

2018 FUNCTIONAL AND PROGRESS REPORT

Introduction

The Injured Patients and Families Compensation Fund (Fund) was created in 1975 to provide medical malpractice insurance for Wisconsin health care providers in excess of the provider's primary limits of coverage. The Fund provides coverage in excess of the primary limit established by statute, which is currently \$1 million per occurrence and \$3 million aggregate per year. Participation in the Fund is mandatory for health care providers as defined by Chapter 655, Wis. Stat.

The Office of the Commissioner of Insurance (OCI) provides administrative support for the Fund's operations. The Fund is governed by a 13-member Board of Governors (Board) which is chaired by the Commissioner of Insurance. The Board is comprised of 4 public members appointed by the Governor, 3 insurance industry representatives, a member named by the Wisconsin Association for Justice, a member named by the State Bar of Wisconsin, 2 members named by the Wisconsin Medical Society, and a member named by the Wisconsin Hospital Association.

2018 Board of Governors:

Theodore K. Nickel, Commissioner of Insurance (Board Chair)
Gregory Banaszynski, Public Member
Carla Borda, Public Member
Bud Chumbley, M.D., Wisconsin Medical Society
M. Angela Dentice, Wisconsin Association for Justice
Edward W. (Jed) Frees, Industry Representative (resigned May 2018)
Kim Hertz, Public Member (resigned December 2018)
Robert Jaeger, M.D., Wisconsin Medical Society (resigned September 2018)
David Maurer, Industry Representative
David Nelson, Industry Representative
Linda Syth, Wisconsin Medical Society
Ralph Topinka, Wisconsin Hospital Association
Sridhar Vasudevan, M.D., Public Member
John Walsh, State Bar of Wisconsin (resigned December 2018)
Vacant, Industry Representative
Vacant, Public Member
Vacant, State Bar of Wisconsin

The following committees and council support the Fund's governance and typically meet each quarter:

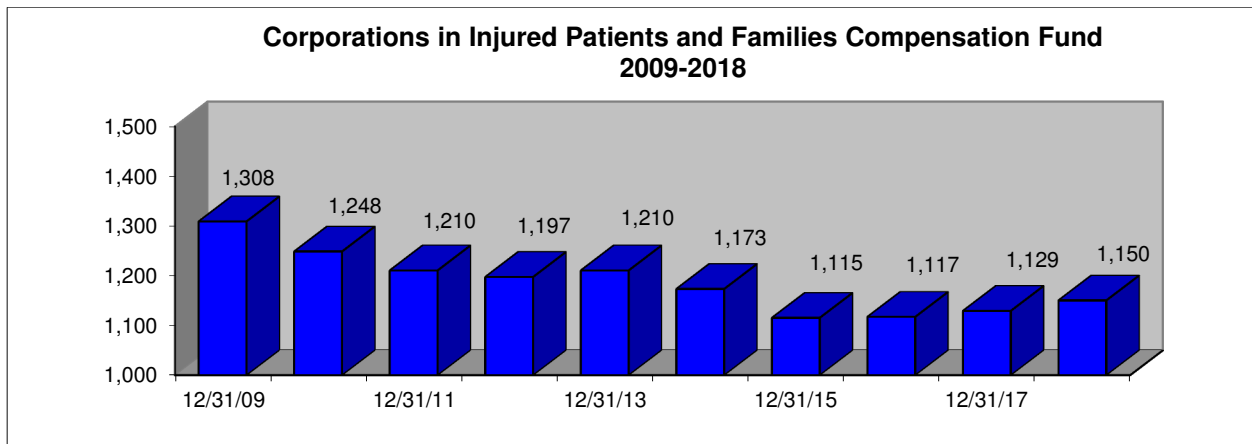
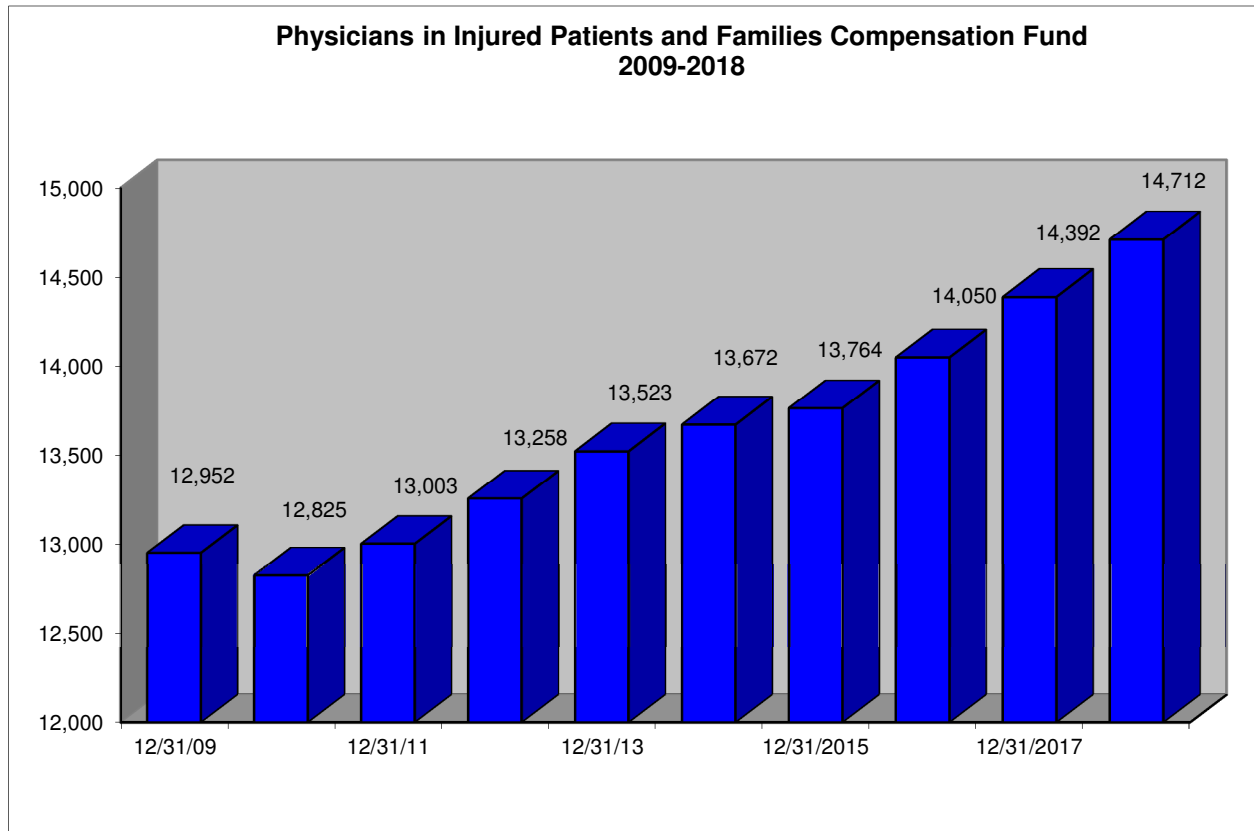
- Actuarial and Underwriting Committee
- Legal Committee
- Claims Committee
- Finance/Investment/Audit Committee
- Risk Management and Patient Safety Committee
- Peer Review Council

The Fund operates on a fiscal year basis: July 1 through June 30. Administrative costs, operating costs, and claim payments are funded through assessments on participating health care providers.

