WEST VIRGINIA LEGISLATIVE AUDITOR

PERFORMANCE EVALUATION AND RESEARCH DIVISION

Preliminary Performance Review

State Board of Risk and Insurance Management

BRIM Reduced Its Unfunded Liability During FY 2004, in Large Part By Increasing Premium Revenues

BRIM Has Transferred the Remaining Assets and Liabilities of Its Former Medical Malpractice Insurance Program to the West Virginia Physicians' Mutual Company, Which Began Operations During FY 2005, and Left BRIM With No Remaining Unfunded Liability

BRIM Has Expanded Its Loss Control Department and Enacted New Loss Control Initiatives in Response to PERD's November 2003 Recommendations

February 2005
PE 04-28-339

JOINT COMMITTEE ON GOVERNMENT OPERATIONS

Senate

Edwin J. Bowman
Chair

Billy Wayne Bailey, Jr.
Vice Chair

Walt Helmick

Joseph M. Minard

Sarah M. Minear

Citizen Members

Dwight Calhoun

John Canfield

James Willison

W. Joseph McCoy

(Vacancy)

House Of Delegates

J.D. Beane
Chair

Timothy R. Ennis
Vice Chair

Joe Talbott

Craig P. Blair

Otis Leggett

Scott G. Varner, Ex Officio Non-Voting Member

OFFICE OF THE LEGISLATIVE AUDITOR

Aaron Allred
Legislative Auditor

John Sylvia
Director

Russell Kitchen
Senior Research Analyst

Brandon Burton
Research Analyst

Performance Evaluation and Research Division
Building 1, Room W-314
State Capitol Complex
Charleston, West Virginia 25305
(304) 347-4890

WEST VIRGINIA LEGISLATURE

Performance Evaluation and Research Division

Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610
(304) 347-4890
(304) 347-4939 FAX

John Sylvia
Director

February 6, 2005

The Honorable Edwin J. Bowman
State Senate
129 West Circle Drive
Weirton, West Virginia 26062

The Honorable J.D. Beane
House of Delegates
Building 1, Room E-213
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0470

Dear Chairs:

Pursuant to the West Virginia Sunset Law, we are transmitting a Preliminary Performance Review of the State Board of Risk and Insurance Management, which will be presented to the Joint Committee on Government Operations on Sunday, February 6, 2005. The issues covered herein are "BRIM Reduced Its Unfunded Liability During FY 2004, in Large Part By Increasing Premium Revenues;" "BRIM Has Transferred the Remaining Assets and Liabilities of Its Former Medical Malpractice Insurance Program to the West Virginia Physicians' Mutual Company, Which Began Operations During FY 2005, and Left BRIM With No Remaining Unfunded Liability;" and "BRIM Has Expanded Its Loss Control Department and Enacted New Loss Control Initiatives in Response to PERD's November 2003 Recommendations."

We transmitted a draft copy of the report to the State Board of Risk and Insurance Management on January 18, 2005. We held an exit conference with the Board on January 25, 2005. We received the agency response on January 28, 2005.

Let me know if you have any questions.

Sincerely,

John Sylvia

John Sylvia

JS/wsc

Joint Committee on Government and Finance

Contents

Executive Summary

Issue 1: BRIM Reduced Its Unfunded Liability During FY 2004, in Large Part By Increasing Premium Revenues.

Fiscal year 2004 premium revenues totaled over $109 million, which represents more than double the FY 2002 total of $48.7 million. Clearly, the decline in the unfunded liability that occurred during FY 2004 was largely due to premium increases.

The November 2003 Preliminary Performance Review of BRIM described BRIM's financial plan to eliminate the unfunded liability. BRIM has utilized premium rate increases in the State Agencies, Senate Bill 3, and Medical Malpractice Programs as a means to reduce the unfunded liability. The Legislature also made appropriations to BRIM in the following amounts, for the purpose of reducing the unfunded liability: $1,907,904 for FY 2003 and $1,942,000 for FY 2004. BRIM has also made special assessments for insured entities in the State Agencies and Senate Bill 3 Programs for the same purpose.

BRIM has made substantial progress recently in reducing the unfunded liability. By the end of November 2004, the total unfunded liability was $17,806,844. This compares favorably with the total at the end of November 2003, which was $36,776,748.

BRIM's premium revenues increased substantially during the last two fiscal years. Fiscal year 2004 premium revenues totaled over $109 million, which represents more than double the FY 2002 total of $48.7 million. Clearly, the decline in the unfunded liability that occurred during FY 2004 was largely due to premium increases.

By FY 2004, no BRIM line of business had claims losses exceeding premium revenues.

By FY 2004, no BRIM line of business had claims losses exceeding premium revenues. Premium revenues exceeded claims losses for the State Agencies Program during FY 2004 for the first time since FY 2001. As claims losses for the State Agencies Program fell by over $4 million, premium revenues increased by $9.3 million. Premium revenues exceeded claims losses for the SB 3 Program during FY 2004 for the first time since FY 1998. Premium revenues exceeded claims losses for the Medical Malpractice Program during both fiscal years 2003 and 2004, but claims losses increased substantially each year. The end of BRIM's Medical Malpractice Program at the end of FY 2004 and the creation of the West Virginia Physicians' Mutual Insurance Company relieves BRIM of any further concern regarding medical malpractice claims losses. Claims losses for the Senate Bill 3 Program increased consistently each year for the period examined.

During the last several recent years, BRIM's investment income has generally been just over $5 million annually, with the notable exception of FY 2004, during which BRIM only earned $1 million in investment income. Clearly, investment income has not helped in reducing the unfunded liability.

Issue 2: BRIM Has Transferred the Remaining Assets and Liabilities of Its Former Medical Malpractice Insurance Program to the West Virginia Physicians' Mutual Company, Which Began Operations During FY 2005, and Left BRIM With No Remaining Unfunded Liability.

