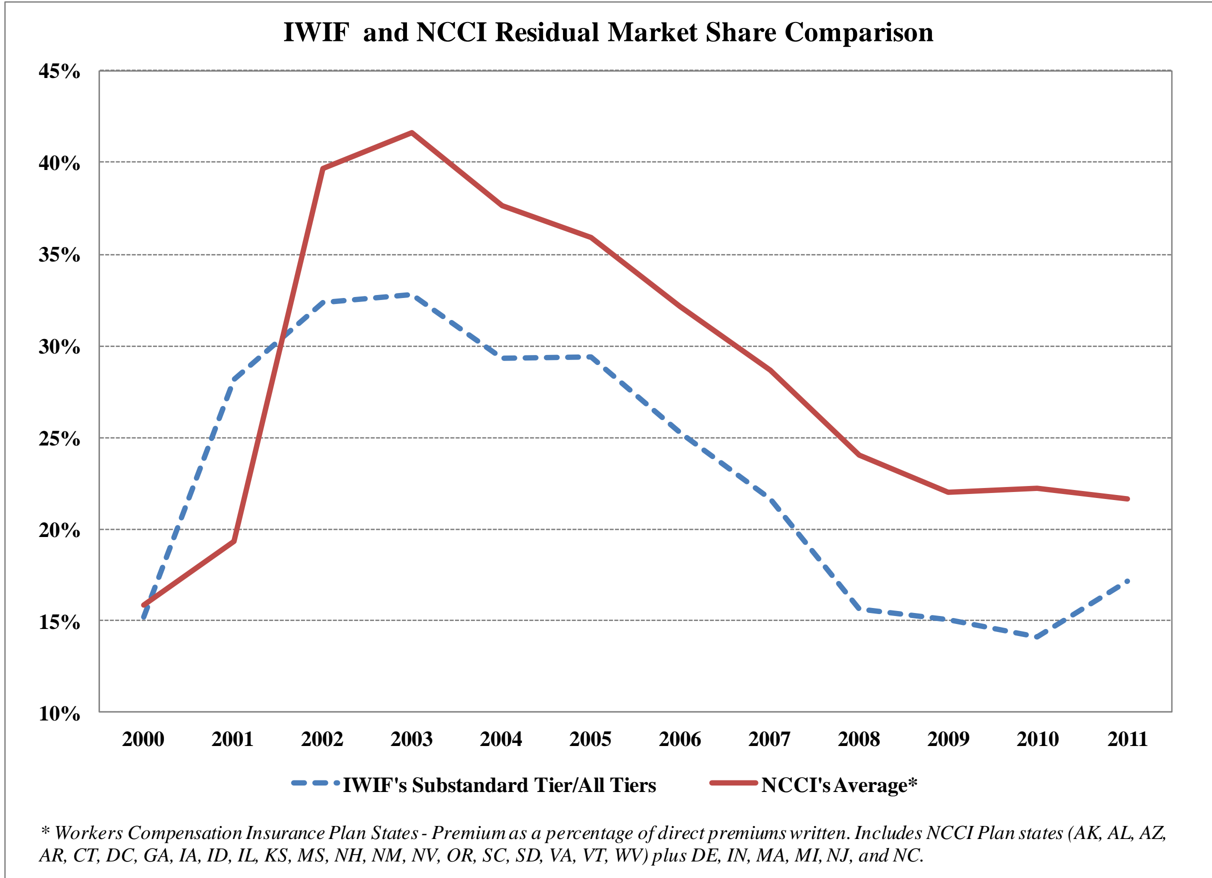
[9] Legislation effective October 1, 2009 statutorily required IWIF to serve as a competitive insurer as well as guaranteeing the availability of workers' compensation insurance in the State. This was a factor to be considered by Senate Bill 745. We concluded that this was a reaffirmation of what IWIF had been doing since 1997. The competitive business post-1997 is valued in our Model, see Section VI.

Therefore IWIF management has stated that requiring declinations would be at odds with its mandate and its business philosophy. IWIF is required to write a policy for any request made. In addition, a policyholder whose loss experience improves, or due to market conditions may have options for workers' compensation insurance other than through IWIF, may choose to stay with IWIF. A number of years ago, IWIF attempted to institute an informal system of requiring declinations on a pilot basis. This proved largely unsuccessful, as its evaluation of the results disclosed that agents, looking to get the best possible insurance quote for their customers, as well as receive the highest commission, were not always candid in their responses.

In the absence of a precise means to determine the residual percentage of IWIF's book of business, we referred to statistics developed by the National Council on Compensation Insurance (NCCI). The NCCI manages the nation's largest database of workers' compensation insurance information. NCCI analyzes industry trends, prepares workers' compensation insurance rate recommendations, determines the cost of proposed legislation, and provides a variety of services and tools to the workers' compensation system. Additionally, the NCCI provides services for residual markets in 29 jurisdictions, including the administration of NCCI's Workers Compensation Insurance Plan (WCIP), and the National Workers Compensation Reinsurance Pool (NWCRP). Based on the data available to the NCCI from the jurisdictions it serves, reports are produced annually illustrating, on a national basis, the percent that the residual market represents to the total workers' compensation premiums written. IWIF represented to us that, in its opinion, the NCCI's averages for residual business as extrapolated to the IWIF book of business would be a reasonable proxy for IWIF's residual business. The averages for residual business, developed from the NCCI statistics for the period 1997 to 2010 are as follows:



IWIF utilizes five pricing tiers - a regular tier, two preferred tiers, and two substandard tiers, which are referred to as base plus and base plus extended tiers. While IWIF has no working definition of its residual business, nor any means to precisely determine the amount of its residual business, it acknowledges that, at a minimum all of the substandard tier business is residual. This is supported by IWIF's commission policy. IWIF pays agents a 3 percent commission on business rated in the substandard tiers, versus an average of 7 percent for business rated in the regular and preferred tiers. In this regard, we compared the portion of IWIF's book of business in the substandard tiers to an estimate of the residual business of IWIF applying the NCCI averages to IWIF. The chart below summarizes this comparison:



The chart above indicates that the residual market estimate of IWIF's book of business, determined by applying the NCCI averages, is slightly higher than the percent that IWIF's substandard tiers represent to their total business. This is to be expected, as the above comparison does not consider that a portion of IWIF's regular tier business is residual as well (and IWIF has no means by which to identify the portion of its regular tier that is residual).

Conclusion: Based upon the factors discussed above, prior to the revisions in the manner in which IWIF operated its business and the creation of an active marketing program, including the implementation of a commission program, we believe that IWIF's book of business (i.e., prior to 1997) should be considered 100% the result of its existence in the residual market. By advertising and by paying commissions, IWIF's goal was to grow its competitive book of business. However, IWIF does not have any means by which to identify what portion of its business is truly residual business versus commercial business. IWIF is required to write a policy for anyone desiring it to do so. In addition, a policyholder whose loss experience improves, or due to market conditions may have options for workers' compensation insurance other than through IWIF, may choose to stay with IWIF. In the absence of a precise method to determine the amount of residual business of IWIF, we have determined that the NCCI averages of residual business are a suitable proxy.

VI. COMPETITIVE BUSINESS FINANCIAL BENEFIT MODEL

As previously discussed in this Report, we reviewed and considered IWIF's history and its evolution from a residual market insurer prior to 1997 to the significant role it plays in the competitive market today. A factor that we considered, as stated in Senate Bill 745, was that because IWIF only began advertising and paying commissions to licensed insurance producers beginning in 1996, IWIF's entire book of business was considered the residual market through 1996. We concluded that IWIF's entire book of business through 1996 should be considered attributable to the residual market. We noted that subsequent to a 1990 law change that completely removed IWIF from the State budget process, and required IWIF to market it services, IWIF's operating philosophy, its systems, its insurance products, and the manner in which it interacted with its policyholders all underwent significant changes. A commission program for agents and brokers was put in place in 1996, and in 1997 IWIF began paying significant amounts of commissions to agents and brokers. As a result of the significant changes that were in place by 1997, enabling it to operate in a manner similar to private carriers, we considered the pre-1997 business to be all residual market business.

Our review of the numerous factors to be considered in this study, as stated in SB 745, disclosed several instances where the State made a direct financial contribution to IWIF (e.g., providing the Fund with start-up money). However, there have also been other forms of support provided to IWIF by the State, some direct and some indirect. From this support, IWIF received a financial benefit. The most significant of these are the tax exemptions provided to IWIF. It is clear that IWIF did not receive a direct financial benefit equivalent to the total amount of the tax exemptions, since this benefit was passed on to IWIF's policyholders in the form of lower rates. Also, the fact that IWIF's risk based capital levels at the time it became fully regulated by the MIA were below regulatory minimums is evidence that profits were not accumulated prior to the transformation that occurred in the early 1990's, culminating in 1997. However, IWIF did receive a financial benefit from the tax exemptions and other forms of State support. The tax exemptions and State support enabled IWIF to compete in the competitive market at an advantage to private carriers when it actively began

doing so in 1997.[10]

To quantify the financial benefit received from the State by IWIF in the competitive market, two broad steps are required. First, we calculated the gross value of IWIF's business attributable to IWIF's participation in the competitive market versus the residual market. Second, we performed an analysis to determine the portion of the estimated value of IWIF's participation in the competitive market that is the result of financial contributions provided by the State or, more generally, IWIF's relationship with the State. See **Exhibit 9** for the financial model we constructed to estimate the value of IWIF's participation in the competitive market.

1. Estimation of the fair value of IWIF's participation in the competitive market

In general, every valuation should consider three valuation approaches: (a) Asset Approach, (b) Income Approach, and (c) Market Approach. They can be briefly described as follows:

- Asset Approach: This approach assumes that an asset's value is indicated by the cost of reproducing or replacing it less an allowance for physical deterioration or obsolescence. It is commonly used for assets that are not sold on an active market, and it can be used to value individual components of a business enterprise.
- Income Approach: Under this approach, future ownership benefits are estimated and discounted to present value using a rate suitable for the risks associated with realizing those benefits.
- Market Approach: This approach assumes that value can be estimated by analyzing recent sales of comparable assets.

We have considered all three approaches. We considered and rejected a Market Approach due to the unique attributes of the business component being valued, its

[10] As previously discussed in this Report, IWIF provides a significant financial benefit to the State of Maryland by acting as the residual market insurer. A mechanism must exist to serve the residual market, and provide a source for a mandated insurance coverage, and IWIF is that mechanism. Otherwise, Maryland employers in the residual market would not have a source for workers' compensation insurance, and may leave the State or simply go out of business. Additionally, if IWIF were to financially fail, the source for workers' compensation insurance for the residual market would disappear, absent other action. As such, to continue to provide this significant financial benefit to the State of Maryland by serving the residual market, and to offset the significantly increased risks associated with this business, it is important that IWIF maintain an adequate level of surplus.

relationship to IWIF and the State, and the level of maturity of the business component being valued. We concluded that reasonable comparables do not exist in the public market.

We concluded that the proper approach to estimate the fair value of the entire competitive business is the Asset Approach. The Asset Approach, based on the value of the assets less the value of its liabilities, is most appropriate when valuing an asset-intensive business. However, we then used an Income Approach valuation methodology to estimate the value of the competitive business' individual assets (investment portfolio) and liabilities (future claims payments). The Income Approach is appropriate for valuing the individual assets and liabilities because the value of each asset and liability can be viewed based upon their individual cash flows (generally the factor used to measure benefits received) and related risk/return factors. As noted above, these are the factors underlying the Income Approach. The value of IWIF's assets derived from its competitive business is the result of actual cash flows and returns realized by IWIF on the competitive business since 1997. Similarly, the liability for IWIF's competitive business, as of the valuation date, is derived from the projected future cash flows required to satisfy that liability, discounted to a present value based upon the estimated level of return that can be realized on the invested assets and the risk whether or not the projected levels of cash flow are reasonable.

As noted above, under the Income Approach an entity's value can be estimated based upon its future ownership benefits, discounted to its present value.[11] This statement is the underlying fundamental principal behind valuations. Value is based upon future benefits. Whatever occurred in the past is only relevant to the extent that it is representative of, or can help predict, what will occur in the future. At any point in time, the entity's assets, including not just its tangible assets, but also its intangible assets such as a workforce, customer base, trade name, and goodwill, only has value to the extent that it can produce future cash flows or benefits.

Therefore, by beginning our Model in 1997, we recognize that IWIF had in place the components required to generate future cash flows, including an established customer base. The value of that customer base, along with all of IWIF's assets, is estimated based the expected future cash flows that will be derived from those tangible and intangible assets.

[11] Guide to BusinessValuations, Volume 1, Jay E. Fishman, 2010.

As the valuation analysis is modeled from 1997 through 2011, the value of IWIF is increased both as a result of (a) the existence of IWIF's 1997 customer base and (b) the addition of new customers as a result of IWIF's competitive advantage provided by the State.

Pertaining to the valuation of IWIF's competitive business, the assets are primarily its investment portfolio built from cash flows over time, in this case, from 1997 to December 31, 2011; its liabilities are the present value of future claims payments related to the same business (the 1997 to present period) that created the investment portfolio. Future claims liabilities are discounted to account for the expectation of returns generated from funds held in the investment portfolio until the claims would be paid. The assets net of the discounted liabilities represent the estimated value of IWIF's competitive business.

Major Assumptions

- The start date for our analysis is January 1, 1997, the year IWIF began operating as a competitive insurer in earnest, e.g., fully began its marketing efforts, including paying commissions.

- IWIF's proportion of competitive business premiums is estimated by first calculating an estimate of IWIF's residual business and then dividing the residual premiums by IWIF's total premiums. Since IWIF is Maryland's only residual market workers' compensation insurer, all residual business is assumed to be written by IWIF. As discussed in the preceding section of this Report entitled "Residual versus Competitive Business," the residual business is estimated based upon Maryland's total workers' compensation premiums and by applying percentages of residual workers' compensation premiums based upon national averages, as compiled by the NCCI.