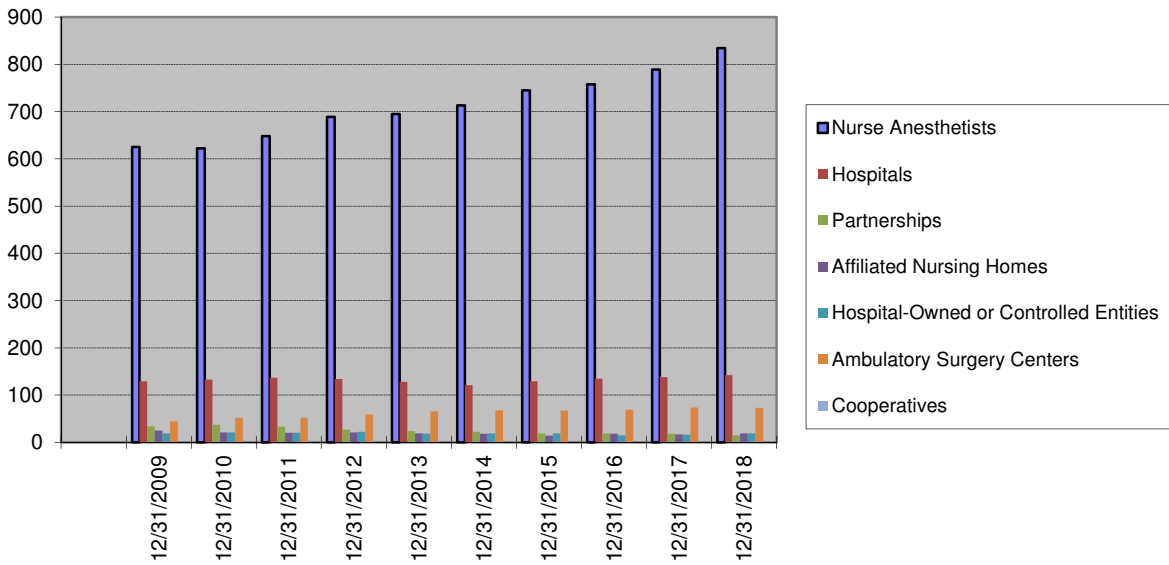
Fund Participants

As of December 31, 2018, there were a total of 16,965 Fund participants comprised of 142 hospitals with 19 affiliated nursing homes, 14,712 physicians, 834 nurse anesthetists, 19 hospital-owned or controlled entities, 73 ambulatory surgery centers, 1 cooperative, 15 partnerships, and 1,150 corporations actively participating in the Fund.

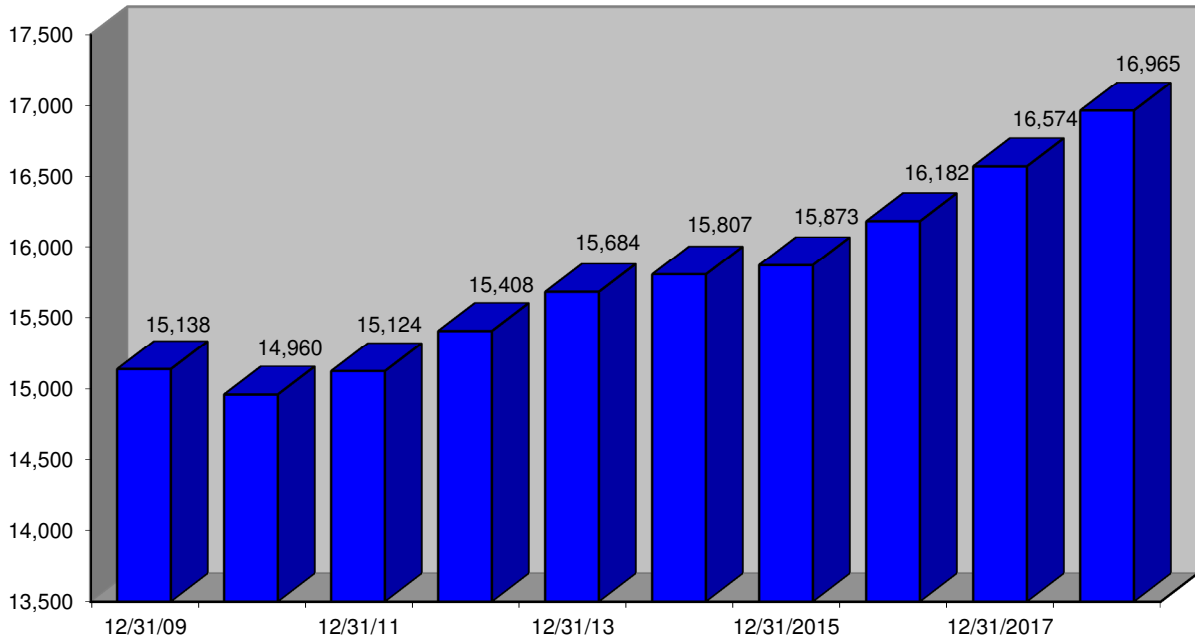
As of December 31, 2018, Fund participants consisted of 87 percent physicians, 7 percent corporations, and the remaining 6 percent included all other participants.



**Other Participants in Injured Patients and Families Compensation Fund
2009-2018**



**Injured Patients and Families Compensation Fund Participants
2009-2018**



Claims Activity

From July 1, 1975, through December 31, 2018, the Fund was named in 6,216 claims filed. During this period, the Fund's total number of paid claims was 675, totaling \$873,279,174. Of the total number of claims in which the Fund has been named, 5,441 claims have been closed with no indemnity payment.

Board Committees

Actuarial and Underwriting Committee

The Actuarial and Underwriting Committee advises the Board on actuarial and underwriting issues.

The committee assisted the Board to promulgate the Fund Fee Rule for the fiscal year 2018-2019 fees. There was a 10 percent decrease in total fees for the fiscal year 2018-2019. Mediation panel fees for physicians (excluding physicians in a residency program) were set at \$28.25 per physician and \$6.25 per occupied hospital bed.

Claims Committee

The Claims Committee is responsible for establishing claims policies and procedures for the Fund and the Wisconsin Health Care Liability Insurance Plan (Plan).

Functions of the Claims Committee include:

- Establish guidelines and review claims management by the contractor and OCI staff of the Fund and Plan.
- Provide for the evaluation of the claims contractor no less often than prior to the renegotiation of each contract to assure claims are being handled in an appropriate and expeditious manner.
- Review all claims involving alleged sexual misconduct, neurological impairment, quadriplegia, and claims which the contractor has set reserves of \$500,000 or more. In addition, provide settlement authorization and advise on those claims where settlement value exceeds \$1 million or when the contractor has a claim management question.
- Monitor claims administration costs and make recommendations for possible savings to the Board and the contractor.
- Establish guidelines for annuity purchases for structured settlements and review such purchases periodically. Develop Board recommendations for changes to statutes or administrative rules needed to facilitate claims policies and procedures of the Fund or Plan.
- Refer legal or other issues that come to the committee's attention to the appropriate committees.
- Prepare reports analyzing claims trends for risk management purposes.
- Report quarterly to the Board on all committee activities.