BRIM completed the transfer of assets to the West Virginia Physicians' Mutual Insurance Company at the end of calendar year 2004, with no remaining unfunded liability attached to BRIM's former medical malpractice program (BRIM II). At the time of PERD's last report, there was a concern on the part of BRIM's management that some residual unfunded liability could result from claims filed after the end of the BRIM II Program. Recommendation 3 of PERD's November 2003 report advised BRIM to prepare financially for the fiscal impact of medical malpractice claims losses occurring after the end of the medical malpractice program:

Given the successful novation of BRIM II into the West Virginia Physicians' Mutual Insurance Company, including the complete transfer of remaining assets and BRIM's lack of a residual unfunded liability, BRIM is in full-compliance with Recommendation 3 of PERD's November 2003 report.

> *Recommendation 3. BRIM should carefully evaluate actuarial projections for future claims losses from the BRIM II Program [BRIM's designation for the medical malpractice program] and make sufficient claims loss allowances to compensate for the projected fiscal impact.*

Given the successful novation of BRIM II into the West Virginia Physicians' Mutual Insurance Company, including the complete transfer of remaining assets and BRIM's lack of a residual unfunded liability, BRIM is in full-compliance with Recommendation 3 of PERD's November 2003 report.

Issue 3: BRIM Has Expanded Its Loss Control Department and Enacted New Loss Control Initiatives in Response to PERD's November 2003 Recommendations.

The Performance Evaluation and Research Division released its last report on BRIM during November 2003. That report included a series of recommendations, recommendations 4 through 6, aimed at improving the efficiency and effectiveness of BRIM's Loss Control Department. Since the release of the last report, BRIM has taken action regarding each of those recommendations. Recommendation 4 stated:

> 4. *The Legislature should consider expanding the number of positions in BRIM's Loss Control Department in order to provide an adequate number of Loss Control Specialists to monitor the efforts of vendors, the compliance of insureds with loss control recommendations and to reduce the need to employ outside vendors.*

BRIM has hired one additional Loss Control Representative more than it had at the time of the last report. BRIM should evaluate its staff needs and determine if one additional Loss Control Representative is adequate to monitor its loss control vendors and carry out the other functions of BRIM's Loss Control Department.

BRIM has hired one additional Loss Control Representative more than it had at the time of the last report. BRIM should evaluate its staff needs and determine if one additional Loss Control Representative is adequate to monitor its loss control vendors and carry out the other functions of BRIM's Loss Control Department. Since BRIM currently pays over a half million dollars annually to loss control vendors, adequate BRIM Loss Control Department staffing levels are important in the monitoring of vendor performance.

Recommendation 5 of PERD's November 2003 report stated:

> 5. *BRIM and its loss control vendors should design a system for categorizing loss control recommendations that ranks them according to their level of importance in order to facilitate the monitoring of action plans.*

BRIM has also introduced a system for categorizing loss control recommendations from Schirmer Engineering Corporation. BRIM has, therefore, complied with this recommendation with respect to future loss control recommendations issued by its most important loss control vendor.

BRIM has also introduced a system for categorizing loss control recommendations from Schirmer Engineering Corporation. BRIM has, therefore, complied with this recommendation with respect to future loss control recommendations issued by its most important loss control vendor. While BRIM has made progress towards following up on recommendations in a timely manner, the backlog of recommendations from previous years did increase by 9% during calendar year 2004. BRIM also has a system for categorizing loss control recommendations from Hartford Steam Boiler, but needs to follow-up on them.

Recommendation 6 of PERD's November 2003 report stated:

> 6. *BRIM should comply with Recommendation 4 of PERD's 1997 report and implement a system of surcharges and credits, using the number and severity of loss control recommendations as criteria, as soon as possible.*

BRIM is implementing a system of surcharges and credits during FY 2006 and is, therefore, in planned compliance with this recommendation.

BRIM has also introduced on-line driver training to the employees of state agencies and plans to extend the program to employees of Senate Bill 3 entities if it is successful. Given the continued growth of the Senate Bill 3 Program's portion of BRIM's unfunded liability, BRIM should consider extending on-line driver training to the employees of Senate Bill 3 entities, if it proves successful with state employees and proves cost-effective.

Recommendations

1. *The Legislative Auditor recommends continuing the Board of Risk and Insurance Management.*

2. *BRIM should evaluate its staff needs and determine if one additional Loss Control Representative is adequate to monitor its loss control vendors and carry out the other functions of BRIM's Loss Control Department.*

3. *BRIM should make following-up on Hartford Steam Boiler recommendations a priority in order to encourage compliance with all categories of loss control recommendations.*

4. *BRIM should consider extending its on-line driver training to the employees of Senate Bill 3 entities, if it proves successful with state employees and cost-effective.*

Review Objective, Scope and Methodology

Objective

The Legislature created the Board of Risk and Insurance Management (BRIM) in 1957 to provide property and liability insurance for all units of state government. The objective of the Preliminary Performance Review of BRIM is to determine BRIM's level of compliance with the recommendations of the Performance Evaluation and Research Division's (PERD) October 1997 Preliminary Performance Review of BRIM, as well as evaluating the progress of BRIM's plan to eliminate the unfunded liability and BRIM's transfer of the assets of the Medical Malpractice Insurance Program (known as the BRIM II Program) to the West Virginia Physician's Mutual Insurance Company. PERD's 2003 report included the following recommendations:

1. *BRIM should evaluate recent premium rate increases following the release of ARMTECH's actuarial study, in order to determine if premium rate structures reflect accurate loss exposure data and adequately address BRIM's unfunded liability.*

2. *BRIM should maintain separate financial statements for each subsection of the SB3 Program to differentiate the various types of entities included in the Program.*

3. *BRIM should carefully evaluate actuarial projections for future claims losses from the BRIM II Program and make sufficient claims loss allowances to compensate for the projected fiscal impact.*

4. *The Legislature should consider expanding the number of positions in BRIM's Loss Control Department in order to provide an adequate number of Loss Control Specialists to monitor the efforts of vendors, the compliance of insureds with loss control recommendations and to reduce the need to employ outside vendors.*

5. *BRIM and its loss control vendors should design a system for categorizing loss control recommendations that ranks them according to their level of importance in order to facilitate the monitoring of action plans.*

6. *BRIM should comply with Recommendation 4 of PERD's 1997 report and implement a system of surcharges and credits, using the relative importance of loss control recommendations as criteria, as soon as possible.*

7. *BRIM should examine its current methods for documenting loss exposure and ensure that the current ARMTECH study adequately addresses the need for accurate data.*

8. *BRIM should make the use of appraisal, or other data for state property value verification, a priority.*

9. *BRIM's Underwriting Department should establish regular communications with the Loss Control Department for the purpose of obtaining accurate loss exposure data on insureds when determining premium levels.*

Scope

The scope of this review focuses on the period from FY 2003 to November 30, 2004, but includes data from previous years, back to FY 1997, for the purpose of making year-to-year comparisons.