- Premiums written and expenses (except for commissions) were apportioned based on a calculated percentage of competitive business to residual business. Commissions were apportioned differently, as IWIF commission rates are different for substandard (all of which is considered residual) and regular and preferred tiers of its business.

- Investment earnings are calculated based upon IWIF's average annual rate of return and the investment portfolio balance generated from competitive business each year.

- All cash flows are assumed to occur at the time that the revenue or expense is recognized, except for claim payments. Claim payments related to each year's competitive business are also allocated proportionally, based upon IWIF's actual history of claim payments for each underwriting year.

- Future claim payments, beyond 2011, are estimated based on IWIF's analyses of historical cumulative payment ratios that are used by IWIF to determine loss reserves. The estimated future claim payments are then discounted to a present value assuming a discount rate based upon guidance provided by Statement of Statutory Accounting Principle ("SSAP") No. 65, Exhibit A, which provides guidance to states who prescribe or permit discounting of unpaid losses and unpaid loss adjustment expenses on a non-tabular basis. The guidance states: "the [discount] rate is lesser of (1) If the reporting entity's statutory invested assets are at least equal to total of all policyholder reserves, the reporting entity's net rate of return on statutory invested assets, less 1.5%; otherwise, the reporting entity's average net portfolio yield rate less 1.5% as indicated by dividing the net investment income earned by the average of the reporting entity's current and prior year total assets; or (2) current yield to maturity on a U.S. Treasury debt instrument with maturities consistent with the expected payout of the liabilities" (and for this analysis, the 30 year U.S. Treasury rate as of December 31, 2011 was used). In considering this guidance we noted the following:
    a. IWIF's actual investment rate of return for 2011 of 4.1% less 1.5% (as stated in the guidance above) results in 2.61%.
    b. Current yield to maturity on a U.S. Treasury debt instrument with maturities consistent with the expected payout of the liabilities, which for this case, is the 30-year U.S. Treasury rate was 2.89% as of December 31, 2011.
    c. Based upon the above guidance, the lesser of the rates per a. and b., above, or 2.61%, is selected.

Considering the high level of uncertainty and risk associated with expected rates of return, the predictability of actual claim payments projected thirty years, or more, into the future, the costs associated with claim payments and, considering the guidance promulgated by the NAIC in SSAP 65 on this very issue, we selected 2.61% as the most appropriate discount factor. The discounting was applied using the mid-year convention Present value calculations implicitly assume that all cash receipts or payments occur at the end of the year. However, actual cash flows generally occur throughout the year. Use of the mid-year convention, which assumes all payments at mid-year more closely, approximates payments throughout the year.

- Assets and liabilities, other than the investment portfolio and claims reserves, such as working capital and fixed assets, are considered immaterial for the analysis. Surplus requirements are not considered part of this analysis.

- Since financial information regarding claim payments from January 1, 2012 to June 30, 2012 was not available, we calculated the present value of the competitive business as of June 30, 2012.

Conclusion: Based upon our financial model, included as **Exhibit 9**, we estimated the fair value of IWIF's competitive business from January 1, 1997 to December 31, 2011, valued as of June 30, 2012, to be approximately $74,700,000. However, this amount is adjusted as described in Step 2 below.

2. **Estimation of the portion of the fair value of IWIF's competitive business resulting from benefits that IWIF received from the State**

As discussed above, the State has provided support to IWIF throughout its existence, primarily to better enable IWIF to serve the residual workers' compensation marketplace. When IWIF transitioned to a competitive insurer, this support continued, thus resulting in a financial benefit to IWIF. As a result, IWIF has been able to use these cost advantages, along with other strengths, to significantly grow its share of the competitive workers' compensation market. However, IWIF has been successful in the competitive market for reasons beyond the competitive advantages it received from

the support and tax exemptions provided by the State. For example, IWIF has been continually serving the Maryland Workers' Compensation Insurance market since 1914, and maintains a strong local presence.

On an annual basis, surveys of both broker and policyholder satisfaction are conducted by an independent marketing research firm on IWIF's behalf. Our review of the December 31, 2011 survey indicated that price was the most important consideration in placing business with IWIF, ranging from 46% to 61% of the responses during the period from 2000 to 2011. However, the survey indicated other compelling reasons, for which business is placed with IWIF, including:

- Ease of doing business with – 32%
- Customer service – 27%
- Relationship – 13%
- Knowledge of personnel – 11%
- Stable, reliable reputation – 10% [12]

The broker and policyholder surveys also demonstrated significant preferred factors that IWIF did not possess, including:

- Write other lines of insurance.
- Larger carrier / multi state exposure / capability.

Another significant factor considered was IWIF's competition in the Maryland workers' compensation marketplace. IWIF's competitive market share grew significantly between 1997 (10%) and 2005 (24%), and has since declined marginally to 19% in 2011. During this period, IWIF's competitive market share averaged 17%. During this same period, the market shares of IWIF's next five competitors, on a legal entity basis, varied from 1% to 6%. In 2011, IWIF's next largest competitor, on a legal entity basis, held a 4% market share. Other competitors included very large insurance underwriters with significant capital and expertise in both workers' compensation insurance and in marketing (e.g., Hartford, Liberty, Travelers, AIG,

[12] See **Exhibit 10**, p.18 of IWIF 2011 Broker Satisfaction Report.

Zurich).[13]

Based upon the factors discussed above, it is logical to assume that, given IWIF's strengths (other than simple cost advantages), it had the ability to effectively compete in the market place regardless of State support. However, given the significant strengths of IWIF's competitors in the market place, it is also reasonable to conclude that IWIF's market share would not significantly exceed the next largest competitor's market share. Therefore, we have concluded that without IWIF's cost and other advantages provided by the State, IWIF would have been expected to achieve a market share approximately equal to that of its next-largest competitor.

However, for analysis purposes, we have assumed various levels for (a) IWIF's total competitive market share and (b) the estimated market share that IWIF would have realized absent any competitive advantage received from the State. We have varied IWIF's estimated total competitive market share from its average market share during the 1997 to 2011 period (17%) to its 2011 estimated competitive market share (19%). We then assumed that, at a very minimum, IWIF would have realized a 2% market share (approximately 50% of its largest competitor) with no assistance from the State up to an 8% market share (approximately 200% of its largest competitor.) The resulting adjustment to the fair value of the competitive business calculated in step 1 above, which represents our estimate of the value of the competitive business IWIF earned regardless of State support, is as follows:

[13] If IWIF's competitors are viewed as groups, their market shares are much higher. For example, the Hartford Fire and Casualty Group wrote workers' compensation in Maryland utilizing eight different legal entities for a combined 12.5% market share in 2010. The Liberty Mutual Group utilized 21 separate companies for a combined 9.6% market share. However, we chose to compare IWIF to other legal entities as opposed to groups, as it was not known to what extent the groups write workers' compensation insurance as one business unit or as separate units for each legal entity. See **Exhibit 11.**

Adjustments to Fair Value of Competitive Business

(*In thousands USD, unless otherwise stated*)

		IWIF Competitive Market Share with State Benefit		
		17%	18%	19%
IWIF Competitive Market Share without State Benefit	2%	$ 8,800	$ 8,300	$ 7,900
	3%	13,200	12,500	11,800
	4%	17,600	16,600	15,700
	5%	22,000	20,800	19,700
	6%	26,400	24,900	23,600
	7%	30,800	29,100	27,500
	8%	35,200	33,200	31,500

Considering the range of potential adjustments above, we selected $17,600,000 as the most reasonable yet conservative estimate, as it corresponds to IWIF's average market share during the 1997 to 2011 period (17%), and the market share of its nearest competitor (4%). Therefore, we adjusted the $74,700,000 fair value of the competitive business calculated in step 1 by this amount. The result, totaling approximately $57,100,000 (i.e., $74,700,000 - $17,600,000) represents financial benefit that IWIF realized from the tax exemption and other forms of State support.

Conclusion: IWIF would have held a significant share of Maryland competitive workers' compensation insurance market even without the tax exemptions and other forms of support provided to it by the State. Numerous factors support this. IWIF has continuously served the Maryland workers' compensation market since 1914. Independent surveys indicate a number of reasons policyholders choose IWIF, other than price. While it is not possible to precisely pinpoint what percent of market share IWIF would have held absent State support, it is likely that its market share of the competitive market would have been within a range of two to eight percent. Within this range, we conclude that four percent is the most reasonable estimate. After this adjustment, the fair value of the financial benefit IWIF received from tax exemption and State support related to its competitive book of business totaled approximately $57,100,000.

VII. CONCLUSION

As a result of our study, we conclude that the fair value of the net benefits received by IWIF valued as of June 30, 2012 is as follows:

Summary of Fair Value of Net Benefits Received by IWIF

	Report Reference	Financial Benefits and Contributions	
		IWIF Received from State	State Received from IWIF
Start-up Funding	Sec. V. 1 (p.15)	900,000	-
Unreimbursed Operating Expenses	Sec. V. 1 (p.15)	1,100,000	-
Benefit from State on Competitive Business	Sec. VI. 1 (p.40)	57,100,000	-
Incremental Investment Income Earned for State	Sec. V. 9 (p.31)	-	10,800,000
Benefit from $6 MM Transfer	Sec. V. 5 (p.25)	-	3,800,000
Total		**$59,100,000**	**$14,600,000**
Fair Value of Net Benefits Received by IWIF		**$44,500,000**	

18 SECTION 7. AND BE IT FURTHER ENACTED, That:

19 (a) The Maryland Insurance Administration shall contract with an
20 independent financial, accounting, or valuation consulting firm to conduct a study to
21 determine, since the enactment of Chapter 800 of 1914, the fair value of:

22 (1) any financial contribution made by the State to the Injured
23 Workers' Insurance Fund; and

24 (2) any financial benefit the Fund received from the State.

25 (b) (1) The study shall consider the fair value of:

26 (i) funds, including start–up funding, provided by the State to
27 the Fund at any time;

28 (ii) real estate or other assets transferred or otherwise provided
29 to the Fund, net of any amounts paid for the real estate or other asset by the Fund out
30 of Fund revenues;

31 (iii) property taxes or transfer taxes on Fund–owned real
32 property that would have been paid if the Fund had not been a State agency;

33 (iv) sales and excise taxes that would have been paid to the
34 State if the Fund had not been a State agency;

1 (v) premium taxes not paid to the State by the Fund due to its
2 tax exempt status prior to June 1, 2011~~, but only to the extent that the benefit of the~~
3 ~~tax exemption was not passed on to policyholders of the Fund through the rate making~~
4 ~~process~~; and

5 (vi) any other direct financial contribution made by the State to
6 the Fund and any other financial benefit the Fund received from the State.

7 *(2) In determining the fair value of the items listed in paragraph (1) of*
8 *this subsection, the study shall consider:*

9 *(i) additional costs the Fund incurred from the Fund's status as*
10 *the insurer of last resort which required the Fund to provide workers' compensation*
11 *insurance to businesses regardless of the degree of risk;*

12 *(ii) that the Fund is a nonprofit entity with profits passed on to*
13 *its policyholders;*

14 *(iii) whether the benefit of the taxes not paid was passed on to*
15 *policyholders since the Fund was not subject to the taxes;*

16 *(iv) that since the Fund only began advertising and paying*
17 *commissions to licensed insurance producers beginning in 1996, the Fund's entire book*
18 *of business was considered the residual market through 1995;*

19 *(v) that effective October 1, 2009, the Fund was statutorily*
20 *required to serve as a competitive insurer in the marketplace, in addition to*
21 *guaranteeing the availability of workers' compensation insurance in the State, serving*
22 *as the workers' compensation insurer of last resort, and engaging only in the business of*
23 *workers' compensation insurance in accordance with State law; and*

(vi) that effective October 1, 2003, the Fund was required to be subject to risk–based capital standards.

~~(2)~~ *(3)* The study also shall consider:

~~(i) additional costs the Fund incurred from the Fund's status as the insurer of last resort which required the Fund to provide workers' compensation insurance to businesses regardless of the degree of risk;~~

~~(ii) that while the Fund was part of the former State Department of Personnel, the State purchased four parcels of land with Fund revenues but the State held the title to the land until it was transferred to the Fund;~~

(i) any subsidy that the Fund provided to the State in connection with the State self–insured workers' compensation program; and

~~(iii)~~ *(ii)* that the Fund is required to transfer $6,000,000 to the General Fund on or before June 30, 2012, as provided in Section 20 of Chapter 397 of the Acts of the General Assembly of 2011, less the amount received by the State on or before June 30, 2012, as a result of the imposition of a premium tax on the Fund under § 6–101 of the Insurance Article~~;~~

~~(iv) that the Fund is a nonprofit entity with profits passed on to its policyholders; and~~

~~(v) the estimated cost of any subsidy provided by the State to cover the future costs of retiree health benefits for retired Fund employees and their dependents.~~

(c) In conducting the study, the firm:

(1) shall consult with the Fund, the Maryland Insurance Commissioner, and the Secretary of Budget and Management;

(2) may consult with any other person or entity that the firm considers appropriate; and

(3) shall consider any studies conducted by the Administration or the Department of Budget and Management on the Fund, including the study on the Fund's role as the third party administrator for the State.

(d) (1) The Administration shall require the firm to report the findings and conclusions of its study of the fair value to the Administration before October 1, 2012.

(2) On or before October 1, 2012, the Administration shall report, in accordance with § 2–1246 of the State Government Article, the firm's findings and conclusions of its study of the fair value to the Legislative Policy Committee, the Fund, the Governor, the Senate Budget and Taxation Committee, the Senate Finance Committee, the House Appropriations Committee, and the House Economic Matters Committee.