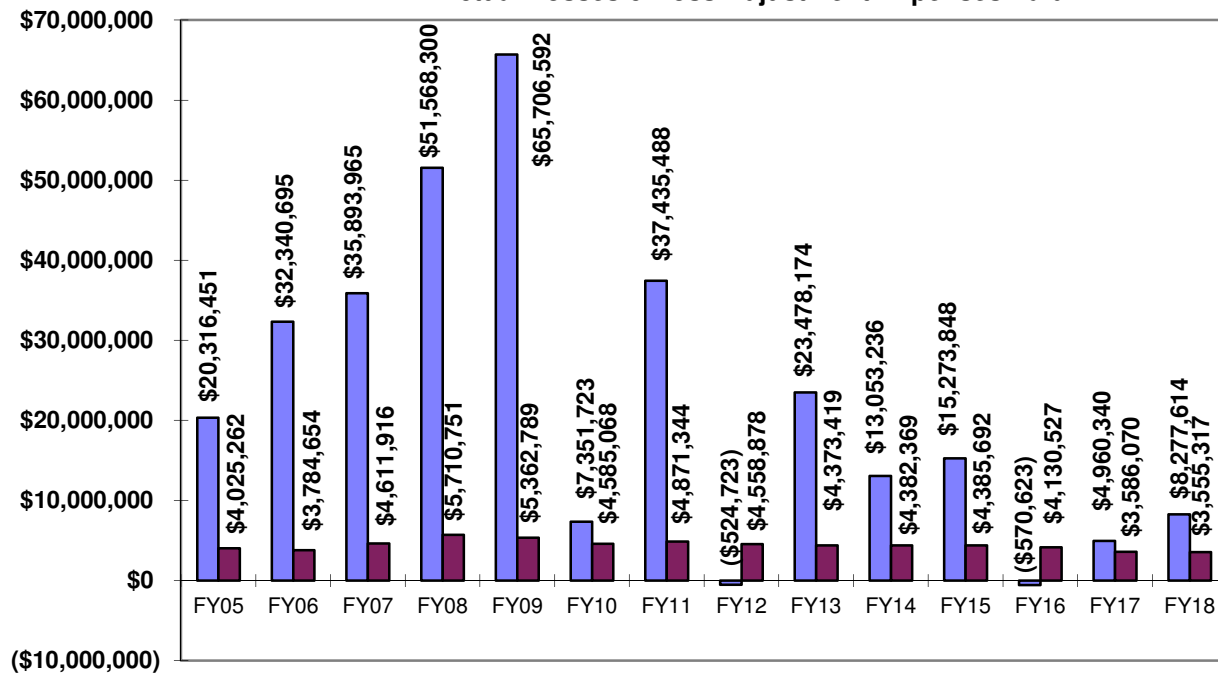
Table 1 summarizes quarterly loss payments by amount and number of claims paid from fiscal 2013 through fiscal 2018. The Actual Losses and Loss Adjustment Expenses Paid chart shows the range of annual Fund loss and loss expense payments beginning with the fiscal year 2005. The Fund's fiscal year runs from July 1 to June 30. The Fund reported loss payments totaling approximately \$8,277,614.40 during fiscal 2018.

Table 1

Amount and Number of Losses Paid by Fiscal Year

Quarter Ending	2013-2014 Amount #	2014-2015 Amount #	2015-2016 Amount #	2016-2017 Amount #	2017-2018 Amount #
September 30	\$3,496,884 1	\$469,442 1	\$4,112 0	\$(15,646.10) 0	\$506 0
December 31	9,000,391 1	5,856,158 2	1,096,671 1	\$6,814.87 0	\$296,444.08 1
March 31	575,570 1	8,866,670 2	391 0	\$4,223.47 0	\$8,000,391.26 1
June 30	<u>(19,609)</u> 0	<u>81,578</u> 0	<u>(1,671,796)</u> 1	<u>\$4,964,947.45</u> 1	<u>\$(19,727.16)</u> 0
Total	<u>\$13,053,236</u> 3	<u>\$15,273,848</u> 5	<u>\$(570,623)</u> 2	<u>\$4,960,339.69</u> 1	<u>\$8,277,614.40</u> 2

Actual Losses & Loss Adjustment Expenses Paid



■ Losses Paid
■ Loss Adjustment Expenses Paid

Table 2 summarizes the range of Fund claim payments for the last five fiscal years.

Table 2

Range of Fund Claim Payments

	# of Claims 2013-2014	# of Claims 2014-2015	# of Claims 2015-2016	# of Claims 2016-2017	# of Claims 2017-2018
\$1-500,000	0	1	0	0	1
\$500,001-1,000,000	1	1	0	0	0
\$1,000,001-2,000,000	0	0	1	0	0
\$2,000,001-5,000,000	1	1	1	1	0
\$5,000,001-10,000,000	1	2	0	0	1
Over \$10,000,000	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	<u>3</u>	<u>5</u>	<u>2</u>	<u>1</u>	<u>2</u>