Methodology

The progress of BRIM's plan to eliminate the unfunded liability included an analysis of five factors:

- claims losses;
- investment income;
- premium rates and revenues;
- special assessments against insured entities;
- legislative appropriations earmarked for the reduction of the unfunded liability.

The primary source of financial data for this report was BRIM's annual and monthly unaudited financial statements. BRIM also provided information on its recent premium rate increases, special assessments against insured entities and appropriated funds and other revenue sources used to reduce the unfunded liability. BRIM provided information regarding the transfer of the BRIM II Program's assets to the West Virginia Physicians' Mutual Insurance Company. BRIM also provided information on its Loss Control Program, including information on the staff of the Loss Control Department, loss control initiatives, loss control vendors and their activities.

Issue 1

BRIM Reduced Its Unfunded Liability During FY 2004, in Large Part By Increasing Premium Revenues.

Issue Summary

The Board of Risk and Insurance Management (BRIM) fulfills an important role in providing insurance coverage for state agencies, local governments and non-profit organizations. In the process of providing this coverage, BRIM has historically suffered from claims losses that have exceeded premium revenues for many of its lines of business. BRIM has also experienced a persistent unfunded liability, which was discussed in the Performance Evaluation and Research Division's (PERD) last report dated November 2003. BRIM has sought to increase premium rates and therefore revenues during recent years, while reducing claims losses, and eventually, to eliminate its unfunded liability. Legislative appropriations during fiscal years 2003 and 2004, as well as special assessments against insured entities in the State Agencies and Senate Bill 3 Programs also helped to reduce the unfunded liability. BRIM succeeded in reducing its unfunded liability to $17,806,844 by November 30, 2004 and BRIM's management considers the board ahead of schedule in its plan to eliminate the unfunded liability. The unfunded liability had been as high as $39,246,229 at the end of FY 2003.

BRIM has sought to increase premium rates and therefore revenues during recent years, while reducing claims losses, and eventually, to eliminate its unfunded liability.

BRIM's Plan to Eliminate the Unfunded Liability

The November 2003 Preliminary Performance Review of BRIM described BRIM's financial plan to eliminate the unfunded liability:

> *BRIM has developed a financial plan to eliminate the unfunded liability. For the last three years BRIM has made an assessment to SB3 insureds, in addition to standard premium charges, totaling $1 million. This assessment is divided among the 1,400 entities in this program. Beginning in FY 2004, state agencies will also be assessed an additional $1 million. BRIM will continue to request $2 million annually from the Legislature to be applied towards the unfunded liability. In describing the program, a BRIM representative stated:*
>
> > *If all agencies pay their respective amounts, practice good loss control, and losses don't continue to deteriorate, we expect that we can eliminate the unfunded liability within 10 years.*

BRIM has utilized premium rate increases in the State Agencies, Senate Bill 3 and Medical Malpractice Programs as a means to reduce the unfunded liability. The Legislature also made appropriations to BRIM in the following amounts, for the purpose of reducing the unfunded liability: $1,907,904 for FY 2003 and $1,942,000 for FY 2004. BRIM has also made special assessments for insured entities in the State Agencies and Senate Bill 3 Programs for the same purpose. BRIM's executive director commented on the factors that have contributed to the recent reductions in the unfunded liability:

The Legislature also made appropriations to BRIM in the following amounts, for the purpose of reducing the unfunded liability: $1,907,904 for FY 2003 and $1,942,000 for FY 2004.

> *...our board approved the implementation of the premium increases in conjunction with our financial stability plan that was unanimously adopted by the board on 11/20/2003. The premium increases were instrumental in addressing the unfunded liability, in addition to obtaining accurate exposure information, and finally pro-active loss control measures by our insureds. If we combine all three of these factors, we are hopeful that we can reduce losses which translates to monetary savings for the state. We are currently assessing both the state agencies and the SB#3 entities an unfunded liability assessment, as well as requesting from the legislature the appropriation to reduce the unfunded liability. Due to budgetary constraints, our appropriations were reduced just as most other state agencies. However, all the factors mentioned above have contributed to reducing our unfunded liability to the extent that we are ahead of schedule. As you can tell by our audited financial statements, at June 30, 2003 BRIM had a negative retained earnings of $(39,246,000). At June 30, 2004 BRIM's negative retained earnings were $(27,386,000). As you see, progress has been made.*

By the end of November 2004, the total unfunded liability was $17,806,844. This compares favorably with the total at the end of November 2003, which was $36,776,748.

The executive director feels that loss control measures on the part of insured entities have also contributed to the reduction of the unfunded liability. Claims losses will be discussed later in this report and Table 3 illustrates that losses for the State Agencies Program have been significantly reduced since FY 2002.

Recent Developments With BRIM's Unfunded Liability

Table 1 illustrates the development of the unfunded liability over time, broken down by line of business. BRIM has made substantial progress recently in reducing the unfunded liability. By the end of November 2004, the total unfunded liability was $17,806,844. This compares favorably with the total at the end of November 2003, which was $36,776,748.

Table 1 Components of Retained Earnings or Unfunded Liability: FY 1997-2004						
Fiscal Year	State Agencies	SB3 Entities	Mine Subsidence	Flood	House Bill 601 Medical Malpractice: Preferred and High Risk	Total BRIM Retained Earnings or Unfunded Liability (End of Year)
1997	*N/A	N/A	N/A	N/A	--	$-18,035,000
1998	$-7,751,000	$-6,429,000	$12,507,000	$2,158,000	--	$485,000
1999	$-5,928,000	$-7,423,000	$13,438,000	$2,251,000	--	$2,338,000
2000	$-19,032,000	$-14,699,000	$12,634,000	$2,063,000	--	$-19,034,000
2001	$-14,849,000	$-19,005,000	$12,215,000	$2,252,000	--	$-19,387,000
2002	$-27,674,451	$-23,587,509	$14,494,921	N/A	$-1,167,328	$-37,934,367
2003	$-26,942,251	$-26,467,822	$16,829,402	--	$-2,665,558	$-39,246,229
2004	$-15,690,572	$-29,571,951	$17,356,992	--	$519,581	$-27,385,951
11/30/04	**N/A	N/A	N/A	N/A	N/A	$-17,806,844

Source: Board of Risk and Insurance Management
**BRIM's accounting practices did not separate retained earnings/unfunded liability by line of business prior to FY 1998.*
***Data represents the current total as of November 30, 2004. BRIM's current accounting practices do not separate retained earnings/unfunded liability by line of business on a monthly basis.*

Premium revenues exceeded claims losses and BRIM experienced a positive net income ($11.9 million) for the first time since 1999.