(e) If the study concludes that the fair value is $60,000,000 or more:

(1) the Administration shall contract with consultants to conduct a comprehensive assessment of the long–term effect of transferring the fair value to the State on the adequacy of the Fund's surplus;

32 (2) the Chesapeake Employers' Insurance Company shall owe a debt
33 to the General Fund in an amount equal to:

34 (i) the fair value; less

1 (ii) 1. the $50,000,000 which is required to be transferred
2 from the Fund to the General Fund under Chapter (S.B. 152/H.B. 87) of the Acts of
3 the General Assembly of 2012; and

4 2. the cost of the study and the assessment paid by the
5 Fund, as provided under subsection (g) of this section.

6 (f) (1) Subject to paragraph (2) of this subsection, the Company shall pay
7 the debt calculated under subsection (e) of this section, without interest, to the State
8 in 10 equal annual installments beginning in fiscal year 2014 or, as agreed by the
9 Fund and the Secretary of Budget and Management, in payments over an alternative
10 period of time.

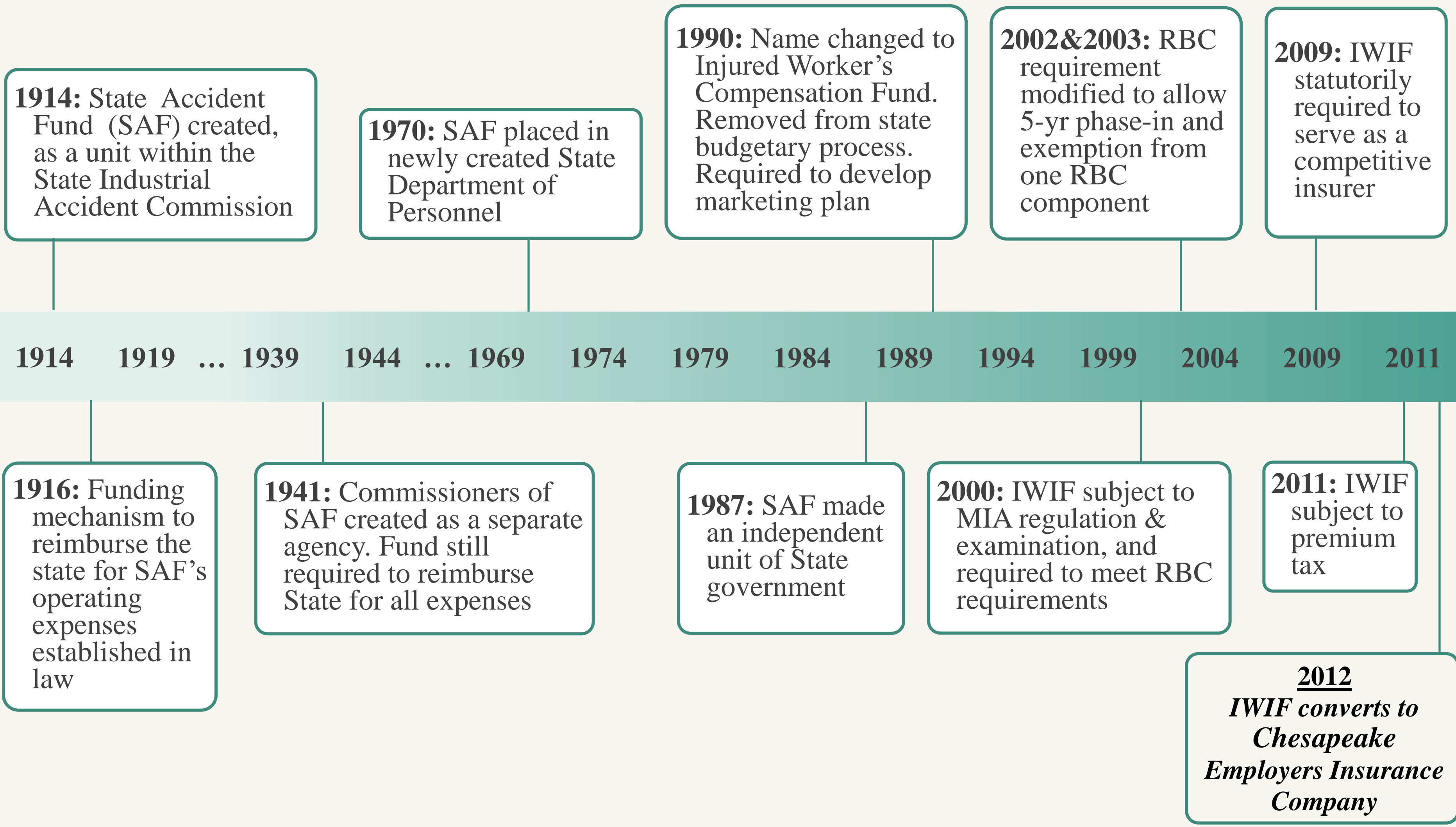
11 (2) (i) *1.* An installment or other payment shall be suspended
12 or delayed, and may not be paid, in any year in which the *Company's risk–based*
13 *capital ratio is less than 700% of its authorized control level.*

14 *2.* *If the Company's risk–based capital ratio is 700% or*
15 *higher than its authorized control level, an installment or other payment shall be*
16 *suspended or delayed, and may not be paid, in any year in which the* Maryland
17 Insurance Commissioner determines that the Company's surplus is not adequate to
18 make a payment or that the Company's ability to meet its financial obligations would
19 be impaired if a payment is made.

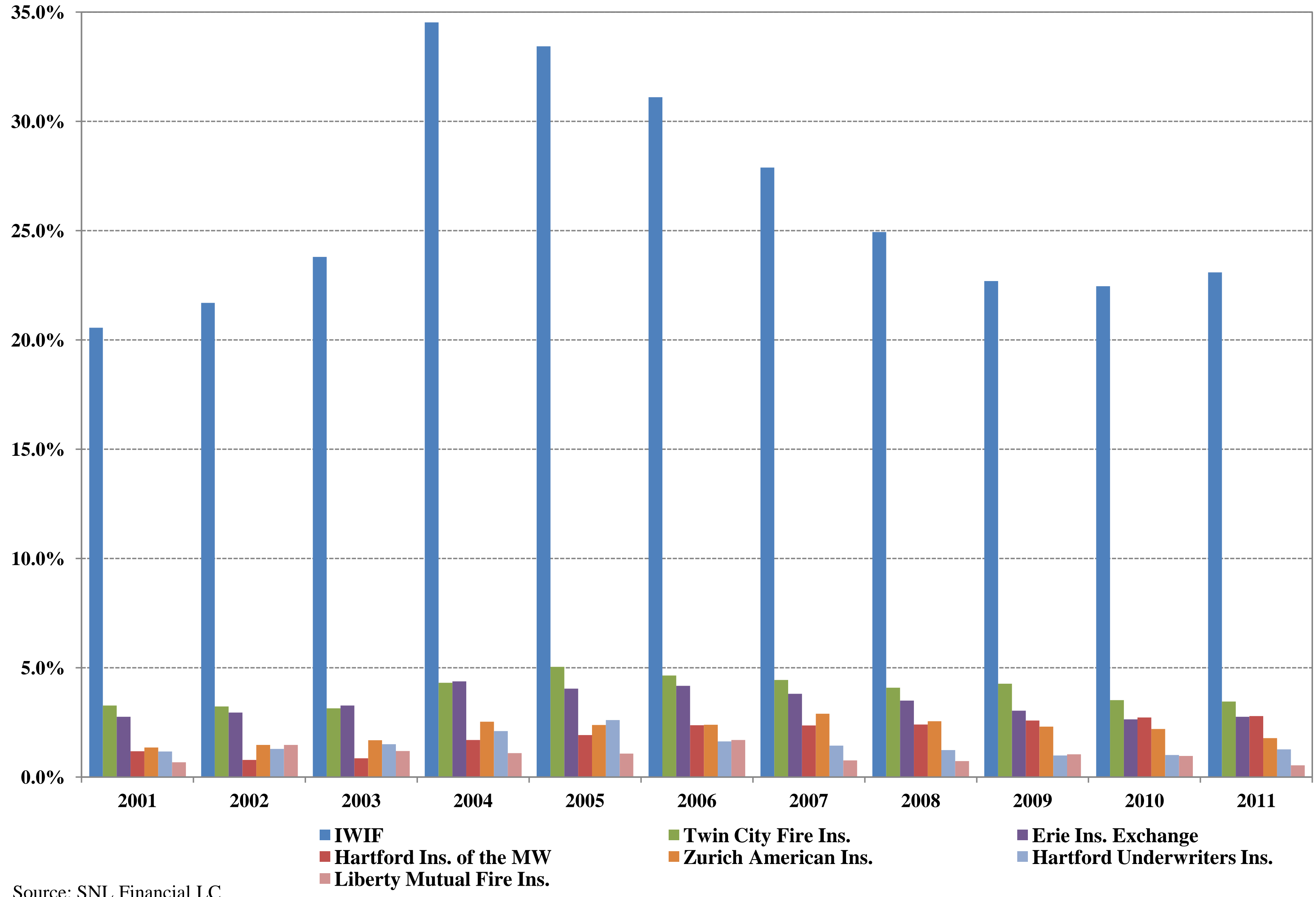
20 (ii) The Company shall pay any suspended or delayed
21 installment or other payment in a subsequent year until the debt is fully satisfied.

22 (g) The Fund shall be responsible for the payment of the costs of the study
23 required under subsection (a) of this section and the assessment required under
24 subsection (e) of this section, including any costs incurred by the Administration in
25 contracting with consultants to perform the study and the assessment.

Exhibit 2



Prepared by Invotex Group



Source: SNL Financial LC

Annual Rates of Return

	3 Month T-Bill Rate	General Fund Average Interest Rate	Calculated IWIF Annual Inv't Return
1915-1919*			
1920	5.42%		
1921	4.83%		
1922	3.47%		
1923	3.93%		
1924	2.77%		
1925	3.03%		
1926	3.23%		
1927	3.10%		
1928	3.97%		
1929	4.42%		
1930	2.23%		
1931	1.40%		
1932	0.88%		
1933	0.52%		
1934	0.28%		
1935	0.17%		
1936	0.17%		
1937	0.28%		
1938	0.07%		
1939	0.05%		
1940	0.04%		
1941	0.13%		
1942	0.34%		
1943	0.38%		
1944	0.38%		
1945	0.38%		
1946	0.38%		
1947	0.60%		
1948	1.05%		
1949	1.12%		
1950	1.20%		
1951	1.52%		
1952	1.72%		
1953	1.89%		
1954	0.94%		
1955	1.73%		
1956	2.63%		
1957	3.23%		
1958	1.77%		
1959	3.39%		
1960	2.88%		
1961	2.35%		
1962	2.77%		
1963	3.16%		
1964	3.55%		
1965	3.95%		

	3 Month T-Bill Rate	General Fund Average Interest Rate	Calculated IWIF Annual Inv't Return
1966	4.86%		
1967	4.31%		
1968	5.34%		
1969	6.67%		
1970	6.39%		
1971	4.33%		
1972	4.07%		
1973	7.03%		
1974	7.83%		
1975	5.78%	7.70%	
1976	4.97%	5.38%	
1977	5.27%	4.94%	
1978	6.12%	6.49%	
1979	8.66%	9.25%	
1980	11.12%	12.15%	
1981	13.02%	14.48%	
1982	13.01%	14.47%	
1983	8.43%	9.05%	
1984	9.23%	9.78%	
1985	8.70%	9.06%	
1986	6.83%	7.54%	
1987	5.52%	6.38%	10.34%
1988	5.96%	6.91%	7.57%
1989	7.92%	9.55%	7.52%
1990	7.79%	8.58%	9.00%
1991	6.51%	7.25%	9.34%
1992	4.37%	4.75%	10.55%
1993	3.02%	3.30%	9.34%
1994	3.32%	3.47%	7.27%
1995	5.27%	5.34%	8.46%
1996	5.29%	5.58%	9.80%
1997	5.17%	5.37%	10.78%
1998	5.16%	5.54%	7.21%
1999	4.60%	5.18%	7.50%
2000	5.38%	5.61%	7.24%
2001	5.27%	5.93%	5.68%
2002	2.18%	2.92%	0.82%
2003	1.32%	1.94%	7.00%
2004	0.98%	1.28%	7.13%
2005	2.26%	2.26%	5.00%
2006	4.17%	4.06%	5.48%
2007	4.74%	5.16%	5.81%
2008	1.89%	4.89%	4.00%
2009	0.56%	3.39%	4.42%
2010	0.12%	2.07%	4.03%
2011	0.11%	2.00%	4.11%
H1 2012	0.09%	1.10%	2.02%

** 1915-1919 rates estimated based on 1920 3 Month T-Bill rate*

Injured Workers' Insurance Fund
Fair Value of Initial Funding

(In USD, unless otherwise stated)	**1915 FYE 9/30**		**1916 FYE 9/30**		**3 months 10/1/16-12/31/16**		**1917 CYE 12/31**		**1918 FYE 9/30**	
Start-up funding	$15,000	[a]	$0		$0		$0		$0	
Fair Value of start-up funding as of 6/30/2012 (rounded)									**$900,000**	**[h]**
Operating Expenses:										
SIAC total expenditures	$60,611	[b]	$51,413	[c]	$14,319	[d]	$63,135	[e]	$69,205	[f]
SAF percent of total	*17.0%*	[g]	*17.0%*	[g]	*17.0%*	[g]	*16.5%*		*17.3%*	
SAF expenses	$10,304		$8,740		$2,434	[d]	$10,412	[e]	$12,001	[f]
Fair Value of unreimbursed operating expenses ($21,478) as of 6/30/2012 (rounded)									**$1,100,000**	**[h]**
Fair Value of total fundings received as of 6/30/2012 (rounded)									**$2,000,000**	

Sources/Notes:

[a] First SIAC Annual Report, p. 10.
[b] First SIAC Annual Report, p. 68.
[c] Second SIAC Annual Report, p.13.
[d] Estimated, based on month average expenses for FYE 09/30/1916 and CY 1917.
[e] Fourth SIAC Annual Report, p.14.
[f] Fourth SIAC Annual Report, p.8.
[g] Estimated SAF share of total expenses, based upon CY 1917 and FYE 09/30/1918.
[h] Fair value calculated using the following rates:
1915-1919: Assumed 1920 3 Month T-Bill rate.
1920-1974: 3 Month T-Bill rates.
1975-1986: MD State Treasurer provided General Fund Average interest rates.
1987-H1 2012: IWIF investment rate of return.