Range of Claim Payments

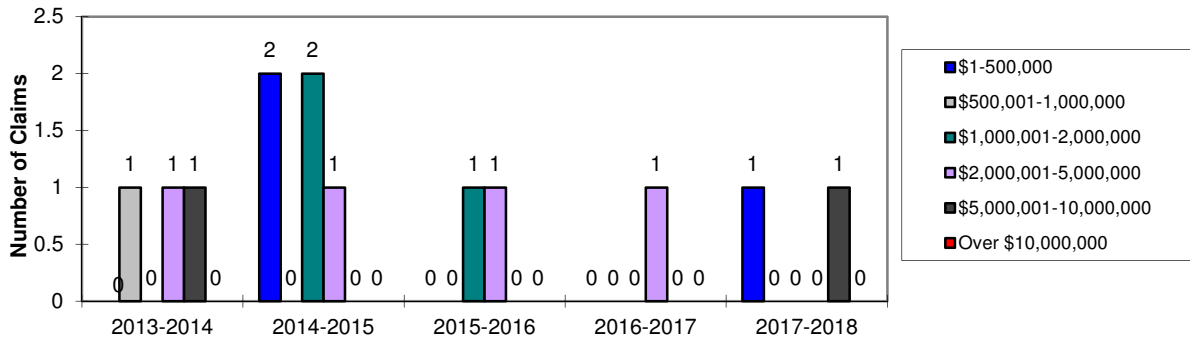


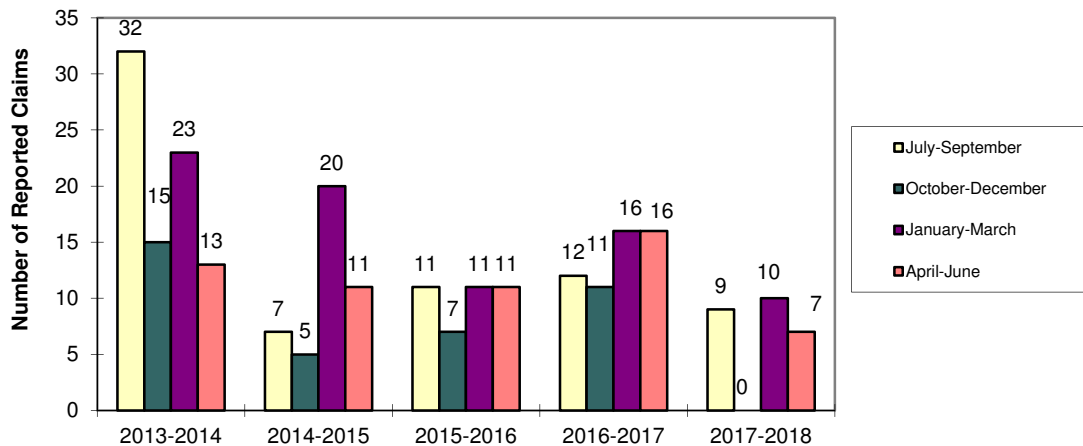
Table 3 summarizes Fund claims reported by quarter and fiscal year. A total of 43 claims were opened during fiscal 2015.

Table 3

Claims Opened Quarterly by Fiscal Year

	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
July 1-September 30	32	7	11	12	9
October 1-December 31	15	5	7	11	0
January 1-March 31	23	20	11	16	10
April 1-June 30	<u>13</u>	<u>11</u>	<u>11</u>	<u>16</u>	<u>17</u>
	<u>83</u>	<u>43</u>	<u>40</u>	<u>55</u>	<u>26</u>

Claims Reported by Quarter by Fiscal Year



Finance/Investment/Audit Committee

The Finance/Investment/Audit Committee’s responsibilities include establishing, monitoring, and amending as necessary, the investment strategy for the Fund to ensure obligations are met. The committee periodically reviews investments for compliance with investment guidelines and evaluates cash flow liquidity needs. In addition, the committee oversees the financial reporting process. Responsibilities include the review of financial position and results, as well as correspondence with auditors concerning audit scope, accounting issues, internal controls and management recommendations.

Legal Committee

The Legal Committee advises the Board on legal issues, including retroactive coverage requests, appeals, proposed statutory changes, administrative rule changes, and other issues that affect eligibility or Fund participation.

During 2018, the committee reviewed 172 requests for retroactive coverage of which 171 were approved, and 1 was denied.

Peer Review Council

The Peer Review Council (Council) reviews physician claim records to determine whether a surcharge should be imposed against the Fund fee or Plan premium, if applicable. The surcharge is a percentage of a provider's Fund fee or Plan premium based on the number of closed medical liability claims reported and the aggregate amount paid for those claims.

During fiscal year July 1, 2017, through June 30, 2018, 81 claims paid reports were filed. These included 17 for physicians or nurse anesthetists, 58 for hospitals, nursing homes, corporations or clinics, and 6 for other types of providers. No providers were subject to a possible surcharge.

Since the inception of the Council in 1986, 67 providers have been subject to a possible surcharge. The status, or disposition, of those providers as of June 30, 2018, is reported below:

- Exemptions from participation in the Fund have been filed by 35 providers, resulting in the suspension of the review for a surcharge.
- No surcharge was warranted for 12 providers as a result of the Council's review or consultant opinions.
- Two providers have been surcharged for failure to respond to Council requests for information.
- The review for surcharge was pending for two providers.

Risk Management and Patient Safety Committee

The purpose of the Risk Management and Patient Safety Committee is to reduce patient/claimant compensable injuries, reduce Fund losses and associated expenses, improve the general quality of medical care, and reduce the premiums of participating health care providers.

In 2018, the committee continued its focus on electronic communication tools to increase awareness of risk management services available through the Fund.

- E-newsletters were circulated via e-mail and the Fund's LinkedIn page. E-newsletter articles are available on the Fund's risk management Web page on the following topics:
 - *Mobile Devices: Considerations for Health Care Providers*
 - *To Be or Not To Be is Not the Question*
- *Locum Tenens—Considerations for Risk Managers* was the topic of the learning event held via webinar. Continuing education credits were available to attendees who were members of the America Society for Healthcare Risk Management. The recorded event is available on the Fund's risk management Web page.

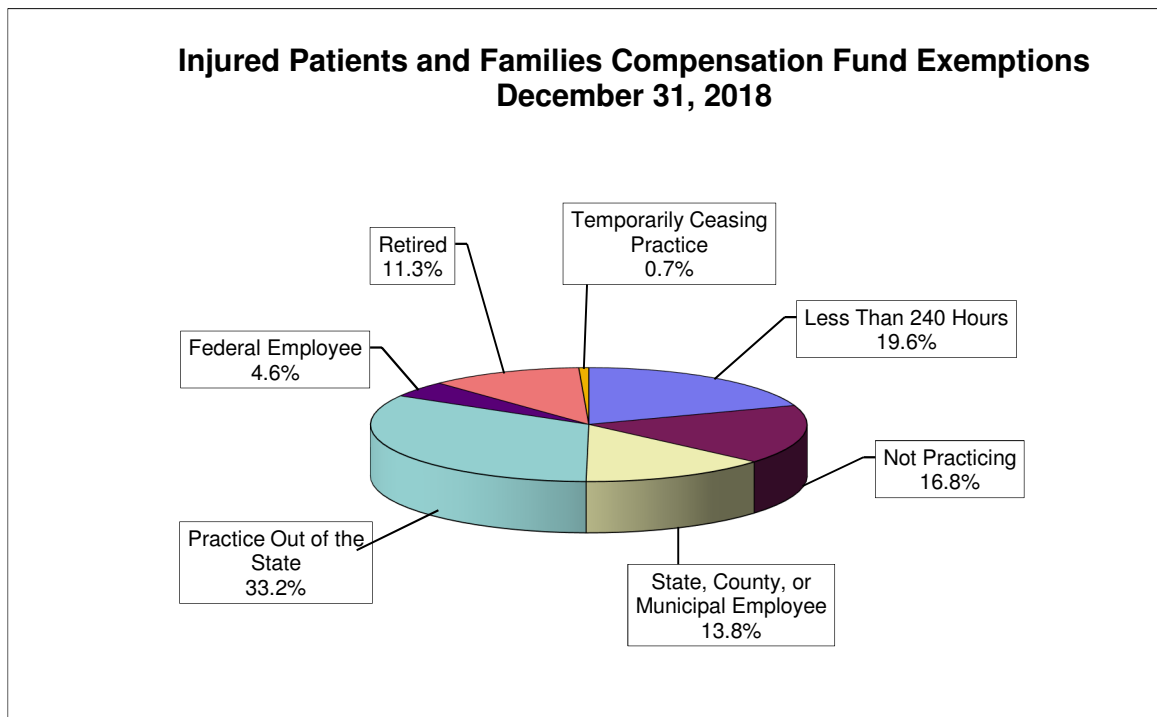
Other Fund Activities

Fund administration closely monitors the use of outside counsel. Pursuant to a court decision in 2000, the Fund hires separate defense counsel on each claim. Fund staff monitors claims and use of outside counsel to ensure that while the Fund receives the necessary representation, legal fees are controlled.