Increases in Premium Revenues During FY 2003 and FY 2004 Clearly Account for the Recent Reduction in the Unfunded Liability

As mentioned in the November 2003 Preliminary Performance Review of BRIM, BRIM increased premium levels for the State Agencies Program that totaled $9,024,057 for FY 2004. This represented an increase equal to 18.5% of BRIM's total FY 2002 premium revenues. Premium revenues continued to increase for various types of BRIM insurance coverage, or line of business, during FY 2004. The result was that premium revenues exceeded claims losses and BRIM experienced a positive net income ($11.9 million) for the first time since 1999.

As Figure 1 illustrates, BRIM's premium revenues increased substantially during the last two fiscal years. Fiscal year 2004 premium revenues totaled over $109 million, which represents more than double the FY 2002 total of $48.7 million. Clearly, the decline in the unfunded liability that occurred during FY 2004 was largely due to premium increases.

Figure 1

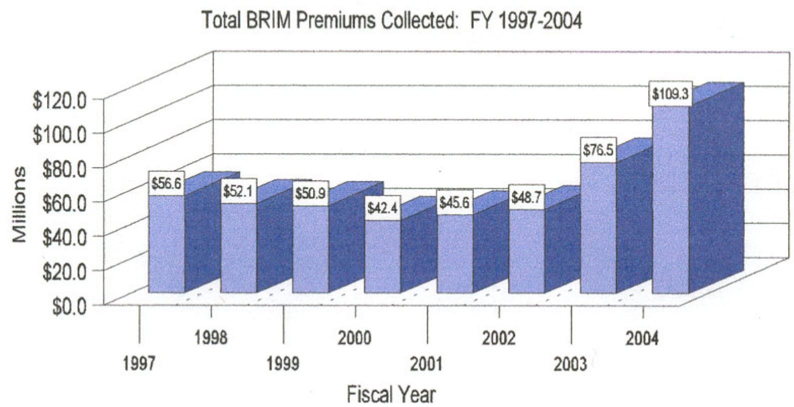


Table 2 illustrates the growth of BRIM's premium revenues since FY 1998. Total premium revenues for fiscal year 2004 ($109,268,185) represent more than double the total for FY 1998 ($52,117,000).

Table 2:
Premium Revenues By Line of Business: FY 1998-2004

Fiscal Year	State Agencies	Senate Bill 3	Mine Subsidence	House Bill 601 Medical Malpractice: Preferred and High Risk	Total
1998	$25,078,000	$25,545,000	$1,494,000	$0	$52,117,000
1999	$26,377,000	$23,071,000	$1,440,000	$0	$50,888,000
2000	$20,373,000	$20,597,000	$1,435,000	$0	$42,405,000
2001	$23,241,000	$20,951,000	$1,414,000	$0	$45,606,000
2002	$22,839,530	$21,922,125	$1,480,460	$2,425,560	$48,667,675
2003	$26,914,959	$27,198,665	$1,528,078	$20,846,596	$76,488,298
2004	$36,202,830	$35,793,345	$1,550,969	$35,721,041	$109,268,185

Source: Board of Risk and Insurance Management

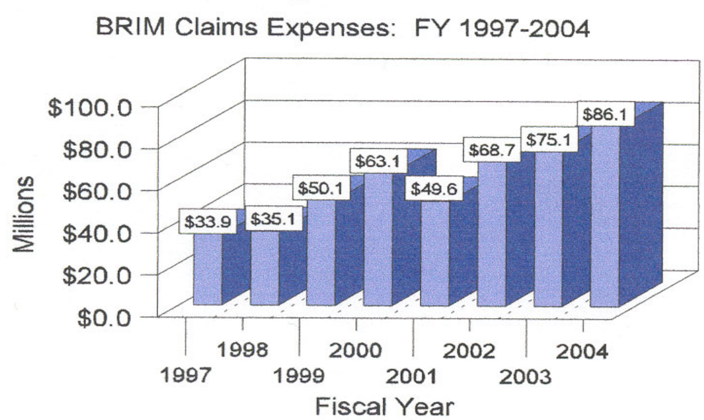
BRIM's Claims Losses Have Continued to Increase During Recent Years for the Senate Bill 3 and Medical Malpractice Programs

Claims expenses for the medical malpractice program reached a high of $26,425,950 during FY 2004.

Figure 2 provides data on claims expenses each year from FY 1997-2004. Claims expenses climbed steadily during the period of BRIM's medical malpractice insurance program (FY 2002-2004). Claims expenses for the medical malpractice program reached a high of $26,425,950 during FY 2004. This program ceased to operate at the end of FY 2004, with the exception of *tail insurance coverage* purchased from BRIM by hospitals that were not eligible to enter the physicians' mutual program. *Tail coverage* is optional malpractice protection that allows an insured to report claims that occurred while its policy was in force but after the policy has ended. The vast majority of claims expenses for the medical malpractice program ended after FY 2004, therefore these expenses should decrease accordingly during FY 2005. Data on BRIM's claims expenses that were current as of November 30, 2004 indicated that non-property insurance claims expenses for the year-to-date totaled $20,557,787, as opposed to the November 30, 2003 total of $37,723,491. A substantial decrease in claims expenses does appear to have occurred so far during FY 2005.

Premium revenues exceeded claims losses for the State Agencies Program during FY 2004 for the first time since FY 2001.