Exhibit 6

Tax Rates

Year	MD Premium Tax	MD Sales Tax	MD Excise Tax
1928	0%	0%	0%
1929	1%	0%	0%
1930	1%	0%	0%
1931	1%	0%	0%
1932	1%	0%	0%
1933	1%	0%	1%
1934	1%	0%	1%
1935	1%	0%	1%
1936	1%	0%	1%
1937	1%	0%	1%
1938	1%	0%	1%
1939	2%	0%	1%
1940	2%	0%	1%
1941	2%	0%	1%
1942	2%	0%	1%
1943	2%	0%	1%
1944	2%	0%	1%
1945	2%	0%	1%
1946	2%	0%	1%
1947	2%	2%	1%
1948	2%	2%	1%
1949	2%	2%	1%
1950	2%	2%	1%
1951	2%	2%	1%
1952	2%	2%	1%
1953	2%	2%	1%
1954	2%	2%	1%
1955	2%	2%	1%
1956	2%	2%	1%
1957	2%	2%	1%
1958	2%	2%	1%
1959	2%	3%	1%
1960	2%	3%	1%
1961	2%	3%	1%
1962	2%	3%	1%
1963	2%	3%	1%
1964	2%	3%	1%
1965	2%	3%	1%
1966	2%	3%	1%
1967	2%	3%	1%
1968	2%	4%	1%
1969	2%	4%	1%

Year	MD Premium Tax	MD Sales Tax	MD Excise Tax
1970	2%	4%	1%
1971	2%	4%	1%
1972	2%	4%	1%
1973	2%	4%	1%
1974	2%	4%	1%
1975	2%	4%	1%
1976	2%	4%	1%
1977	2%	5%	5%
1978	2%	5%	5%
1979	2%	5%	5%
1980	2%	5%	5%
1981	2%	5%	5%
1982	2%	5%	5%
1983	2%	5%	5%
1984	2%	5%	5%
1985	2%	5%	5%
1986	2%	5%	5%
1987	2%	5%	5%
1988	2%	5%	5%
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1990	2%	5%	5%
1991	2%	5%	5%
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1994	2%	5%	5%
1995	2%	5%	5%
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1997	2%	5%	5%
1998	2%	5%	5%
1999	2%	5%	5%
2000	2%	5%	5%
2001	2%	5%	5%
2002	2%	5%	5%
2003	2%	5%	5%
2004	2%	5%	5%
2005	2%	5%	5%
2006	2%	5%	5%
2007	2%	6%	5%
2008	2%	6%	6%
2009	2%	6%	6%
2010	2%	6%	6%
2011	2%	6%	6%

Injured Worker's Insurance Fund
Fair Value of Exempt Taxes

(In USD, unless otherwise stated)

			Year	[c]	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
			Rate of return	[a]	*7.2%*	*5.7%*	*0.8%*	*7.0%*	*7.1%*	*5.0%*	*5.5%*	*5.8%*	*4.0%*	*4.4%*	*4.0%*	*4.1%*
Year	**Available premium data**	**Premium tax rate**	**Estimated premium tax**													
1914-1927		0.0%	**-**		-	-	-	-	-	-	-	-	-	-	-	-
1928	420,144	1.0%	**4,201**		107,826	113,954	114,884	122,930	131,698	138,287	145,866	154,345	160,520	167,608	174,364	181,534
1940	741,254	2.0%	**14,825**		342,978	362,471	365,429	391,023	418,910	439,868	463,977	490,947	510,588	533,136	554,626	577,431
1950	859,259	2.0%	**17,185**		374,666	395,960	399,191	427,149	457,613	480,508	506,844	536,306	557,762	582,392	605,868	630,780
1960	3,286,040	2.0%	**65,721**		1,156,330	1,222,049	1,232,021	1,318,308	1,412,329	1,482,989	1,564,268	1,655,198	1,721,417	1,797,434	1,869,888	1,946,772
1970	5,366,731	2.0%	**107,335**		1,236,536	1,306,813	1,317,477	1,409,748	1,510,291	1,585,852	1,672,769	1,770,006	1,840,818	1,922,107	1,999,587	2,081,804
1980	42,306,084	2.0%	**846,122**		5,005,820	5,290,320	5,333,490	5,707,030	6,114,051	6,419,942	6,771,807	7,165,448	7,452,111	7,781,192	8,094,850	8,427,688
1990	169,194,095	2.0%	**3,383,882**		7,821,922	8,266,472	8,333,928	8,917,609	9,553,606	10,031,581	10,581,393	11,196,483	11,644,413	12,158,623	12,648,734	13,168,816
2000	95,929,443	2.0%	**1,918,589**		1,918,589	2,027,630	2,044,176	2,187,343	2,343,343	2,460,582	2,595,442	2,746,313	2,856,183	2,982,311	3,102,527	3,230,094
2001	132,892,995	2.0%	**2,657,860**			2,657,860	2,679,548	2,867,215	3,071,703	3,225,383	3,402,160	3,599,925	3,743,945	3,909,275	4,066,857	4,234,075
2002	181,721,722	2.0%	**3,634,434**				3,634,434	3,888,979	4,166,337	4,374,783	4,614,556	4,882,798	5,078,141	5,302,388	5,516,126	5,742,934
2003	236,846,212	2.0%	**4,736,924**					4,736,924	5,074,758	5,328,652	5,620,705	5,947,434	6,185,369	6,458,511	6,718,852	6,995,113
2004	299,899,807	2.0%	**5,997,996**						5,997,996	6,298,081	6,643,267	7,029,436	7,310,658	7,633,492	7,941,196	8,267,716
2005	320,410,472	2.0%	**6,408,209**							6,408,209	6,759,431	7,152,353	7,438,492	7,766,971	8,080,056	8,412,286
2006	308,149,232	2.0%	**6,162,985**								6,162,985	6,521,235	6,782,126	7,081,621	7,367,079	7,669,993
2007	262,704,835	2.0%	**5,254,097**									5,254,097	5,464,294	5,705,594	5,935,585	6,179,640
2008	216,458,519	2.0%	**4,329,170**										4,329,170	4,520,344	4,702,558	4,895,914
2009	159,514,526	2.0%	**3,190,291**											3,190,291	3,318,890	3,455,354
2010	159,253,061	2.0%	**3,185,061**												3,185,061	3,316,022
2011	171,166,936	2.0%	**1,247,087**	[b]												1,247,087
Total					**131,107,717**	**141,216,947**	**146,003,729**	**160,966,289**	**178,444,269**	**193,780,199**	**210,563,900**	**228,057,948**	**241,510,891**	**255,366,150**	**268,844,959**	**281,146,209**
Total (Rounded)					**131,100,000**	**141,200,000**	**146,000,000**	**161,000,000**	**178,400,000**	**193,800,000**	**210,600,000**	**228,100,000**	**241,500,000**	**255,400,000**	**268,800,000**	**281,100,000**

Notes/Source(s):

[a] 1928-1974: 3 Month T-Bill rates.
1975-1986: MD State Treasurer provided General Fund Average interest rates.
1987-H1 2012: IWIF investment rate of return.

[b] Estimated premium tax $3,423,339 (=$171MM x 2%) less 2011 premium taxes paid $2,176,252.

[c] For presentation purposes, the period from 1928 to 2000 are not shown above.

Injured Worker's Insurance Fund
Fair Value of Exempt Taxes

(In USD, unless otherwise stated.)

			Year	[b]	1947	1950	1960	1970	1980	1990	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
			Rate of return	[a]	*0.6%*	*1.2%*	*2.9%*	*6.4%*	*12.2%*	*9.0%*	*7.2%*	*5.7%*	*0.8%*	*7.0%*	*7.1%*	*5.0%*	*5.5%*	*5.8%*	*4.0%*	*4.4%*	*4.0%*	*4.1%*
Year	**Available sales data**	**Sales tax rate**	**Estimated Sales tax**																			
1914-1946		0.0%	**-**		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
1947	3,141	2.0%	**63**		63	65	81	123	239	613	1,416	1,497	1,509	1,615	1,730	1,816	1,916	2,027	2,109	2,202	2,290	2,385
1950	3,270	2.0%	**65**			65	81	124	241	617	1,426	1,507	1,519	1,626	1,742	1,829	1,929	2,041	2,123	2,216	2,306	2,401
1960	14,943	3.0%	**448**				448	685	1,333	3,412	7,887	8,336	8,404	8,992	9,633	10,115	10,670	11,290	11,742	12,260	12,754	13,279
1970	26,615	4.0%	**1,065**					1,065	2,073	5,306	12,265	12,962	13,067	13,983	14,980	15,729	16,591	17,556	18,258	19,064	19,833	20,648
1980	10,572	5.0%	**529**						529	1,353	3,127	3,305	3,332	3,565	3,820	4,011	4,231	4,476	4,656	4,861	5,057	5,265
1990	205,744	5.0%	**10,287**							10,287	23,779	25,131	25,336	27,110	29,044	30,497	32,168	34,038	35,400	36,963	38,453	40,034
2000	400,711	5.0%	**20,036**								20,036	21,174	21,347	22,842	24,471	25,696	27,104	28,679	29,827	31,144	32,399	33,731
2001	423,152	5.0%	**21,158**									21,158	21,330	22,824	24,452	25,675	27,083	28,657	29,803	31,119	32,374	33,705
2002	445,593	5.0%	**22,280**										22,280	23,840	25,540	26,818	28,288	29,932	31,130	32,504	33,815	35,205
2003	468,034	5.0%	**23,402**											23,402	25,071	26,325	27,768	29,382	30,557	31,907	33,193	34,558
2004	865,289	5.0%	**43,264**												43,264	45,429	47,919	50,704	52,733	55,062	57,281	59,636
2005	1,089,814	5.0%	**54,491**													54,491	57,477	60,818	63,251	66,045	68,707	71,532
2006	1,091,422	5.0%	**54,571**														54,571	57,743	60,053	62,705	65,233	67,915
2007	1,231,579	6.0%	**73,895**															73,895	76,851	80,245	83,479	86,912
2008	1,205,494	6.0%	**72,330**																72,330	75,524	78,568	81,799
2009	1,208,243	6.0%	**72,495**																	72,495	75,417	78,518
2010	1,178,145	6.0%	**70,689**																		70,689	73,595
2011	1,188,825	6.0%	**71,330**																			71,330
Total					**63**	**247**	**2,721**	**12,923**	**45,207**	**201,198**	**749,838**	**813,611**	**842,530**	**924,940**	**1,034,170**	**1,140,402**	**1,257,476**	**1,404,467**	**1,532,984**	**1,673,174**	**1,811,308**	**1,957,114**
Total (Rounded)					**60**	**200**	**3,000**	**10,000**	**50,000**	**200,000**	**700,000**	**800,000**	**800,000**	**900,000**	**1,000,000**	**1,100,000**	**1,300,000**	**1,400,000**	**1,500,000**	**1,700,000**	**1,800,000**	**2,000,000**

Notes/Source(s):

[a] 1947-1974: 3 Month T-Bill rates.
1975-1986: MD State Treasurer provided General Fund Average interest rates.
1987-2011: IWIF investment rate of return.

[b] Data omitted for presentation purposes.

Injured Workers' Insurance Fund
Incremental Investment Income Earned for State

(In USD, unless otherwise noted)		**1990** 30-Jun	**1991** 30-Jun	**1992** 30-Jun	**1993** 31-Dec	**1994** 31-Dec	**1995** 31-Dec	**1996** 31-Dec	**1997** 31-Dec	**1998** 31-Dec	**1999** 31-Dec	**2000** 31-Dec
Income:												
Net investment income allocated to the State of Maryland	[a]	2,121,746	2,922,968	1,380,792	794,945	456,716	1,019,545	2,853,297	4,097,035	4,258,000	6,516,905	8,232,072
Asset balance invested for State		23,577,324	31,310,151	13,085,617	8,512,376	6,280,833	12,049,898	29,130,096	38,017,020	59,083,866	86,873,873	113,652,443
IWIF Investment Rate of Return	[b]	*9.00%*	*9.34%*	*10.55%*	*9.34%*	*7.27%*	*8.46%*	*9.80%*	*10.78%*	*7.21%*	*7.50%*	*7.24%*
Investment Income per GF Avg. Interest Rate		2,022,934	2,269,986	621,567	280,908	335,396	643,465	1,625,459	2,041,514	3,273,246	4,500,067	6,375,902
MD General Fund Average Interest Rate	[c]	*8.58%*	*7.25%*	*4.75%*	*3.30%*	*5.34%*	*5.34%*	*5.58%*	*5.37%*	*5.54%*	*5.18%*	*5.61%*
Incremental investment income	[d]	**98,812**	**652,982**	**759,225**	**672,876**	**121,320**	**376,080**	**1,227,838**	**2,055,521**	**984,754**	**2,016,838**	**1,856,170**

Total Incremental investment income	**$ 10,822,415**
Total Incremental investment income (rounded)	**$ 10,800,000**

Sources/Notes:

[a] IWIF Financial Statements - Schedule of Claims Adminsitration Activity for State of Maryland
[b] IWIF investment rate of return, calculated as net investment income over average cash and invested assets
[c] MD State Treasurer provided General Fund Average interest rates
[d] Incremental investment income in 1993 reflects adjustment of $158,839 for change from fiscal year to calendar year.
For the period 7/1/1993-12/31/1993, adjustment calculated by taking 50% of 1993 and 1994 average incremental investment income.