The Fund continually monitors and updates the exemption status for providers that held a license to practice in Wisconsin but for which a current exemption or certificate of insurance was not on file with the Fund. Providers that remain in noncompliance are referred to their respective licensing boards for appropriate enforcement action.

As of December 31, 2018, there were 13,557 providers exempt from participation in the Fund. The exemptions are categorized as follows:

Practice Out of Wisconsin	4,499
Less Than 240 Hours	2,656
Not Practicing or Never Practiced in Wisconsin	2,274
State, County, or Municipal Employee	1,875
Retired	1,535
Federal Employee	618
Temporarily Ceasing Practice	100

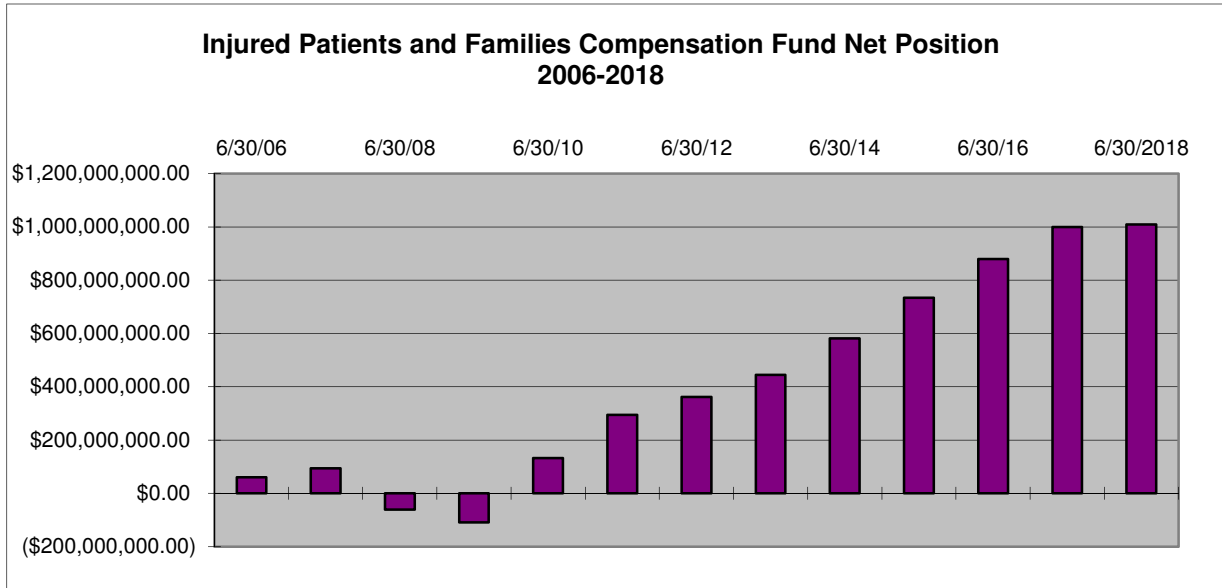


Financial Statistics

Attached, Exhibit 1, is the Fund's financial statement for the fiscal year ending June 30, 2018. The Fund reports its financial operations on a July 1 to June 30, succeeding year basis. The financial statistics will use "fiscal 2018" to disclose the one-year time July 1, 2017, to June 30, 2018, and similarly for other fiscal years.

The Fund reported an *unaudited* net position of \$1,009,527,768 as of June 30, 2018.

The following graph reflects the Fund's net position over the last 13 fiscal years.



The Fund reports its liabilities for losses and loss adjustment expenses on a discounted basis. This means the actuarially determined amount expected to be needed to pay all claims that have occurred, and those that will occur during the current fiscal year has been reduced by the amount of investment income expected to be received during the payout period. Any changes in interest rates or investment balance will have an impact on the financial position of the Fund.

The significant shift in the Fund's equity position from fiscal 2009 to 2010 was primarily due to the booking of an asset associated with the Supreme Court decision declaring the \$200 million transfer under 2007 Wisconsin Act 20 unconstitutional and the return of \$233.7 million, received in 2011. The increase in net position from fiscal 2011 to 2018 was the result of an increase in investment income, decreases in loss and LAE liabilities.

The Fund's next progress report, due March 1, 2020, will include an update on the Fund's 2019 activities.

**WISCONSIN INJURED PATIENTS AND FAMILIES
COMPENSATION FUND
Unaudited Statement of Net Position
6/30/2018**

ASSETS

Current Assets

Cash and Cash Equivalents	8,325,794
State Investment Fund Shares (market value)	12,863,844
Short Term Investments (market value)	20,709,173
Securities Sold Receivable	12,503,776
Bond Investment Income Receivable	9,523,242
Investment And Securities Lending Receivable	4,582
Inventories	1,372
Prepaid Items	60
Interfund Receivables	50,000

Total Current Assets	<u>63,981,844</u>
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Restricted Cash - Liability for FME Account	31,401,156
Investments (market value)	1,295,108,314
Depreciable Capital Assets (net of accumulated depreciation)	913,529
Restricted Assets	<u>99,545</u>

Total Noncurrent Assets	<u>1,327,522,544</u>
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Total Assets	<u>1,391,504,388</u>
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Deferred Outflows of Resources	<u>175,864</u>
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Total Assets and Deferred Outflows of Resources	<u>\$1,391,680,252</u>
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LIABILITIES

Current Liabilities

Future Benefits and Loss Liabilities	68,822,000
Unearned Assessments Levied	1,234,881
Provider Refunds Payable	1,202,725
Medical Mediation Panels Payable	142,234
Compensated Absences	5,057
Due to Other Funds	6,036
Accounts Payable and Other Accrued Liabilities	115,436
Securities Purchases Payable	12,497,055

Total Current Liabilities 84,025,424

Noncurrent Liabilities

Loss liabilities:

Loss Liability IBNR	275,826,058
Loss Liability Reported Losses	16,995,486
Loss Liability LAE	65,863,113

Estimated Loss Liabilities 358,684,657
Less: Amount Representing Interest (23,536,220)

Discounted Loss Liabilities 335,148,437
Liabilities for Future Medical Expenses 31,401,156
Contributions Being Held 0

Total Loss liabilities 366,549,593
Less: Loss Liabilities, Current Portion (68,822,000)
Noncurrent Loss Liabilities 297,727,593

Compensated Absences – Long Term	41,105
Net Pension Liability	0
Other Postemployment Benefits	<u>152,104</u>

Total Noncurrent Liabilities 297,920,802

Total Liabilities 381,946,226

Deferred Inflows of Resources 206,257

Total Liabilities and Deferred Inflows of Resources 382,152,483

NET POSITION

Net Position:

Invested in Capital Assets, Net of Related Debt	913,529
Restricted for Other Purposes	99,545
Restricted for Injured Patients and Families	<u>1,008,514,694</u>

Total Net Position 1,009,527,768

Total Liabilities, Deferred Inflows of Resources and Net Position **\$1,391,680,252**