Figure 2



By FY 2004, no BRIM line of business had claims losses exceeding premium revenues. A comparison of Table 2 and Table 3 shows that premium revenues exceeded claims losses for the State Agencies Program during FY 2004 for the first time since FY 2001. As claims losses for the State Agencies Program fell by over $4 million, premium revenues increased by $9.3 million.

The end of BRIM's Medical Malpractice Program at the end of FY 2004 and the creation of the West Virginia Physicians' Mutual Insurance Company relieves BRIM of any further concern regarding medical malpractice claims losses.

Premium revenues exceeded claims losses for the SB 3 Program during FY 2004, for the first time since FY 1998. Premium revenues exceeded claims losses for the Medical Malpractice Program during both fiscal years 2003 and 2004, but claims losses increased substantially each year. The end of BRIM's Medical Malpractice Program at the end of FY 2004 and the creation of the West Virginia Physicians' Mutual Insurance Company relieves BRIM of any further concern regarding medical malpractice claims losses. Claims losses for the Senate Bill 3 Program increased consistently each year for the period examined.

Table 3:
Claims Losses By Line of Business: FY 1998-2004

Fiscal Year	State Agencies	Senate Bill 3	Mine Subsidence	Flood*	House Bill 601 Medical Malpractice: Preferred and High Risk**	Total
1998	$17,999,000	$16,886,000	$194,000	$22,000	$0	$35,101,000
1999	$25,797,000	$23,386,000	$942,000	$0	$0	$50,125,000
2000	$32,401,000	$27,886,000	$2,542,000	$300,000	$0	$63,129,000
2001	$21,431,000	$25,707,000	$2,502,000	$0	$0	$49,640,000
2002	$39,542,308	$25,723,065	$225,266	$0	$3,240,858	$68,731,497
2003	$28,557,137	$28,071,633	$79,479	$0	$18,457,068	$75,165,317
2004	$24,284,896	$34,366,477	$1,044,581	$0	$26,425,950	$86,121,904

Source: Board of Risk and Insurance Management

**BRIM's Flood Insurance Program experienced negligible losses after FY 2001. Due to their small dollar amounts, these data were not separated from other claims losses in BRIM's financial statements.*
***BRIM's Medical Malpractice Program did not exist until FY 2002.*

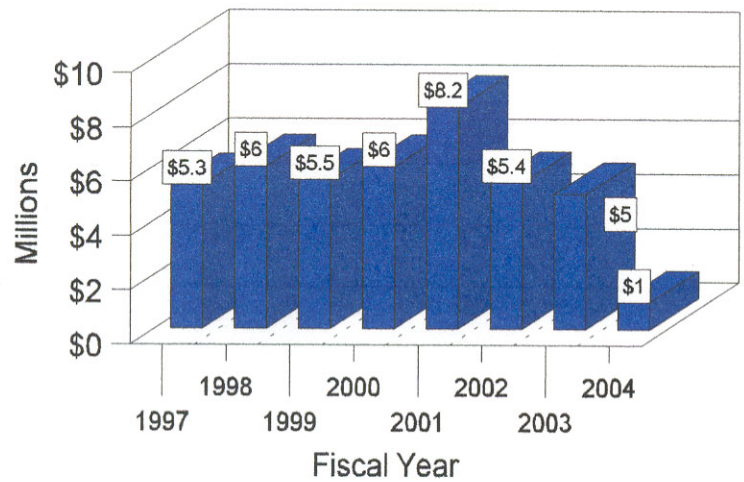
Investment Revenues Did Not Contribute to the Recent Decrease in the Unfunded Liability

During the last several recent years, BRIM's investment income has generally been just over $5 million annually, with the notable exception of FY 2004.

Figure 3 shows that during the last several recent years, BRIM's investment income has generally been just over $5 million annually, with the notable exception of FY 2004. BRIM invests certain funds in the Enhanced Yield Pool managed by the West Virginia Investment Management Board. The total annual rate of return for the pool fell from 5.7% in FY 2003 to 0.4% in FY 2004, thereby accounting for the sharp decline in BRIM's investment income. BRIM's investment income was definitely not a contributing factor in the reduction of the unfunded liability during FY 2004. Even prior to FY 2004, the long-term lack of growth in investment income made this source of revenue an unreliable means of reducing the unfunded liability.

Figure 3

Total BRIM Investment Income: FY 1997-2004



__BRIM has fulfilled its mission of providing insurance coverage to state agencies, local governments and non-profit organizations, while successfully reducing its unfunded liability.__

Conclusion

BRIM has been able to reduce its unfunded liability as premium revenues have increased during recent years. Claims losses fell by over $4 million for the State Agencies Program during FY 2004 but continued to increase for the Senate Bill 3 Program. The medical malpractice line of business had combined losses for the Preferred and High Risk Programs of $26,425,950, which was the greatest amount yet. The end of the medical malpractice line of business (see Issue 2) and BRIM's new loss control initiatives (see Issue 3) offer the possibility of reducing BRIM's claims losses even more in the future. BRIM has fulfilled its mission of providing insurance coverage to state agencies, local governments and non-profit organizations, while successfully reducing its unfunded liability.

Recommendation

1. *The Legislative Auditor recommends continuing the Board of Risk and Insurance Management.*

Issue 2

BRIM Has Transferred the Remaining Assets and Liabilities of Its Former Medical Malpractice Insurance Program to the West Virginia Physicians' Mutual Company, Which Began Operations During FY 2005, and Left BRIM With No Remaining Unfunded Liability.

BRIM completed the transfer of assets to the West Virginia Physicians' Mutual Insurance Company at the end of calendar year 2004, with no remaining unfunded liability attached to BRIM's former medical malpractice program (BRIM II). At the time of PERD's last report, there was a concern on the part of BRIM's management that some residual unfunded liability could result from claims filed after the end of the BRIM II Program. Recommendation 3 of PERD's November 2003 report advised BRIM to prepare financially for the fiscal impact of medical malpractice claims losses occurring after the end of the medical malpractice program:

BRIM completed the transfer of assets to the West Virginia Physicians' Mutual Insurance Company at the end of calendar year 2004, with no remaining unfunded liability attached to BRIM's former medical malpractice program (BRIM II).