Competitive Business Valuation Model
Valuation Summary

As of June 30, 2012
(*In thousands USD, unless otherwise stated. Rounded*)

Investment Portfolio Value			
Investment portfolio balance as of 12/31/11		$ 651,200	[a]
Less: Remaining Liability from 1997 forward underwriting			
Total present value IWIF remaining liability as of 12/31/11		826,700	[b]
Average competitive percent	x	69.9%	[c]
Estimated Remaining Competitive Business Liability		578,000	
Net Fair Value of Benefit from Competitve Business as of 12/31/11		$ 73,200	
Adjustments for 06/30/12 valuation		$ 1,500	[d]
Net Fair Value of Benefit from Competitve Business as of 06/30/12		**$ 74,700**	

Sources/Notes:

[a] See Exhibit 9-5.
[b] See Exhibit 9-7b.
[c] See Exhibit 9-6.
[d] Calculated by multiplying Net Fair Value of Benefit from Competitive Business as of 12/31/11 by average net investment returns as of 06/30/12 (Exhibit 9-8).

Competitive Business Valuation Model
Calculated Statement of Income (Accrual)

(In thousands USD, unless otherwise stated)			1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
UNDERWRITING INCOME																	
	Premiums	[a]	$ 62,507	$ 60,620	$ 64,378	$ 80,730	$ 107,207	$ 109,588	$ 138,271	$ 187,000	$ 205,399	$ 209,082	$ 187,334	$ 164,367	$ 124,369	$ 123,801	$ 134,098
Less	Losses incurred and loss adjustment expense incurr	[b]	(57,214)	(75,987)	(83,103)	(96,854)	(101,900)	(111,933)	(124,639)	(145,649)	(169,316)	(177,104)	(170,454)	(155,988)	(151,396)	(138,264)	(144,699)
Less	Commissions	[e]	(798)	(2,876)	(2,998)	(6,134)	(9,527)	(12,162)	(15,273)	(19,343)	(21,484)	(22,446)	(19,708)	(17,562)	(13,831)	(13,469)	(15,023)
Less	Provisions for bad debt	[a]	(597)	(2,631)	(2,297)	(1,106)	(1,319)	(1,388)	(1,709)	(2,182)	(2,596)	(3,135)	(4,227)	(4,156)	(1,425)	(1,146)	(886)
Less	Premium deficiency reserve	[a]	N/A	N/A	N/A	N/A	(1,000)	(760)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0	621
Less	Other underwriting expenses incurred	[a]	(5,708)	(5,535)	(5,878)	(7,371)	(8,852)	(8,074)	(8,441)	(9,451)	(10,848)	(13,919)	(14,952)	(16,943)	(15,190)	(14,639)	(18,313)
	Total underwriting deductions		(64,316)	(87,029)	(94,276)	(111,465)	(122,598)	(134,317)	(150,063)	(176,624)	(204,245)	(216,604)	(209,341)	(194,649)	(181,842)	(167,518)	(178,301)
	Net underwriting gain (loss)		(1,809)	(26,409)	(29,898)	(30,735)	(15,391)	(24,729)	(11,792)	10,376	1,154	(7,522)	(22,006)	(30,282)	(57,473)	(43,716)	(44,203)
INVESTMENT INCOME																	
Add	Net investment income (loss)	[c]	2,726	4,498	6,743	8,346	8,410	1,552	16,553	22,541	20,795	27,616	33,419	25,018	28,114	25,728	26,285
OTHER INCOME																	
Add	Total other income	[a]	232	82	17	216	461	345	252	437	568	487	437	457	678	585	481
	Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes		1,149	(21,829)	(23,138)	(22,173)	(6,520)	(22,833)	5,013	33,354	22,517	20,580	11,850	(4,808)	(28,682)	(17,403)	(17,437)
DIVIDENDS																	
Less	Dividends to policyholders	[a]	(6,142)	0	(112)	(1,064)	(896)	(831)	(1,045)	(1,923)	(3,175)	(3,831)	(3,796)	(1,941)	(1,588)	(676)	216
NET INCOME		[d]	**$ (4,993)**	**$ (21,829)**	**$ (23,249)**	**$ (23,237)**	**$ (7,416)**	**$ (23,663)**	**$ 3,968**	**$ 31,431**	**$ 19,342**	**$ 16,750**	**$ 8,054**	**$ (6,748)**	**$ (30,270)**	**$ (18,079)**	**$ (17,221)**

Sources/Notes:

[a] Line item (Exhibit 9-8) multiplied by % non-residual business (Exhibit 9-6).
[b] Schedule P, Part 2 Incurred Losses (Exhibit 9-7a) multiplied by % non-residual business (Exhibit 9-6).
[c] Net of investment expenses. See Exhibit 9-5.
[d] IWIF does not incur any income tax.
[e] Reflects adjustment for 3% commission rate for BP +20% and BPE +50% tier policies.

Competitive Business Valuation Model
Calculated Balance Sheet (Accrual)

(In thousands USD, unless otherwise stated)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
ASSETS															
Investment assets [a]	$ 47,171	$ 83,198	$ 104,673	$ 133,052	$ 170,424	$ 210,564	$ 277,645	$ 375,096	$ 473,797	$ 557,709	$ 621,738	$ 652,039	$ 647,780	$ 653,797	$ 651,233
Total Assets	47,171	83,198	104,673	133,052	170,424	210,564	277,645	375,096	473,797	557,709	621,738	652,039	647,780	653,797	651,233
LIABILITIES															
Losses [c]	52,164	110,020	154,744	206,361	250,148	313,192	376,305	442,325	521,683	588,846	644,820	681,870	707,881	731,976	747,255
Premium deficiency reserve [b]	N/A	N/A	N/A	N/A	1,000	1,760	1,760	1,760	1,760	1,760	1,760	1,760	1,760	1,760	1,139
Total Liabilities	52,164	110,020	154,744	206,361	251,149	314,952	378,065	444,085	523,443	590,606	646,580	683,630	709,641	733,736	748,394
SURPLUS															
Beginning surplus, December 31 prior year	0	(4,993)	(26,822)	(50,071)	(73,309)	(80,725)	(104,388)	(100,420)	(68,989)	(49,647)	(32,897)	(24,843)	(31,591)	(61,861)	(79,940)
Net Income [b]	(4,993)	(21,829)	(23,249)	(23,237)	(7,416)	(23,663)	3,968	31,431	19,342	16,750	8,054	(6,748)	(30,270)	(18,079)	(17,221)
Total Surplus, December 31 current year	(4,993)	(26,822)	(50,071)	(73,309)	(80,725)	(104,388)	(100,420)	(68,989)	(49,647)	(32,897)	(24,843)	(31,591)	(61,861)	(79,940)	(97,161)
TOTAL LIABILITIES AND SURPLUS	**$ 47,171**	**$ 83,198**	**$ 104,673**	**$ 133,052**	**$ 170,424**	**$ 210,564**	**$ 277,645**	**$ 375,096**	**$ 473,797**	**$ 557,709**	**$ 621,738**	**$ 652,039**	**$ 647,780**	**$ 653,797**	**$ 651,233**

Sources/Notes:

[a] See Exhibit 9-5.
[b] See Exhibit 9-2.
[c] Calculated by summing total losses incurred from prior years less cumulative losses paid.

Competitive Business Valuation Model
Calculated Statement of Income (Cash)

(In thousands USD, unless otherwise stated)		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
UNDERWRITING CASH INCOME																
Premiums	[a]	$ 62,507	$ 60,620	$ 64,378	$ 80,730	$ 107,207	$ 109,588	$ 138,271	$ 187,000	$ 205,399	$ 209,082	$ 187,334	$ 164,367	$ 124,369	$ 123,801	$ 134,098
Less Loss and loss adjustment expense paid	[b]	(5,050)	(18,130)	(38,378)	(45,237)	(58,112)	(48,890)	(61,526)	(79,629)	(89,958)	(109,941)	(114,480)	(118,938)	(125,385)	(114,168)	(129,420)
Less Commissions	[a]	(798)	(2,876)	(2,998)	(6,134)	(9,527)	(12,162)	(15,273)	(19,343)	(21,484)	(22,446)	(19,708)	(17,562)	(13,831)	(13,469)	(15,023)
Less Provisions for bad debt	[a]	(597)	(2,631)	(2,297)	(1,106)	(1,319)	(1,388)	(1,709)	(2,182)	(2,596)	(3,135)	(4,227)	(4,156)	(1,425)	(1,146)	(886)
Less Other underwriting expenses incurred	[a]	(5,708)	(5,535)	(5,878)	(7,371)	(8,852)	(8,074)	(8,441)	(9,451)	(10,848)	(13,919)	(14,952)	(16,943)	(15,190)	(14,639)	(18,313)
Total underwriting deductions		(12,152)	(29,172)	(49,551)	(59,849)	(77,810)	(70,514)	(86,950)	(110,604)	(124,886)	(149,441)	(153,367)	(157,600)	(155,831)	(143,422)	(163,643)
Net underwriting gain (loss)		50,355	31,447	14,827	20,882	29,397	39,074	51,321	76,396	80,513	59,641	33,968	6,768	(31,463)	(19,621)	(29,545)
INVESTMENT INCOME																
Add Net investment income (loss)	[c]	2,726	4,498	6,743	8,346	8,410	1,552	16,553	22,541	20,795	27,616	33,419	25,018	28,114	25,728	26,285
OTHER INCOME																
Add Total other income	[a]	232	82	17	216	461	345	252	437	568	487	437	457	678	585	481
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes		53,313	36,027	21,587	29,443	38,268	40,971	68,126	99,374	101,875	87,743	67,824	32,242	(2,671)	6,693	(2,779)
DIVIDENDS																
Less Dividends to policyholders	[a]	(6,142)	0	(112)	(1,064)	(896)	(831)	(1,045)	(1,923)	(3,175)	(3,831)	(3,796)	(1,941)	(1,588)	(676)	216
NET INCOME	[d]	**$ 47,171**	**$ 36,027**	**$ 21,475**	**$ 28,379**	**$ 37,372**	**$ 40,140**	**$ 67,081**	**$ 97,451**	**$ 98,701**	**$ 83,913**	**$ 64,028**	**$ 30,301**	**$ (4,259)**	**$ 6,017**	**$ (2,564)**

Sources/Notes:

[a] See Exhibit 9-2.
[b] Schedule P, Annual Paid Losses (Exhibit 9-7a) multiplied by % non-residual business (Exhibit 9-6).
[c] See Exhibit 9-5.
[d] IWIF does not incur any income tax.

Competitive Business Valuation Model
Net Investment Income

	(In thousands USD, unless otherwise stated)		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Portfolio Balance																	
	Beginning Investment Portfolio Balance	[a]	$ -	$ 47,171	$ 83,198	$104,673	$133,052	$170,424	$210,564	$277,645	$375,096	$473,797	$557,709	$621,738	$652,039	$647,780	$653,797
Add	Net underwriting income	[b]	50,355	31,447	14,827	20,882	29,397	39,074	51,321	76,396	80,513	59,641	33,968	6,768	(31,463)	(19,621)	(29,545)
Add	Other income	[b]	232	82	17	216	461	345	252	437	568	487	437	457	678	585	481
Less	Dividends to policyholders	[b]	(6,142)	0	(112)	(1,064)	(896)	(831)	(1,045)	(1,923)	(3,175)	(3,831)	(3,796)	(1,941)	(1,588)	(676)	216
Add	Net investment income		2,726	4,498	6,743	8,346	8,410	1,552	16,553	22,541	20,795	27,616	33,419	25,018	28,114	25,728	26,285
	Ending Portfolio Balance		47,171	83,198	104,673	133,052	170,424	210,564	277,645	375,096	473,797	557,709	621,738	652,039	647,780	653,797	651,233
Portfolio Return %																	
	% Returns on average investment portfolio balance	[c]	10.8%	7.1%	7.4%	7.2%	5.7%	0.8%	7.0%	7.1%	5.0%	5.5%	5.8%	4.0%	4.4%	4.0%	4.1%
	% Returns on current balance	[d]	5.4%	3.6%	3.7%	3.6%	2.8%	0.4%	3.5%	3.6%	2.5%	2.7%	2.9%	2.0%	2.2%	2.0%	2.1%
Portfolio Returns																	
	Returns on Beginning Portfolio Balance		0	3,371	6,191	7,582	7,562	1,391	14,747	19,801	18,766	25,968	32,419	24,873	28,794	26,112	26,882
Add	Returns on current balance	[e]	2,726	1,127	552	764	848	161	1,806	2,740	2,028	1,648	1,000	145	(680)	(384)	(598)
	Net investment income		**$ 2,726**	**$ 4,498**	**$ 6,743**	**$ 8,346**	**$ 8,410**	**$ 1,552**	**$ 16,553**	**$ 22,541**	**$ 20,795**	**$ 27,616**	**$ 33,419**	**$ 25,018**	**$ 28,114**	**$ 25,728**	**$ 26,285**

Sources/Notes:

[a] 1997 Beginning balance is assumed to be $0 at inception of this competitive business.
[b] See Exhibit 9-4.
[c] See Exhibit 9-8.
[d] Returns on current balance is assumed to be 50% of Returns on average investment portfolio balance.
[e] Current balance from net underwriting income and other income; returns on current balance from net income additions

Competitive Business Valuation Model
Residual Market Business

(In thousands USD, unless otherwise stated)		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
																[f]
IWIF Premium	[a]	$ 101,769	$ 77,889	$ 77,209	$ 95,929	$ 132,893	$ 181,722	$ 236,846	$ 299,900	$ 320,410	$ 308,149	$ 262,705	$ 216,459	$ 159,515	$ 159,253	$ 171,167
Total MD Workers' Compensation Premiums	[b]	490,769	431,720	427,688	506,632	513,722	655,761	758,269	868,461	958,430	990,672	942,129	868,187	702,920	709,038	741,381
Residual Market %	[c]	8.0%	4.0%	3.0%	3.0%	5.0%	11.0%	13.0%	13.0%	12.0%	10.0%	8.0%	6.0%	5.0%	5.0%	5.0%
Residual Market Premiums	[d]	39,261	17,269	12,831	15,199	25,686	72,134	98,575	112,900	115,012	99,067	75,370	52,091	35,146	35,452	37,069
Residual % of IWIF	[e]	**38.6%**	**22.2%**	**16.6%**	**15.8%**	**19.3%**	**39.7%**	**41.6%**	**37.6%**	**35.9%**	**32.1%**	**28.7%**	**24.1%**	**22.0%**	**22.3%**	**21.7%**

Average residual portion of IWIF business is 30.1% and competitive portion of IWIF business is 69.9%.