**WISCONSIN INJURED PATIENTS AND FAMILIES
COMPENSATION FUND
Statement of Revenues, Expenses, and Changes in Fund Net Position
For the Fiscal Year Ended
6/30/2018**

OPERATING REVENUES

Assessments	\$11,399,860
Assessment Interest Income	4,719
Administrative Fee Income	<u>25,728</u>
 Total Operating Revenues	 <u>11,430,308</u>

OPERATING EXPENSES

Underwriting Expenses:	
Net Losses Paid	6,816,493
Loss Adjustment Expense Paid	3,591,301
Risk Management Expenses	65,159
Medical Expenses Paid	1,341,575
Change in Liability for IBNR	(27,647,199)
Change in Liability for Reported Losses	2,298,826
Change in Liability for Loss Adjustment Expense	11,230,855
Change in Amount Representing Interest	25,178,299
Change in Liability for Future Medical Expense	<u>(624,236)</u>
Total Underwriting Expenses	22,251,073
General and Administrative Expenses	890,716
Depreciation Expense	<u>524,023</u>
 Total Operating Expenses	 <u>23,665,812</u>
 Operating Income (Loss)	 (12,235,505)

NONOPERATING REVENUES (EXPENSES)

Investment Income	22,345,190
Miscellaneous Revenue	<u>6,755</u>
 Change in Net Assets	 10,109,685
Transfers to the General Fund	<u>(13,643)</u>
Change in Net Position	10,102,798

NET POSITION

Net Position—Beginning of the Period	<u>999,496,722</u>
Prior Period Adjustment	<u>(71,752)</u>
 Net Position—End of the Period	 <u>\$1,009,527,768</u>

**WISCONSIN INJURED PATIENTS AND FAMILIES
COMPENSATION FUND
Statement of Cash Flows
6/30/2018**

CASH FLOWS FROM OPERATING ACTIVITIES

Cash Received from Providers for Assessments	\$11,587,154
Cash Paid for Losses	(7,761,422)
Cash Paid for Loss Adjustment Expenses	(3,591,301)
Cash Paid for Future Medical Expenses	(1,440,983)
Cash Paid For Risk Management Expenses	(65,159)
Cash Paid for Other Expenses	(932,184)
Cash Paid to Providers for Refunds of Fund Fees	(382,158)
Cash Paid for Medical Mediation Panel Fees	<u>(188,903)</u>
Net Cash Provided by Operating Activities	(2,774,957)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Transfers Out to Other Post-Employment Benefit	<u>(13,643)</u>
Net Cash Provided (used) by Capital or Related Financing Activities	(13,643)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Cash Paid to Develop Capital Assets	<u>(447,269)</u>
Net Cash Used by Capital or Related Financing Activities	(447,269)

CASH FLOWS FROM INVESTING ACTIVITIES

Investment and Interest Received	33,993,144
Cash Received as Proceeds from Sales of Investments	211,809,190
Cash Paid for Purchase of Investment Securities	<u>(253,320,876)</u>
Net Cash Provided by (Used for) Investment Activities	<u>(7,518,542)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(10,754,410)
Cash and Cash Equivalents—Beginning of the Year	<u>63,345,204</u>
Cash and Cash Equivalents—End of the Year	<u>\$52,590,794</u>

**RECONCILIATION OF OPERATING INCOME TO
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES**

Operating Income	\$(12,235,505)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation Expense	524,023
Change to software assets due to capitalization	
Changes to Assets and Liabilities	
Increase in Other Assets	(99,545)
Decrease in other receivables	38,948
Increase in supplies inventory	(376)
Decrease in prepaid items	1
Decrease in Deferred Outflows of Resources	15,465
Increase in OPEB	88,371
Increase in compensated absences	209
Increase in due to other funds	1,151
Decrease in unearned revenue	(423,969)
Decrease in provider Refund Payable	(192,830)
Increase in Loss Liabilities	9,436,545
Decrease in Unearned Revenue	(430,620)
Increase in Deferred Inflows of Resources	119,880
Decrease in Other Liabilities	<u>(47,325)</u>
Total Adjustments	<u>9,460,547</u>
Net Cash Provided by (Used for) Operating Activities	<u>\$(2,774,957)</u>
Noncash Activities:	
Net Change in Unrealized Gains and Losses	\$9,707,148
Other	

Notes to the Financial Statements

1. Description of the Injured Patients and Families Compensation Fund (Fund)

The Fund is part of the state of Wisconsin financial reporting entity and is reported as a major enterprise fund in the State's Comprehensive Annual Financial Report. The Fund, formerly known as the Patients Compensation Fund, was created in 1975 for the purpose of paying that portion of medical malpractice claims exceeding the legal primary insurance limits prescribed in s. 655.23 (4), Wis. Stat., or the maximum liability limit for which the health care provider is insured, whichever limit is greater. Most health care providers permanently practicing or operating in the state of Wisconsin are required to pay annual assessments.

Management of the Fund is vested with the 13-member Board of Governors, which is chaired by the Commissioner of Insurance. The Board has designated the Commissioner of Insurance as the administrator of the Fund. Similarly, under s. 655.27 (2), Wis. Stat., the Commissioner shall either provide staff services necessary for the operation of the Fund or, with the approval of the Board, contract for all or part of these services. During fiscal 2018, fiscal 2017, and fiscal 2016, the Board contracted for the Fund's actuarial, risk management, and claims administration services.

2. Summary of Significant Accounting Policies

A. Fund Accounting and Basis of Presentation

Financial statements of the Fund have been prepared in conformance with generally accepted accounting principles (GAAP) for proprietary funds. The accompanying financial statements were prepared based upon the flow of economic resources focus and full accrual basis of accounting, with revenues, recognized when earned and expenses recognized when incurred.

The Statement of Revenues, Expenses, and Changes in Fund Net Position classifies the Fund's fiscal year activity as either operating or non-operating. Because the Fund is an enterprise fund, which is a type of proprietary fund, it accounts for operations in a manner similar to private businesses in which operating revenues are derived from exchange transactions. Assessments, which are received from health care providers in exchange for coverage under the Fund, represent a significant component of operating revenues. Operating expenses include underwriting and administrative expenses.

Certain revenues and expenses that are not related to the Fund's primary purpose, such as interest expense, are reported as non-operating revenues and expenses. The most significant source of the Fund's non-operating income is investment income.

The Fund applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure. Further, the Fund has not elected to apply the provisions of relevant pronouncements of FASB issued after November 30, 1989.

B. Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Estimates that are particularly susceptible to significant changes in future years are the liabilities for unpaid losses and loss adjustment expenses. In estimating these liabilities, management uses the methodology discussed in Note 4 on ultimate and discounted loss liabilities.

C. Cash and Cash Equivalents

Cash and cash equivalents include cash balances deposited with the state and shares in the State Investment Fund, which is a short-term pool of state and local funds. The State Investment Fund shares are included in both the current portion of cash and cash equivalents and noncurrent portion restricted for future medical expenses.

D. Investment Valuation

Investments of the Fund consist of fixed income securities and shares in equity index funds. All investments are managed by the State of Wisconsin Investment Board and are reported at fair value. Fair value information is determined using quoted market prices.