Recommendation 3. BRIM should carefully evaluate actuarial projections for future claims losses from the BRIM II Program [BRIM's designation for the medical malpractice program] and make sufficient claims loss allowances to compensate for the projected fiscal impact.

BRIM's executive director provided an overview of the history of the BRIM II Program and its successful novation (the substitution of a new entity to the existing obligations of the BRIM II Program) into the West Virginia Physicians' Mutual Insurance Company:

> *In December 2001, the WV Legislature passed House Bill 601, which authorized BRIM to provide medical malpractice and general liability coverage to health care providers. This bill was created as a result of the medical malpractice insurance crisis created in the state by insurance companies non-renewing policies for doctors and hospitals nationally, and in the State of West Virginia. House Bill 2122 was enacted in March 2003. This bill allowed for BRIM's medical malpractice program to novate to a physicians' mutual.*

West Virginia Physicians' Mutual Insurance Company (WVPMIC)

House Bill 601 allowed for all insurance policies issued to physicians, physician corporations and physician-operated clinics to be transferred from BRIM and be assumed by a physicians' mutual by July 1, 2004. The establishment of this company would not only help physicians secure insurance but stabilize the insurance market as well.

House Bill 601 allowed for all insurance policies issued to physicians, physician corporations and physician-operated clinics to be transferred from BRIM and be assumed by a physicians' mutual by July 1, 2004. The establishment of this company would not only help physicians secure insurance but stabilize the insurance market as well.

Continuing to administer a program that was initiated in October 2001, from July 1, 2003 to June 30, 2004, the BRIM staff and Board of Directors and the Department of Administration Secretary, and with the assistance of the Governor's Office, all worked very diligently in responding to the charge of the Legislature. After a Provisional Board was seated, the BRIM staff and Provisional Board, of which the BRIM Board was a part, established a time line for writing Bylaws and Articles of Incorporation, organizing committees, preparing and mailing requests for proposals, awarding contracts, addressing staffing issues (CEO search), and working with the Insurance Commissioner's Office in establishing rates and meeting licensure requirements.

The three-part funding mechanism consisted of: 1) receipt of $3,265,000 from the West Virginia Insurance Commissioner's Office on January 20, 2004, generated by the one-time $2,500 assessment on all licensed insurance companies; 2) receipt of $3,331,000 derived from the one-time assessment on physicians licensed to practice allopathic medicine and $338,050 derived from the one-time assessment on physicians licensed to practice osteopathic medicine from the State Treasurer on June 18, 2004; and 3) receipt of a $24,000,000 wire transfer to the Mutual's bank account from the State Treasurer, which is a loan secured by a Surplus Note payable to the State of West Virginia, executed and delivered by the Mutual at closing. On June 30, 2004 eighty-five (85%) percent of the assets of the BRIM House Bill 601 program, and <u>all</u> of the liabilities of the BRIM House Bill 601 program, except those that by statute would not novate, were transferred to the West Virginia Physicians' Mutual Insurance Company.

On July 1, 2004, the novation was completed and the West Virginia Physicians' Mutual Insurance Company became operational. The remaining 15% of the assets were transferred to the Mutual in December 2004 at the conclusion of the BRIM audit of the House Bill 601 program Balance Sheet by independent auditors Ernst & Young LLP.

Given the successful novation of BRIM II into the West Virginia Physicians' Mutual Insurance Company, including the complete transfer of remaining assets and BRIM's lack of a residual unfunded liability, BRIM is in full-compliance with Recommendation 3 of PERD's November 2003 report.

Given the successful novation of BRIM II into the West Virginia Physicians' Mutual Insurance Company, including the complete transfer of remaining assets and BRIM's lack of a residual unfunded liability, BRIM is in full-compliance with Recommendation 3 of PERD's November 2003 report.

Conclusion

BRIM has fulfilled its obligations with respect to the BRIM II Program with the complete transfer of assets and liabilities and is in full-compliance with Recommendation 3 of PERD's November 2003 report.

BRIM Has Expanded Its Loss Control Department and Enacted New Loss Control Initiatives in Response to PERD's November 2003 Recommendations

The Performance Evaluation and Research Division (PERD) released its last report on BRIM during November 2003. That report included a series of recommendations, recommendations 4 through 6, aimed at improving the efficiency and effectiveness of BRIM's Loss Control Department. Since the release of the last report, BRIM has taken action regarding each of those recommendations. Recommendation 4 stated:

> 4. *The Legislature should consider expanding the number of positions in BRIM's Loss Control Department in order to provide an adequate number of Loss Control Specialists to monitor the efforts of vendors, the compliance of insureds with loss control recommendations and to reduce the need to employ outside vendors.*

BRIM should evaluate its staff needs and determine if one additional Loss Control Representative is adequate to monitor its loss control vendors and carry out the other functions of BRIM's Loss Control Department.

BRIM's representative described the additional staff that BRIM has hired since the last report:

> *BRIM has added an additional Loss Control Representative. We now have three technical representatives in the department. Our Loss Control Manager has been the Manager for over 12 years and has many years of experience in the insurance industry. The two Loss Control Representatives each have a Master's Degree in Safety and are a huge asset to BRIM. We will continue to monitor our progress and evaluate the need for additional staff in the future.*

This represents one additional Loss Control Representative more than BRIM had at the time of the last report. BRIM should evaluate its staff needs and determine if one additional Loss Control Representative is adequate to monitor its loss control vendors and carry out the other functions of BRIM's Loss Control Department. Since BRIM currently pays over a half million dollars annually to loss control vendors (see Table 4), adequate BRIM Loss Control Department staffing levels are important in the monitoring of vendor performance.