Sources/Notes:

[a] See Exhibit 9-8.

[b] SNL Financial LC, search criteria LOB: Workers' Compensation, State: MD, Line item: Direct Premium Written.

[c] Workers Compensation Insurance Plan States - Premium as a percentage of direct premiums written. Includes NCCI Plan states (AK, AL, AZ, AR, CT, DC, GA, IA, ID, IL, KS, MS, NH, NM, NV, OR, SC, SD, VA, VT, WV) plus DE, IN, MA, MI, NJ, and NC. As presented in p. 48 of NCCI Holding Inc. presentation "State of the Line" dated May 5, 2011.

[d] Calculated by mutliplying Residual Market % to Total Workers' Compensation Direct Premiums Written.

[e] Calculated by dividing Residual Market Premiums by IWIF Premiums.

[f] Residual Market % for 2011 assumed to remain constant compared to 2010 Residual Market %.

Competitive Business Valuation Model
Loss and Cost Experience [a]

(*In thousands USD, unless otherwise stated*)

SCHEDULE P - PART 2 - SUMMARY INCURRED NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES

Year Which Losses Were Incurred	Reported At Year End															Most Recent Estimate as of 12/31/11 [b]
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007** [b]	**2008** [b]	**2009** [b]	**2010** [b]	**2011** [b]	
Prior	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	
1997	119,883	108,727	104,343	98,248	95,242	94,583	93,575	91,752	92,737	93,150	93,150	93,150	93,150	93,150	93,150	93,150
1998	XXX	106,003	101,915	97,195	96,831	95,816	94,017	93,017	94,534	94,968	97,633	97,633	97,633	97,633	97,633	97,633
1999	XXX	XXX	98,190	99,007	102,441	100,337	100,159	98,124	99,624	99,919	100,333	99,665	99,665	99,665	99,665	99,665
2000	XXX	XXX	XXX	100,412	123,534	118,436	117,254	115,321	116,562	113,990	117,221	115,088	115,088	115,088	115,088	115,088
2001	XXX	XXX	XXX	XXX	145,971	148,314	148,529	145,930	142,813	139,704	131,803	127,933	128,577	126,314	126,314	126,314
2002	XXX	XXX	XXX	XXX	XXX	184,530	183,249	182,052	183,046	179,491	181,569	179,950	186,282	186,405	185,611	185,611
2003	XXX	XXX	XXX	XXX	XXX	XXX	224,378	223,019	221,289	216,081	212,760	209,917	214,016	214,327	213,496	213,496
2004	XXX	XXX	XXX	XXX	XXX	XXX	XXX	252,395	247,154	245,505	239,760	236,935	236,965	235,164	233,583	233,583
2005	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	284,018	278,610	274,047	270,008	266,744	266,707	264,124	264,124
2006	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	292,661	283,925	277,906	271,149	265,343	261,019	261,019
2007	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	266,545	259,339	252,192	243,039	239,033	239,033
2008	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	228,057	222,898	210,112	205,424	205,424
2009	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	190,385	194,824	194,180	194,180
2010	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	178,007	177,857	177,857
2011	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	184,699	184,699
Totals	119,883	214,730	304,448	394,862	564,019	742,016	961,161	1,201,610	1,481,777	1,754,079	1,998,746	2,195,581	2,374,744	2,525,778	2,690,876	2,690,876

SCHEDULE P - PART 3 - SUMMARY CUMULATIVE PAID INCURRED NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES

Year Which Losses Were Incurred	Reported At Year End															Estimated Balance to be Paid as of 12/31/11
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007** [c]	**2008** [c]	**2009** [c]	**2010** [c]	**2011** [c]	
Prior	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	
1997	8,222	20,050	36,938	47,132	52,665	57,311	61,159	64,065	66,336	68,052	69,481	70,940	72,282	73,515	74,775	18,375
1998	XXX	11,467	23,738	40,363	48,468	54,232	58,866	62,399	66,057	69,093	71,630	73,134	74,670	76,082	77,381	20,252
1999	XXX	XXX	16,868	30,154	43,185	51,221	57,358	62,203	65,169	68,000	71,127	72,964	74,496	76,061	77,499	22,166
2000	XXX	XXX	XXX	13,649	36,827	51,207	61,303	70,605	75,352	78,797	81,282	83,746	86,117	87,925	89,772	25,316
2001	XXX	XXX	XXX	XXX	22,188	43,901	59,032	70,270	76,626	81,866	86,698	89,105	92,640	94,645	96,633	29,681
2002	XXX	XXX	XXX	XXX	XXX	26,532	60,515	85,955	100,408	113,020	120,421	125,535	131,537	135,157	138,294	47,317
2003	XXX	XXX	XXX	XXX	XXX	XXX	31,560	71,124	97,213	114,645	127,133	135,462	143,340	148,440	153,913	59,583
2004	XXX	XXX	XXX	XXX	XXX	XXX	XXX	30,876	73,739	102,136	119,907	133,571	144,865	152,225	158,607	74,976
2005	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	36,926	85,972	117,870	138,230	153,219	165,090	173,466	90,658
2006	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	38,278	82,749	113,876	133,577	143,498	154,910	106,109
2007	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	32,100	72,718	101,339	119,243	134,175	104,858
2008	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	27,749	61,557	83,405	101,562	103,862
2009	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	28,210	65,158	91,472	102,708
2010	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	24,266	58,526	119,331
2011	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	28,923	155,776
Totals	8,222	31,517	77,544	131,298	203,333	284,404	389,793	517,497	657,826	819,859	980,398	1,137,030	1,297,849	1,444,711	1,609,907	1,080,969

Competitive Business Valuation Model
Loss and Cost Experience [a]

(*In thousands USD, unless otherwise stated*)

CALCULATED ANNUAL PAID NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES

Year Which Losses Were Incurred	At Year End															Estimated Balance Paid as of 21/31/2011
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	
Prior	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	
1997	8,222	11,828	16,888	10,194	5,533	4,646	3,848	2,906	2,271	1,716	1,429	1,459	1,342	1,233	1,260	74,775
1998	XXX	11,467	12,271	16,625	8,105	5,764	4,634	3,533	3,658	3,036	2,537	1,504	1,536	1,412	1,298	77,381
1999	XXX	XXX	16,868	13,286	13,031	8,036	6,137	4,845	2,966	2,831	3,127	1,837	1,532	1,564	1,439	77,499
2000	XXX	XXX	XXX	13,649	23,178	14,380	10,096	9,302	4,747	3,445	2,485	2,464	2,371	1,808	1,846	89,772
2001	XXX	XXX	XXX	XXX	22,188	21,713	15,131	11,238	6,356	5,240	4,832	2,407	3,535	2,005	1,988	96,633
2002	XXX	XXX	XXX	XXX	XXX	26,532	33,983	25,440	14,453	12,612	7,401	5,114	6,002	3,620	3,137	138,294
2003	XXX	XXX	XXX	XXX	XXX	XXX	31,560	39,564	26,089	17,432	12,488	8,329	7,878	5,100	5,473	153,913
2004	XXX	XXX	XXX	XXX	XXX	XXX	XXX	30,876	42,863	28,397	17,771	13,664	11,294	7,360	6,382	158,607
2005	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	36,926	49,046	31,898	20,360	14,989	11,871	8,376	173,466
2006	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	38,278	44,471	31,127	19,701	9,921	11,412	154,910
2007	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	32,100	40,618	28,621	17,904	14,932	134,175
2008	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	27,749	33,808	21,848	18,157	101,562
2009	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	28,210	36,948	26,314	91,472
2010	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	24,266	34,260	58,526
2011	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	28,923	28,923
Totals	8,222	23,295	46,027	53,754	72,035	81,071	105,389	127,704	140,329	162,033	160,539	156,632	160,819	146,862	165,196	1,609,907

CALCULATED CUMULATIVE PERCENTAGE PAID TO INCURRED NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES (%)

Year Which Losses Were Incurred	At Year End														
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Prior	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
1997	8.8%	21.5%	39.7%	50.6%	56.5%	61.5%	65.7%	68.8%	71.2%	73.1%	74.6%	76.2%	77.6%	78.9%	80.3%
1998	N/A	11.7%	24.3%	41.3%	49.6%	55.5%	60.3%	63.9%	67.7%	70.8%	73.4%	74.9%	76.5%	77.9%	79.3%
1999	N/A	N/A	16.9%	30.3%	43.3%	51.4%	57.6%	62.4%	65.4%	68.2%	71.4%	73.2%	74.7%	76.3%	77.8%
2000	N/A	N/A	N/A	11.9%	32.0%	44.5%	53.3%	61.3%	65.5%	68.5%	70.6%	72.8%	74.8%	76.4%	78.0%
2001	N/A	N/A	N/A	N/A	17.6%	34.8%	46.7%	55.6%	60.7%	64.8%	68.6%	70.5%	73.3%	74.9%	76.5%
2002	N/A	N/A	N/A	N/A	N/A	14.3%	32.6%	46.3%	54.1%	60.9%	64.9%	67.6%	70.9%	72.8%	74.5%
2003	N/A	N/A	N/A	N/A	N/A	N/A	14.8%	33.3%	45.5%	53.7%	59.5%	63.4%	67.1%	69.5%	72.1%
2004	N/A	N/A	N/A	N/A	N/A	N/A	N/A	13.2%	31.6%	43.7%	51.3%	57.2%	62.0%	65.2%	67.9%
2005	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	14.0%	32.5%	44.6%	52.3%	58.0%	62.5%	65.7%
2006	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	14.7%	31.7%	43.6%	51.2%	55.0%	59.3%
2007	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	13.4%	30.4%	42.4%	49.9%	56.1%
2008	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	13.5%	30.0%	40.6%	49.4%
2009	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	14.5%	33.6%	47.1%
2010	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	13.6%	32.9%
2011	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	15.7%
Totals [d]	0.3%	1.2%	2.9%	4.9%	7.6%	10.6%	14.5%	19.2%	24.4%	30.5%	36.4%	42.3%	48.2%	53.7%	59.8%

Sources/Notes:

[a] Schedule P, 2006 - 2011 IWIF Statutory Financial Statements, unless otherwise noted.

[b] Incurred net losses for the following years were assumed to equal to the latest estimate available (equal to Base Year):

Year Which Losses Were Incurred	Incurred Losses Reported At YE	Base Year
1997	2007 - 2011	2006
1998	2008 - 2011	2007
1999	2009 - 2011	2008
2000	2010 - 2011	2009
2001	2011	2010

[c] Cumulative paid losses for the dates listed are calculated by multiplying the prior year available payout by the IWIF payout ratio (Exhibit 9-7b).

[d] Cumulative Paid at YE as a percent of Total of Incurred Net Losses and Defense and Cost Containment Expenses as of 12/31/11.