E. Assessments

Assessments are billed and recognized as revenues on a fiscal year basis, which is also the policy year. Assessments received for the next fiscal year are treated as deferred revenue and reported as assessments received in advance. Accounts of providers are automatically credited and reported as provider refunds payable when primary insurance lapses.

F. Loss Liabilities

Loss liabilities are estimated based on recommendations of a consulting actuary and are discounted to the extent that they are matched by cash and invested assets. The uncertainties inherent in projecting the frequency and severity of claims, the Fund's unlimited liability coverage for economic damages, and extended reporting and settlement periods make it likely that the amounts ultimately paid will differ from the recorded estimated liabilities.

G. Policy Acquisition Costs

Since the Fund has no marketing staff and incurs no sales commissions, acquisition costs are minimal and charged to operations as incurred.

H. Capital Assets

The Fund capitalizes all assets, both tangible and intangible, which have a historical cost or estimated historical cost in excess of \$5,000 and a useful life of two or more years. As of June 30, 2018, the Fund's capital assets totaled \$913,529 and consisted of one asset, the internally developed provider system software which is depreciated on a straight-line basis over seven years.

I. Net Assets

Section 655.27 (6), Wis. Stat., requires the Fund to be held in an irrevocable trust and used for future claim payments for injured patients and families. Available net position is restricted for injured patients and families and totaled \$1,009,527,768 as of June 30, 2017, \$999,496,722 as of June 30, 2016, and \$878,876,683 as of June 30, 2016.

J. Employee Compensated Absences

The Fund's compensated absence liability consists of accumulated unpaid leave, compensatory time, personal holiday hours, and Saturday/legal holiday hours earned and vested as of June 30. The compensated absences liability is classified as either a short-term liability under general and administrative expenses payable or a long-term liability under compensated absences and other post-employment benefit (OPEB) liabilities based upon an estimate determined by management. The long-term liability portion of the compensated absences liability generally is not paid out until retirement.

3. New Accounting Standard

Effective for the Fiscal Year 2018, the State implemented Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. This statement establishes standards of accounting and financial reporting for defined benefit other post-employment benefits (OPEB) and defined contribution OPEB that are provided to the employees of state and local governmental employers. The State also implemented GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*. This statement establishes reporting standards for other post-employment benefits included in the general purpose external financial reports of state and local governmental OPEB plans.

4. Deposits and Investments

The Fund's deposits consist of cash deposited in the state's bank, which totaled \$3,715 as of June 30, 2018, \$16,648 as of June 30, 2017, and \$58,543 as of June 30, 2016.

The Fund's investments are managed by the State of Wisconsin Investment Board, whose objective is to maintain a portfolio of investments to provide a balance between capital appreciation, preservation of capital, and current income consistent with the needs of the Fund. Section 25.17 (3) (a), Wis. Stat., allows investments in loans, securities, and any other investments as authorized by s. 620.22, Wis. Stat. Classes of investments permitted by s. 620.22, Wis. Stat., include bonds of governmental units or private corporations, loans secured by mortgages, preferred or common stock, real property, and other investments not specifically prohibited by statute. In addition, the Board of Governors established a more specific investment policy that limits equity investments to 20% of the Fund's total portfolio.

Although classified as cash and cash equivalents on the Statement of Net Assets and the Statement of Cash Flows, shares in the State Investment Fund are subject to investment risk disclosures. The State Investment Fund is a short-term investment pool of state and local funds managed by the State of Wisconsin Investment Board, with oversight by its Board of Trustees and in accordance with Wisconsin Statutes. It is not registered with the Securities and Exchange Commission as an investment company. Shares in the State Investment Fund are reported at fair value as of June 30. The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17 (3) (b), (ba), (bd), and (dg), Wis. Stat., and include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposit issued by banks in the United States including solvent financial institutions in Wisconsin, and bankers acceptances. The State of Wisconsin Investment Board's Board of Trustees may specifically approve other prudent legal investments. Interest income, gains, and losses of the State Investment Fund are allocated monthly.

The market values of the Fund's investments at fiscal year-end are reported below:

	June 30, 2018	June 30, 2017	June 30, 2016
<u>Short-term Investment Pool</u>			
State Investment Fund ¹	<u>\$52,628,760</u>	<u>\$63,390,067</u>	<u>\$58,206,467</u>
<u>Fixed-Income:</u>			
U.S. Government and Agency	597,918,268	575,021,604	528,767,215
Municipal Bonds	21,047,846	25,515,089	27,921,063
Foreign Governments	40,620,311	22,321,048	23,489,051
Corporate Bonds	<u>428,127,413</u>	<u>466,826,341</u>	<u>430,212,530</u>
Subtotal	<u>1,087,713,838</u>	<u>1,089,684,083</u>	<u>1,012,011,341</u>
<u>Equities:</u>			
MSCI World Ex-US Index Fund	31,960,643	29,822,982	26,689,557
Russell 3000 Index Fund	196,143,006	170,754,337	0
Russell 2000 Index Fund	0	0	16,844,299
S & P 500 Index Fund	0	0	165,877,126
S & P 400 Index Fund	0	0	15,438,271
BAC Capital Trust	<u>0</u>	<u>1,601,448</u>	<u>1,621,482</u>
Subtotal	<u>228,103,649</u>	<u>202,178,767</u>	<u>226,470,735</u>
Total Investments	<u>\$1,368,446,247</u>	<u>\$1,355,252,917</u>	<u>\$1,295,067,060</u>

¹State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Assets.

Custodial Credit Risk - Deposits—the risk in the event of the failure of a depository financial institution, the Fund will not be able to recover deposits that are in possession of an outside party. The Fund does not have a deposit policy specifically for custodial credit risk. None of the Fund's bank balances as of June 30, 2018, June 30, 2017, and June 30, 2016, were exposed to custodial credit risk.

Custodial Credit Risk - Investments—the risk in the event of the failure of the counterparty to a transaction, the Fund will not be able to recover the value of investments that are in possession of an outside party. The Fund does not have an investment policy specifically for custodial credit risk. As of June 30, 2018, June 30, 2017, and June 30, 2016, the Fund did not have any investments exposed to custodial credit risk.

Credit Risk—the risk an issuer or other counterparties to an investment will not fulfill its obligations to the Fund. The Fund's investment guidelines provide that, at the time of purchase, at least 80% of the bond portfolio must be rated AAA/A- or better by Nationally Recognized Statistical Rating Organizations, using the lower of split ratings. In addition, the Fund's investment guidelines require that a minimum of 30% of the Fund's investable assets (excluding the cash restricted for payment of future medical expenses) must be invested in U.S. Treasury or Agency Securities. The State Investment Fund is unrated; however, its guidelines establish specific maximum exposure limits by security type based on the minimum credit ratings as issued by Nationally Recognized Statistical Rating Organizations.