Table 4
BRIM Payments to Loss Control Vendors: FY 1999-FY 2005

Fiscal Year	Hartford Steam Boiler	Schirmer Engineering	CNA Insurance	Total
1999	-	$248,000	$159,500	$407,500
2000	-	$248,000	$159,500	$407,500
2001	-	$243,000	$155,500	$398,500
2002	-	$243,000	$155,500	$398,500
2003	$247,175	$243,000	-	$490,175
2004	$247,175	$250,000	-	$497,175
2005*	$247,175	$262,500	-	$509,675

Source: Board of Risk and Insurance Management
** 2005 is a contractual amount.*

Recommendation 5 of PERD's November 2003 report stated:

> 5. *BRIM and its loss control vendors should design a system for categorizing loss control recommendations that ranks them according to their level of importance in order to facilitate the monitoring of action plans.*

BRIM has also introduced a system for categorizing loss control recommendations from Schirmer Engineering Corporation:

> *Schirmer Engineering Corporation (SEC), the vendor that performs the vast majority of all inspections for BRIM (except for Boilers and Air Conditioning units), has been working with us during this fiscal year to develop a methodology for ranking their recommendations based on the seriousness of the recommendation. BRIM has developed an internal Policy and Procedure for how we will deal with each ranking. I am attaching a copy of the Policy and Procedure which explains the four SEC rankings and our intended effort for each one* [see Appendix C]. *I would note that the rankings are prospective in nature and will not go back and address prior recommendations.*

BRIM has complied with this recommendation with respect to future loss control recommendations issued by its most important loss control vendor. Table 5 illustrates that while BRIM has made progress towards following up on recommendations in a timely manner, the backlog of recommendations from previous years did increase by 9% during calendar year 2004.

BRIM has complied with this recommendation with respect to future loss control recommendations issued by its most important loss control vendor.

Table 5
Status of Recommendations Issued By Schirmer Engineering Corporation

Status	September 1997	Calendar Year 2002	Calendar Year 2003	Calendar Year 2004	Change from 2003 -2004
Total Recommendations from Previous Years	17,866	8,446	7,147	7,802	9% Increase
Recommendations Completed During Current Year	3,659	1,916	2,095	3,245	55% Increase
Remaining Recommendations from Previous Years	14,207	6,530	5,045	4,557	10% Reduction
New Recommendations from Current Year	4,009	3,456	4,338	3,396	22% Reduction
Total Outstanding Recommendations	18,216	9,986	9,358	7,953	15% Reduction

Source: Board of Risk and Insurance Management

Table 6 demonstrates that BRIM has received relatively few responses by insured entities regarding loss control recommendations issued by Hartford Steam Boiler. BRIM has informed the Legislative Auditor's Office that a system for prioritizing Hartford Steam Boiler recommendations exists. Recommendations fall into four categories: 1) code, 2) critical, 3) priority and 4) advisory. The first two categories are considered serious enough to prevent a boiler from being certified for operation by the Department of Labor, therefore, insured entities have a compelling reason to act upon them. The last two categories are much less serious in nature and are frequently not acted upon. Relatively few, recommendations fall the most serious categories and BRIM needs to follow-up on the last two categories in order to encourage compliance with larger numbers of recommendations. BRIM should make following-up on Hartford Steam Boiler recommendations a priority in order to encourage compliance with all categories of loss control recommendations.

Table 6
Recommendations Made By Hartford Steam Boiler

Fiscal Year	Boiler Inspections	Advisory/Recommendation Letters Mailed	Responses to Recommendations
2003	2,096	242	44
2004	1,736	112	67

Source: Board of Risk and Insurance Management

Recommendation 6 of PERD's November 2003 report stated:

The lack of responses appears to indicate that some method for categorizing and prioritizing Hartford Steam Boiler recommendations would assist BRIM in determining compliance with the most critical recommendations.

> 6. *BRIM should comply with Recommendation 4 of PERD's 1997 report and implement a system of surcharges and credits, using the number and severity of loss control recommendations as criteria, as soon as possible.*

BRIM is implementing a system of surcharges and credits during FY 2006 (see Appendix C) and is, therefore, in planned compliance with this recommendation:

BRIM is implementing a system of surcharges and credits during FY 2006 and is, therefore, in planned compliance with this recommendation 4 of PERD's 1997 report.

> *BRIM is implementing a system of Surcharges and Credits (S/C) which will go into effect on July 1, 2005. These will affect premiums developed during FY 2006. The S/C will be based on two or three factors, depending on which BRIM program the insured is in [State v. Senate Bill #3]. For the State, three factors will be considered for S/C: 1] Compliance with Loss Control Standards of Participation (SOP) which have been developed and distributed to each insured; 2] Participation in the on-line driver training program being sponsored and paid for by BRIM and 3] attention to SEC and other BRIM Vendor and BRIM Loss Control Recommendations. For Senate Bill #3 entities, two factors will be utilized: 1] Compliance with SOP; and 2] attention to SEC and other BRIM Vendor and BRIM Loss*

Control Recommendations. At this time, we are not making driver training available to Senate Bill #3 entities. We may consider this in the future, depending on the success of the program with state entities.

The SOP (a copy is attached) spell out basic Loss Control initiatives which we feel each entity should implement to help the entity manage its risks. I have also attached a copy of the S/C which are to be utilized. [The version sent to Senate Bill #3 entities had the section on On-line Driver Training omitted.] We have given the entities until July 1, 2005 to take necessary steps to do what we have asked them to do. We will begin reviewing our insureds' efforts for S/C implementation after July 1, 2005 and the results will be utilized when we determine rates during FY 2006.

The on-line driver training program is intended for state employees and appointees who drive a state vehicle or who drive their own vehicles, on state business, with specified regularity. BRIM sent letters to each state agency in early 2004 seeking a list of those drivers. We rolled out the program in the fall of 2004. BRIM purchased 10,000 on line driver training programs, and to date, almost 5,000 have been used. We will purchase additional views if necessary.

Given the continued growth of the Senate Bill 3 Program's portion of BRIM's unfunded liability, BRIM should consider extending on-line driver training to the employees of Senate Bill 3 entities, if it proves successful with state employees and proves cost-effective.

Given the continued growth of the Senate Bill 3 Program's portion of BRIM's unfunded liability, BRIM should consider extending on-line driver training to the employees of Senate Bill 3 entities, if it proves successful with state employees and proves cost-effective.

Conclusion

BRIM has taken action regarding the three loss control-related recommendations issued in PERD's November 2003 report. BRIM should determine if one additional Loss Control Representative is adequate for its staffing needs and it should extend on-line driver training to the employees of Senate Bill 3 entities.