Competitive Business Valuation Model
Future Loss Estimates

(In thousands USD, unless otherwise stated)

Discount Factor Percentage [a]	**Total Present Value of Future Liabilities as of 12/31/11** [b]
2.61%	$ **826,731**

IWIF PAID LOSS & ALAE EXPERIENCE - Part I [c]

Payout ratio = [payout at year n] / [payout at year n-1]	Years after initial payment														
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**
	2.2006	1.3722	1.1846	1.1088	1.0754	1.0503	1.0341	1.0320	1.0235	1.0210	1.0210	1.0189	1.0171	1.0171	1.0149

IWIF PAID LOSS & ALAE EXPERIENCE - Part II [c]

Payout ratio = [payout at year n] / [payout at year n-1]	Years after initial payment														
	16	**17**	**18**	**19**	**20**	**21**	**22**	**23**	**24**	**25**	**26**	**27**	**28**	**29**	**30**
	1.0140	1.0130	1.0130	1.0120	1.0113	1.0110	1.0110	1.0110	1.0100	1.0090	1.0090	1.0090	1.0080	1.0080	1.0080

IWIF PAID LOSS & ALAE EXPERIENCE - Part III [c]

Payout ratio = [payout at year n] / [payout at year n-1]	Years after initial payment														
	31	**32**	**33**	**34**	**35**	**36**	**37**	**38**	**39**	**40**	**41**	**42**	**43** [f]	**44**	**45**
	1.0070	1.0070	1.0060	1.0050	1.0040	1.0040	1.0040	1.0030	1.0020	1.0020	1.0010	1.0170	N/A	N/A	N/A

PROJECTED CUMULATIVE PAID NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES - Part I [d]

Year Which Losses Were Incurred	At Year End														
	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
Prior	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
1997	75,889	76,951	77,951	78,965	79,912	80,813	81,702	82,600	83,509	84,344	85,103	85,869	86,642	87,335	88,034
1998	78,706	79,879	80,997	82,050	83,117	84,114	85,062	85,997	86,943	87,900	88,779	89,578	90,384	91,197	91,927
1999	78,822	80,172	81,366	82,505	83,578	84,664	85,680	86,646	87,599	88,562	89,537	90,432	91,246	92,067	92,896
2000	91,470	93,031	94,625	96,034	97,378	98,644	99,927	101,126	102,265	103,390	104,527	105,677	106,734	107,695	108,664
2001	98,662	100,528	102,243	103,995	105,544	107,022	108,413	109,822	111,140	112,392	113,629	114,879	116,142	117,304	118,359
2002	141,198	144,163	146,890	149,396	151,956	154,219	156,378	158,411	160,471	162,396	164,226	166,033	167,859	169,705	171,402
2003	157,535	160,843	164,220	167,327	170,182	173,098	175,676	178,135	180,451	182,797	184,990	187,074	189,132	191,213	193,316
2004	163,690	167,542	171,060	174,652	177,956	180,992	184,093	186,835	189,451	191,914	194,409	196,741	198,958	201,147	203,359
2005	179,389	185,138	189,494	193,473	197,536	201,272	204,707	208,214	211,315	214,274	217,059	219,881	222,519	225,027	227,502
2006	162,705	168,260	173,653	177,739	181,471	185,282	188,787	192,008	195,298	198,206	200,981	203,594	206,241	208,716	211,067
2007	144,294	151,555	156,729	161,752	165,558	169,035	172,584	175,849	178,849	181,914	184,623	187,208	189,641	192,107	194,412
2008	112,607	121,099	127,193	131,536	135,751	138,945	141,863	144,842	147,582	150,100	152,672	154,946	157,115	159,157	161,227
2009	108,358	120,143	129,203	135,705	140,338	144,835	148,243	151,356	154,535	157,458	160,145	162,888	165,314	167,629	169,808
2010	80,312	95,138	105,485	113,440	119,148	123,216	127,165	130,157	132,890	135,681	138,247	140,606	143,015	145,145	147,177
2011	63,647	87,340	103,463	114,715	123,366	129,574	133,998	138,293	141,547	144,519	147,554	150,345	152,910	155,530	157,846
Totals	1,737,283	1,831,780	1,904,573	1,963,283	2,012,791	2,055,726	2,094,278	2,130,292	2,163,844	2,195,847	2,226,480	2,255,750	2,283,853	2,310,973	2,336,996

Competitive Business Valuation Model
Future Loss Estimates

(In thousands USD, unless otherwise stated)

PROJECTED CUMULATIVE PAID NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES - Part II [d]

Year Which Losses Were Incurred	At Year End														
	2027	**2028**	**2029**	**2030**	**2031**	**2032**	**2033**	**2034**	**2035**	**2036**	**2037**	**2038**	**2039**	**2040**	**2041**
Prior	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
1997	88,738	89,359	89,985	90,525	90,977	91,341	91,706	92,073	92,350	92,534	92,719	92,812	93,150	N/A	N/A
1998	92,662	93,404	94,057	94,716	95,284	95,761	96,144	96,528	96,914	97,205	97,399	97,594	97,633	N/A	N/A
1999	93,639	94,388	95,143	95,809	96,480	97,059	97,544	97,934	98,326	98,719	99,015	99,213	99,412	99,511	99,665
2000	109,642	110,519	111,403	112,294	113,080	113,872	114,555	115,088	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2001	119,425	120,499	121,463	122,435	123,415	124,278	125,148	125,899	126,314	N/A	N/A	N/A	N/A	N/A	N/A
2002	172,945	174,502	176,072	177,481	178,900	180,332	181,594	182,865	183,962	184,882	185,611	N/A	N/A	N/A	N/A
2003	195,249	197,006	198,780	200,569	202,173	203,791	205,421	206,859	208,307	209,557	210,604	211,447	212,293	213,142	213,496
2004	205,596	207,652	209,521	211,407	213,309	215,016	216,736	218,470	219,999	221,539	222,868	223,983	224,879	225,778	226,681
2005	230,004	232,534	234,860	236,974	239,106	241,258	243,188	245,134	247,095	248,825	250,566	252,070	253,330	254,343	255,361
2006	213,389	215,736	218,109	220,290	222,273	224,273	226,292	228,102	229,927	231,766	233,389	235,023	236,433	237,615	238,565
2007	196,602	198,765	200,951	203,162	205,193	207,040	208,904	210,784	212,470	214,170	215,883	217,394	218,916	220,229	221,331
2008	163,161	165,000	166,815	168,650	170,505	172,210	173,760	175,323	176,901	178,317	179,743	181,181	182,449	183,726	184,829
2009	172,016	174,080	176,041	177,977	179,935	181,915	183,734	185,387	187,056	188,739	190,249	191,771	193,305	194,180	N/A
2010	149,091	151,029	152,841	154,563	156,263	157,982	159,720	161,317	162,769	164,234	165,712	167,038	168,374	169,721	170,909
2011	160,056	162,137	164,245	166,216	168,088	169,937	171,807	173,697	175,434	177,013	178,606	180,213	181,655	183,108	184,573
Totals	2,362,215	2,386,610	2,410,286	2,433,066	2,454,983	2,476,064	2,496,252	2,515,461	2,417,824	2,307,499	2,322,366	2,149,739	2,161,828	1,981,354	1,795,410

PROJECTED CUMULATIVE PAID NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES - Part III [d]

Year Which Losses Were Incurred	At Year End														
	2042	**2043**	**2044**	**2045**	**2046**	**2047**	**2048**	**2049**	**2050**	**2051**	**2052**	**2053**	**2054**	**2055**	**2056**
Prior	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
1997	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1998	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1999	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2001	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2002	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2003	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2004	227,361	227,816	228,272	228,500	232,384	233,583	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2005	256,382	257,151	257,666	258,181	258,439	262,833	264,124	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2006	239,520	240,478	241,199	241,681	242,165	242,407	246,528	261,019	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2007	222,216	223,105	223,997	224,669	225,119	225,569	225,794	229,633	239,033	N/A	N/A	N/A	N/A	N/A	N/A
2008	185,753	186,496	187,242	187,991	188,555	188,932	189,310	189,499	192,721	205,424	N/A	N/A	N/A	N/A	N/A
2009	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2010	172,106	173,138	174,004	174,700	175,399	176,100	176,629	176,982	177,336	177,513	177,857	N/A	N/A	N/A	N/A
2011	184,699	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Totals	1,488,036	1,308,184	1,312,379	1,315,722	1,322,061	1,329,424	1,102,385	857,133	609,089	382,937	177,857	0	0	0	0

Competitive Business Valuation Model
Future Loss Estimates

(In thousands USD, unless otherwise stated)

PROJECTED ANNUAL PAID NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES - Part I

Year Which Losses Were Incurred	At Year End														
	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
Prior	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
1997	1,114	1,062	1,000	1,013	948	900	889	899	909	835	759	766	773	693	699
1998	1,326	1,172	1,118	1,053	1,067	997	948	936	946	956	879	799	806	813	730
1999	1,322	1,351	1,194	1,139	1,073	1,087	1,016	965	953	964	974	895	814	821	829
2000	1,698	1,561	1,594	1,409	1,344	1,266	1,282	1,199	1,139	1,125	1,137	1,150	1,057	961	969
2001	2,029	1,866	1,715	1,752	1,549	1,478	1,391	1,409	1,318	1,252	1,236	1,250	1,264	1,161	1,056
2002	2,904	2,965	2,727	2,506	2,560	2,263	2,159	2,033	2,059	1,926	1,830	1,806	1,826	1,846	1,697
2003	3,622	3,308	3,378	3,106	2,855	2,916	2,578	2,459	2,316	2,346	2,194	2,084	2,058	2,080	2,103
2004	5,083	3,852	3,518	3,592	3,304	3,036	3,101	2,742	2,616	2,463	2,495	2,333	2,217	2,189	2,213
2005	5,923	5,749	4,356	3,979	4,063	3,736	3,434	3,507	3,101	2,958	2,786	2,822	2,639	2,507	2,475
2006	7,795	5,555	5,392	4,086	3,733	3,811	3,505	3,221	3,290	2,909	2,775	2,613	2,647	2,475	2,352
2007	10,119	7,261	5,174	5,023	3,806	3,477	3,550	3,264	3,000	3,064	2,709	2,585	2,434	2,465	2,305
2008	11,045	8,492	6,094	4,343	4,215	3,194	2,918	2,979	2,740	2,518	2,572	2,274	2,169	2,042	2,069
2009	16,886	11,784	9,060	6,501	4,633	4,498	3,408	3,113	3,178	2,923	2,687	2,744	2,426	2,314	2,179
2010	21,786	14,826	10,346	7,955	5,708	4,068	3,949	2,992	2,733	2,791	2,566	2,359	2,409	2,130	2,032
2011	34,724	23,692	16,124	11,252	8,651	6,208	4,424	4,294	3,254	2,972	3,035	2,791	2,565	2,620	2,316
Totals	127,376	94,497	72,792	58,711	49,508	42,935	38,552	36,014	33,552	32,002	30,634	29,270	28,103	27,119	26,024
Discount Factor [e]	0.987	0.962	0.938	0.914	0.890	0.868	0.846	0.824	0.803	0.783	0.763	0.743	0.724	0.706	0.688
Present Value	125,745	90,912	68,248	53,645	44,085	37,258	32,603	29,682	26,949	25,050	23,368	21,760	20,360	19,148	17,907

PROJECTED ANNUAL PAID NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES - Part II

Year Which Losses Were Incurred	At Year End														
	2027	**2028**	**2029**	**2030**	**2031**	**2032**	**2033**	**2034**	**2035**	**2036**	**2037**	**2038**	**2039**	**2040**	**2041**
Prior	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
1997	704	621	626	540	453	364	365	367	276	185	185	93	338	0	0
1998	735	741	654	658	568	476	383	385	386	291	194	195	39	0	0
1999	743	749	755	666	671	579	485	390	392	393	296	198	198	99	154
2000	978	877	884	891	786	792	683	533	0	0	0	0	0	0	0
2001	1,065	1,075	964	972	979	864	870	751	415	0	0	0	0	0	0
2002	1,543	1,557	1,571	1,409	1,420	1,431	1,262	1,271	1,097	920	729	0	0	0	0
2003	1,933	1,757	1,773	1,789	1,605	1,617	1,630	1,438	1,448	1,250	1,048	842	846	849	354
2004	2,237	2,056	1,869	1,886	1,903	1,706	1,720	1,734	1,529	1,540	1,329	1,114	896	900	903
2005	2,503	2,530	2,325	2,114	2,133	2,152	1,930	1,946	1,961	1,730	1,742	1,503	1,260	1,013	1,017
2006	2,322	2,347	2,373	2,181	1,983	2,000	2,018	1,810	1,825	1,839	1,622	1,634	1,410	1,182	950
2007	2,190	2,163	2,186	2,210	2,032	1,847	1,863	1,880	1,686	1,700	1,713	1,511	1,522	1,313	1,101
2008	1,935	1,838	1,815	1,835	1,855	1,705	1,550	1,564	1,578	1,415	1,427	1,438	1,268	1,277	1,102
2009	2,208	2,064	1,961	1,936	1,958	1,979	1,819	1,654	1,668	1,684	1,510	1,522	1,534	875	0
2010	1,913	1,938	1,812	1,722	1,700	1,719	1,738	1,597	1,452	1,465	1,478	1,326	1,336	1,347	1,188
2011	2,210	2,081	2,108	1,971	1,873	1,849	1,869	1,890	1,737	1,579	1,593	1,607	1,442	1,453	1,465
Totals	25,219	24,395	23,676	22,780	21,917	21,081	20,188	19,209	17,451	15,990	14,867	12,984	12,090	10,309	8,235
Discount Factor [e]	0.671	0.654	0.637	0.621	0.605	0.589	0.574	0.560	0.546	0.532	0.518	0.505	0.492	0.480	0.467
Present Value	16,911	15,942	15,079	14,139	13,257	12,427	11,597	10,754	9,521	8,502	7,704	6,557	5,950	4,944	3,849

Competitive Business Valuation Model
Future Loss Estimates

(*In thousands USD, unless otherwise stated*)

PROJECTED ANNUAL PAID NET LOSSES AND DEFENSE AND COST CONTAINMENT EXPENSES - Part III

Year Which Losses Were Incurred	At Year End														
	2042	**2043**	**2044**	**2045**	**2046**	**2047**	**2048**	**2049**	**2050**	**2051**	**2052**	**2053**	**2054**	**2055**	**2056**
Prior	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
1997	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
1998	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
1999	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
2000	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
2001	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
2002	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
2003	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
2004	680	455	456	228	3,884	1,199	0	0	0	0	0	0	0	0	0
2005	1,021	769	514	515	258	4,393	1,291	0	0	0	0	0	0	0	0
2006	954	958	721	482	483	242	4,121	14,491	0	0	0	0	0	0	0
2007	885	889	892	672	449	450	226	3,839	9,400	0	0	0	0	0	0
2008	924	743	746	749	564	377	378	189	3,221	12,703	0	0	0	0	0
2009	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
2010	1,196	1,033	866	696	699	702	528	353	354	177	344	0	0	0	0
2011	126	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Totals	5,788	4,846	4,195	3,343	6,338	7,363	6,544	18,872	12,976	12,881	344	0	0	0	0
Discount Factor [e]	0.456	0.444	0.433	0.422	0.411	0.400	0.390	0.380	0.371	0.361	0.352	0.343	0.334	0.326	0.317
Present Value	2,636	2,151	1,815	1,409	2,604	2,948	2,554	7,177	4,809	4,652	121	0	0	0	0

Sources/Notes:

[a] Per Exhibit A to SSAP 65, the rate used to determine unpaid loss and LAE reserves shall not exceed the lesser of:

If the reporting entity's statutory invested assets are at least equal to total of all policyholder reserves, the reporting entity's net rate of return on statutory invested assets, less 1.5%; otherwise, the reporting entity's average net portfolio yield rate less 1.5% as indicated by dividing the net investment income earned by the average of the reporting entity's current and prior year total assets (4.1%).	2.61%
Current yield to maturity on a U.S. Treasury debt instrument with maturities consistent with the expected payout of the liabilities. (For this analysis, the 30 year U.S. Treasury rate as of 12/30/11 was used.)	2.89%

We assume the same discount rate as the rate to determine unpaid loss and LAE reserves.

[b] Based on the present value of the future liabilities; see footnote [a] for discount factor.

[c] Based on IWIF Historical Loss Triangles.
Ratios represent the cumulative payout of year (n) over (n-1), where n is the years after initial payment.

[d] Projected cumulative loss payout is calculated by multiplying the appropriate payout ratio, according to year(s) after initial payment, to prior year cumulative payment.

[e] Assume midpoint discount factor.

[f] No data was provided for years experience beyond year 42; assume all losses are paid by year 43.

Competitive Business Valuation Model
Select IWIF Financial Line Items [a]

(In thousands USD, unless otherwise stated)		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	30-Jun-12
UNDERWRITING INCOME																	
Premiums	[b]	$ 101,769	$ 77,889	$ 77,209	$ 95,929	$ 132,893	$ 181,722	$ 236,846	$ 299,900	$ 320,410	$ 308,149	$ 262,705	$ 216,459	$ 159,515	$ 159,253	$ 171,167	
UNDERWRITING EXPENSES																	
Other underwriting expenses incurred	[c]	9,292	7,112	7,050	8,759	10,973	13,388	14,459	15,157	16,922	20,514	20,967	22,313	19,483	18,832	23,376	
Other underwriting expenses incurred over Premiums	[c]	*9.1%*	*9.1%*	*9.1%*	*9.1%*	*8.3%*	*7.4%*	*6.1%*	*5.1%*	*5.3%*	*6.7%*	*8.0%*	*10.3%*	*12.2%*	*11.8%*	*13.7%*	
Commissions		1,299	3,695	3,596	6,615	10,650	15,025	19,303	23,980	26,005	26,609	23,035	20,289	15,644	15,393	16,650	
Provisions for bad debt		972	3,381	2,754	1,315	1,635	2,302	2,928	3,499	4,050	4,621	5,928	5,474	1,828	1,474	1,131	
Premium deficiency reserve		N/A	N/A	N/A	N/A	(1,240)	(1,260)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0	793	
INVESTMENT INCOME																	
Investment Expense		750	1,132	1,997	1,572	2,354	1,674	1,506	1,579	2,236	3,020	3,295	3,202	3,640	4,038	4,463	
Net Investment Income		89,261	63,668	68,432	67,641	51,273	7,005	65,772	76,933	61,049	74,567	86,221	62,482	70,336	65,137	66,996	33,662
Investment Expense as a percent of Cash and Invested Assets		0.09%	0.13%	0.22%	0.17%	0.26%	0.20%	0.16%	0.15%	0.18%	0.22%	0.22%	0.21%	0.23%	0.25%	0.27%	
OTHER INCOME																	
Total other income		378	105	20	257	572	572	431	700	886	717	614	601	869	753	614	
DIVIDENDS																	
Dividends to policyholders		10,000	0	134	1,265	1,111	1,378	1,790	3,083	4,952	5,646	5,323	2,556	2,037	869	(275)	
ASSETS																	
Cash and invested assets	[d]	856,677	924,992	914,243	953,463	850,841	866,114	1,012,088	1,145,332	1,295,140	1,425,873	1,540,645	1,582,943	1,602,600	1,629,203	1,629,551	1,709,400
Net Investment Income over average Cash and Invested Assets	[e]	*10.8%*	*7.1%*	*7.4%*	*7.2%*	*5.7%*	*0.8%*	*7.0%*	*7.1%*	*5.0%*	*5.5%*	*5.8%*	*4.0%*	*4.4%*	*4.0%*	*4.1%*	*2.0%*

Sources/Notes:

[a] 1997 - 2003: IWIF financial statements.
2004 - 06/30/2012: IWIF statutory financial statements.

Item	2004 - 2011 Statutory Financial Statement Line Description
Premiums	Direct Premiums Written
Net gain (loss) on sales of investments	Net realized gain (losses) (Line 9. Statement of Income)
Investment expense	Total deductions (Line 16. Exhibit of Net Investment Income)
Net investment income	Net investment gain (Line 11. Statement of Income), incl. realized capital gains (losses)

[b] For 1997 - 2003: Net Premiums Earned, from IWIF financials (see footnote [a]).
For 2004 - 06/30/2012: Direct Premiums Written, from IWIF Statutory Statements.

[c] Other underwriting expenses incurred as a percent of premiums for 1997 - 1999 is assumed to be equal to 2000 results; other underwriting expenses incurred is calculated by multiplying 9.1% to the premiums for 1997 - 1999.

[d] Excludes investment income due or accrued; includes addback for net accumulated depreciation on real estate.

[e] 1997 average Cash and Invested Assets includes 1996 balance sheet value of $799,861,045.
Slight difference in investment income for several years than those on Exhibit 3 and Exhibit 8 are due to rounding differences in the calculation.

Most Important Reason for Placing Customers with IWIF

- As in the past, rates are, by far, the most important reason for placing customers with IWIF, especially among Top 100 brokers.
- Being able to get the coverage they need and the ease of doing business with IWIF are also important reasons for placing customers with them.

	2000	2001	2002	2003	2004	2006*	2007	2009	2011 Total	Broker List	
										Top 100	101-150
Rates	59%	61%	52%	47%	46%	51%	55%	54%	60%	71%	30%
Getting the coverage they need	1%	2%	6%	5%	5%	16%	24%	42%	32%	30%	37%
Ease of doing business with	10%	11%	8%	14%	21%	31%	35%	30%	32%	33%	30%
Customer service	33%	5%	28%	9%	5%	21%	27%	21%	27%	27%	26%
Relationship	**	**	**	**	**	10%	14%	23%	13%	15%	7%
Knowledgeable personnel	**	**	3%	2%	4%	8%	19%	12%	11%	14%	4%
Reputation (stable/reliable)	**	4%	5%	5%	3%	5%	3%	7%	10%	11%	7%
Marketing availability	**	**	**	5%	7%	5%	11%	12%	9%	6%	19%
Commissions	**	**	**	**	**	4%	8%	11%	7%	8%	4%
Claims service	16%	25%	15%	16%	14%	0%	0%	0%	0%	0%	0%
All are important	0%	0%	0%	0%	0%	0%	0%	0%	3%	3%	4%
Other	19%	20%	29%	20%	26%	2%	2%	1%	4%	6%	0%
Not sure	1%	2%	1%	1%	0%	0%	2%	0%	0%	0%	0%
(# of respondents)	(102)	(100)	(100)	(100)	(100)	(98)	(100)	(91)	(100)	(73)	(27)

*Differences compared to other studies may be due to changes in the data collection process

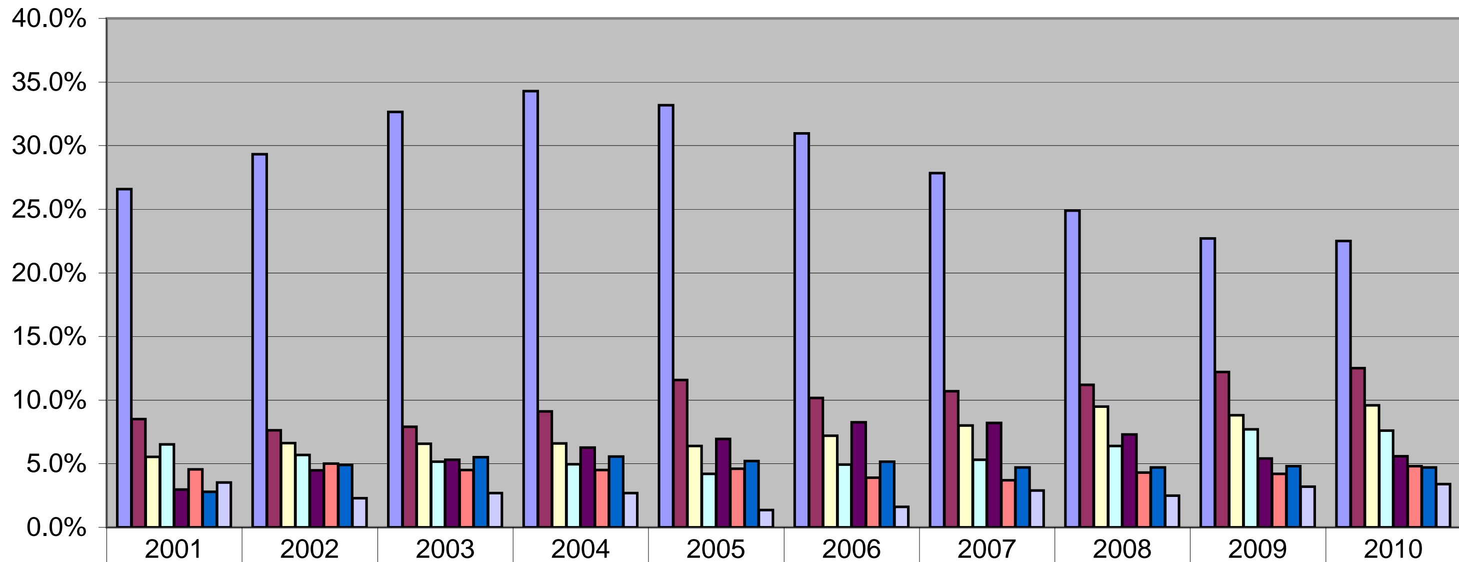
**May be included in "other"

H&M MARKETING RESEARCH

10. Which of the following are most important to you in placing customers with IWIF?

MARYLAND

Comparison of Large Insurance Group Market Shares for 2001 through 2010



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
IWIF	26.6%	29.3%	32.6%	34.3%	33.2%	31.0%	27.8%	24.9%	22.7%	22.5%
Hartford Group	8.5%	7.6%	7.9%	9.1%	11.6%	10.2%	10.7%	11.2%	12.2%	12.5%
Liberty Mutual Group	5.5%	6.6%	6.6%	6.6%	6.4%	7.2%	8.0%	9.5%	8.8%	9.6%
Travelers Group	6.5%	5.7%	5.2%	5.0%	4.2%	4.9%	5.3%	6.4%	7.7%	7.6%
American International Group	3.0%	4.5%	5.3%	6.3%	6.9%	8.3%	8.2%	7.3%	5.4%	5.6%
Zurich Group	4.6%	5.0%	4.5%	4.5%	4.6%	3.9%	3.7%	4.3%	4.2%	4.8%
Erie Insurance Group	2.8%	4.9%	5.5%	5.6%	5.2%	5.2%	4.7%	4.7%	4.8%	4.7%
PMA Group/Old Republic	3.5%	2.3%	2.7%	2.7%	1.4%	1.6%	2.9%	2.5%	3.2%	3.4%

DEPARTMENT OF
BUDGET & MANAGEMENT

MARTIN O'MALLEY
Governor

ANTHONY BROWN
Lieutenant Governor

T. ELOISE FOSTER
Secretary

DAVID C. ROMANS
Deputy Secretary

October 1, 2012

Ms. Therese Goldsmith
Commissioner
Maryland Insurance Administration
Office of the Commissioner
200 Saint Paul Place
Suite 2700
Baltimore, MD 21202-2004

Dear Commissioner Goldsmith:

Thank you for the opportunity to review the draft report on the Fair Value of the State of Maryland Support of IWIF and to discuss the findings with the consultant. I write to express my belief that the consultant's analysis of the "incremental investment income earned for the State" is flawed and results in the fair value of the net benefits provided by the State being understated by $10.8 million.

The consultant's report counts in IWIF's favor $10.8 million of investment returns that IWIF achieved on the State's behalf (from State funds deposited with IWIF to fund the State's workers' compensation clams) that were above and beyond the returns the consultant estimates would have been achieved if the funds had been invested by the State Treasurer's Office over the same 1990-2000 time period. **These funds should not be considered in the analysis as IWIF was fairly reimbursed through its contract with the State for providing the investment services.**

Like any other service, entities contracting for investment services pay the vendor a fee that the two sides agree is a reasonable reimbursement for the cost of providing the service. The provision of investment services under the contract was no different than the provision of risk management and claims settlement services that were also designed to save the State more than the cost of actually providing the service. All three of these services (investment, claims settlement, risk management) could have been purchased from any number of other entities at a cost far below the savings/investment earnings expected to result from delivery of the service.

DBM also disagrees with the methodology the consultant used to calculate the incremental investment income. The consultant compared the returns achieved by IWIF to the returns achieved by the State Treasurer's Office when investing State dollars. By law, the State Treasurer's Office is constrained in the type of investment it can make. **A more appropriate analysis would have been to compare the returns achieved by IWIF to the returns the State could have achieved by placing the funds with other insurance entities that, like IWIF, have greater flexibility in investing funds.**

Sincerely,

T. Eloise Foster

T. Eloise Foster
Secretary