Recommendations

2. *BRIM should evaluate its staff needs and determine if one additional Loss Control Representative is adequate to monitor its loss control vendors and carry out the other functions of BRIM's Loss Control Department.*

3. *BRIM should make following-up on Hartford Steam Boiler recommendations a priority in order to encourage compliance with all categories of loss control recommendations.*

4. *BRIM should consider extending its on-line driver training to the employees of Senate Bill 3 entities, if it proves successful with state employees and cost-effective.*

Appendix A: Transmittal Letter

WEST VIRGINIA LEGISLATURE

Performance Evaluation and Research Division

Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610
(304) 347-4890
(304) 347-4939 FAX

John Sylvia
Director

January 18, 2005

Charles E. Jones, Jr., Executive Director
West Virginia Board of Risk and Insurance Management
90 MacCorkle Avenue S.W., Suite 203
South Charleston, WV 25303

Dear Mr. Jones:

This is to transmit a draft copy of the Full Performance Review of the West Virginia Board of Risk and Insurance Management. This report is scheduled to be presented during the February 6-8, 2005 interim meeting of the Joint Committee on Government Operations. We will inform of the exact time and location once the information becomes available. A representative from your agency should be present at the meeting to orally respond to the report and answer any questions the committee may have.

We would like to schedule an exit conference to discuss any concerns you may have with the report. We would prefer to meet Tuesday, January 25, 2005. We need your written response by noon on Monday, January 31, 2005 in order to include it in the final report. If your agency intends to distribute additional material to committee members at the meeting, please contact the House Government Organization staff at 340-3192 by Thursday, February 3, 2005, to make arrangements. Thank you for your cooperation.

Sincerely,

John Sylvia

John Sylvia

JS/bb

Enclosure

West Virginia Board of Risk and Insurance Management
Loss Control Department
Standards of Participation for Insured Entities
October 1, 2004

1. **The entity is expected to develop a safety policy, to have a safety committee and appoint an individual to serve as safety director.**

   A. The safety policy must be approved by senior management and made available to all employees. All employees must be trained on the policy and the training must be documented.

   B. The safety committee in conjunction with the safety director will implement, establish and maintain the entity's loss control program. Duties and responsibilities must be set forth in writing. Safety committee meetings must be held at regular intervals with meeting minutes being maintained.

   C. Applicable employees must receive an annual safety performance evaluation as part of their annual review process. Copies of the evaluation must be maintained in writing.

2. **The entity is expected to maintain and follow accepted Personnel Practices.**

   A. The entity's personnel policies and/or collective bargaining agreements must clearly define the procedures for hiring, promotion, discipline and termination; as well as compliance with EEOC and all applicable federal and state employment laws. Any appeal processes in these policies must be clearly defined.

   B. The entity must utilize objective, specific and detailed job descriptions for all positions.

   C. The customer must develop and publish an entity-wide policy prohibiting sexual harassment and stating the entity's intolerance of all forms of harassment in the workplace. This policy must provide a clear, open mechanism for reporting allegations of harassment to someone other that the alleged offender.

   D. The entity shall conduct criminal background checks, prior to hiring, for all persons being considered for employment in positions that deal with minor children as part of their jobs.

3. **The entity is expected to maintain and follow certain guidelines regarding the operation of entity-owned motor vehicles and equipment.**

   A. Driver selection

      (1) The entity must verify that prospective driver employees have a valid driver's license and a copy of the license must be kept on file.

      (2) The entity will ensure that the employee is qualified to operate

West Virginia Board of Risk and Insurance Management Loss Control Premium Surcharges and Credits

Standards of Participation

6% credit	91% or greater compliance with each applicable standard
no surcharge or credit	81-90% compliance with each applicable standard
15% surcharge	80% or less compliance with each applicable standard

On-line Driver Training

2% credit	90% or more of the entity's drivers (whose names were provided to BRIM) successfully complete approved on-line driver training within the prescribed period.
5% surcharge	Less than 90% of the entity's drivers (whose names were provided to BRIM) successfully complete approved on-line driver training within the prescribed period.

Schirmer Engineering Corporation Recommendations

2% credit	To BRIM's satisfaction, the entity provides a timely plan of action which addresses all Schirmer Engineering Corporation recommendations and follows through with the proposed plan of action.
5% surcharge	The entity fails to address Schirmer Engineering Corporation recommendations to BRIM's satisfaction.

Appendix D: Agency Response

STATE OF WEST VIRGIA

DEPARTMENT OF ADMINISTRATION
BOARD OF RISK AND INSURANCE MANAGEMENT

90 MACCORKLE AVENUE SW, SUITE 203
SOUTH CHARLESTON, WV 25303

(304) 766-2646 ADMINISTRATION
(304) 766-2653 FAX
(800) 345-4669 TOLL FREE WV
www.state.wv.us/brim

JOE MANCHIN, III
GOVERNOR

January 27, 2005

John Sylvia, Director
West Virginia Legislature
Performance Evaluation and Research Division
Building 1, Room 314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610

RECEIVED
JAN 28 2005
PERFORMANCE EVALUATION AND RESEARCH DIVISION

Dear Mr. Sylvia:

On behalf of the Board members and the staff of the West Virginia Board of Risk and Insurance Management (BRIM), we acknowledge receipt of the draft copy of the Preliminary Performance Review received January 25, 2005. As always, we appreciate the time and effort given by you and your staff. Our responses to the four recommendations follow.

Recommendation 1

The Legislative Auditor recommends continuing the Board of Risk and Insurance Management.

Response from BRIM

We agree with this recommendation.

Recommendation 2

BRIM should evaluate its staff needs and determine if one additional Loss Control Representative is adequate to monitor its loss control vendors and carry out the other functions of BRIM's Loss Control Department.

Response from BRIM

We agree with this recommendation.

John Sylvia, Director
January 27, 2005
Page 2

Recommendation 3

BRIM should make following-up on Harford Steam Boiler recommendations a priority in order to encourage compliance with all categories of loss control recommendations.

Response from BRIM

We agree with this recommendation.

Recommendation 4

BRIM should consider extending its on-line driver training to the employees of Senate Bill 3 entities, if it proves successful with state employees and is cost-effective.

Response from BRIM

We agree with this recommendation.

Sincerely,

Charles E. Jones, Jr.

Charles E. Jones, Jr.
Executive Director

CEJ/cjs

cc: Brandon Burton, PERD

N:\CEJ\CEJ\LEGAUDIT\LEG0127505.doc