The credit exposures aggregated by credit rating as of June 30, were as follows:

Credit Rating:	June 30, 2017		June 30, 2017		June 30, 2016	
	Fair Value	Percent	Fair Value	Percent	Fair Value	Percent
AAA	\$27,417,307	2.4%	\$26,763,316	2.3%	\$26,968,917	2.5%
AA	631,544,351	55.4	613,379,616	53.1	552,622,282	51.9
A	121,810,827	10.7	130,348,174	11.3	133,228,999	12.5
BBB	275,038,461	24.1	287,145,677	24.9	261,090,179	24.5
BB	15,542,103	2.8	27,393,824	2.4	28,135,743	2.6
B	0	0.0	6,244,475	0.5	7,420,438	0.7
C or Lower	0	0.0	0	0.0	923,000	0.1
Not Rated	<u>32,600</u>	<u>0.0</u>	<u>10,450</u>	<u>0.0</u>	<u>300</u>	<u>0.0</u>
Subtotal	1,087,713,838	95.4	1,091,285,532	94.5	1,010,389,858	94.9
State Investment Fund (unrated)	<u>52,628,760</u>	<u>4.6</u>	<u>63,390,067</u>	<u>5.5</u>	<u>53,913,562</u>	<u>5.1</u>
Total	<u>1,140,342,598</u>	<u>100.0%</u>	<u>1,154,675,599</u>	<u>100.0%</u>	<u>\$1,064,303,420</u>	<u>100.0%</u>

Concentration of Credit Risk—the risk of loss attributed to the magnitude of an organization's investment in a single issuer. The Fund's investment guidelines do not allow for investments in any one single issuer that is in excess of 5% of the Fund's bond portfolio based on market value at the time of purchase. Securities of the United States government and its agencies are excluded from that limitation. As of June 30, 2018, June 30, 2017, and June 30, 2016, the Fund did not have more than 5% of its total investments in a single issuer, excluding the United States government and its agencies. The concentration of credit risk requirements is also not applicable to pooled investments, such as the State Investment Fund.

Interest Rate Risk—the risk that changes in interest rates will adversely affect the fair value of an investment. The Fund uses the duration method to identify and manage its interest rate risk. The Fund's investment guidelines related to interest rate risk provide that the average duration of the aggregate bond portfolio should be less than ten years. The State Investment Fund uses the weighted average maturity method to analyze interest rate risk. Its investment guidelines mandate that the weighted average maturity for the entire portfolio not exceed one year.

The following were the durations for each type of fixed-income security held, as well as for the State Investment Fund:

Type of Security:	June 30, 2018		June 30, 2017		June 30, 2016	
	Fair Value	Duration (In Years)	Fair value	Duration (In Years)	Fair value	Duration (In Years)
Gov/Agency	\$597,918,268	5.33	\$575,021,605	5.21	\$530,401,256	5.09
Corporate	<u>428,127,413</u>	6.75	<u>516,263,926</u>	6.75	<u>479,988,602</u>	7.76
Subtotal	1,091,285,531	6.17	1,091,285,531	6.30	1,010,389,858	6.36
State Investment Fund ¹	<u>52,628,760</u>	0.18	<u>63,390,067</u>	0.24	<u>53,913,562</u>	0.38
Total	<u>\$1,154,675,598</u>	<u>5.89</u>	<u>\$1,154,675,598</u>	<u>5.98</u>	<u>\$1,064,303,420</u>	<u>6.05</u>

¹State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Assets.

Foreign Currency Risk—the risk that changes in exchange rates will adversely affect the fair value of an investment. The Fund's investment guidelines do not specifically address foreign currency risk. As of June 30, 2018, June 30, 2017, and June 30, 2016, the Fund did not directly own any issues denominated in a foreign currency.

5. Total Loss Liabilities

A. Estimated Loss Liabilities

Loss liabilities include individual case estimates for reported losses and estimates for losses that have been incurred but not reported (IBNR), based upon the projected ultimate losses recommended by a consulting actuary. Individual case estimates of the liability for reported losses and net losses paid from the inception of the Fund are deducted from the projected ultimate loss liabilities to determine the liability for IBNR losses as follows:

	June 30, 2018	June 30, 2017	June 30, 2016
Projected Ultimate Loss Liability	\$1,108,669,000	\$1,120,611,000	\$1,170,603,449
Less:			
Net Losses Paid from Inception	(874,411,765)	(866,075,067)	(861,026,275)
Liability for Reported Losses	(16,995,486)	(14,696,660)	(20,999,466)
Risk Margin	<u>58,564,309</u>	<u>63,633,983</u>	<u>77,394,293</u>
Liability for IBNR Losses	<u>\$275,826,058</u>	<u>\$303,473,257</u>	<u>\$365,972,001</u>

The Fund's consulting actuary developed the best estimate of the loss liabilities, and the Board of Governors approved the addition of an explicit 25% risk margin to the best estimate for June 30, 2018, June 30, 2017, and June 30, 2016. The explicit risk margin is applied to ensure the loss liability estimates remain adequate in the event a court decision or law change could adversely affect the number of future claim payments.

Loss liabilities also include a provision for the estimated future payment of costs to settle claims. The actuary estimates the ultimate loss adjustment expense (LAE) using data available through September 30 of the fiscal year. The actuary estimates LAE at 25% of the estimated unpaid loss liabilities for June 30, 2018, June 30, 2017, and June 30, 2016. The percentage used in the financial statements will vary since the actuary's estimate does not include unallocated loss adjustment expenses (ULAE). The LAE paid from the inception of the Fund are deducted from the projected ultimate LAE provision to arrive at the liability for LAE as follows:

	June 30, 2018	June 30, 2017	June 30, 2016
Projected Ultimate LAE Liability	\$155,691,000	\$143,151,000	\$149,329,854
Less:			
Net LAE Paid from Inception	(103,000,511)	(99,445,194)	(95,859,124)
Risk Margin	<u>13,172,622</u>	<u>10,926,451</u>	<u>13,367,682</u>
Liability for LAE	<u>\$65,863,111</u>	<u>\$54,632,257</u>	<u>\$66,838,412</u>

B. Re-estimated Loss Liabilities

Because of the uncertainties inherent in projecting medical malpractice claims with unlimited liability coverage, estimates of the Fund's loss liability and liability for LAE are continually reviewed and adjusted as the Fund gains additional experience. Such adjustments are reflected in current operations. Because of the changes in these estimates for prior years, the total underwriting expenses reported for the year are not necessarily indicative of the loss experience for that year.

C. Discounted Loss Liabilities

Section Ins 17.27 (3), Wis. Adm. Code, requires the liability for reported losses, liability for IBNR losses, and liability for LAE to be maintained on a present-value basis, with the difference from the full value being reported as a contra account to the loss liabilities. The loss liabilities are discounted only to the extent that they are matched by cash and invested assets. The actuarially determined discount factors, which are based on investment yield assumptions of 2% that was approved by the Board of Governors for fiscal 2018, while for the fiscal year 2016 and fiscal year there was a 4% discount factor. The applied discount rate factor was .934 for the fiscal year 2018, 0.869 for fiscal 2017, and 0.861 for fiscal 2016.

D. Future Medical Expense Liability

Section 655.015, Wis. Stat., requires accounts to be established if a settlement or judgment provides for future medical expense (FME) payments in excess of \$100,000. In addition to amounts provided by the Fund, this account may also include deposits provided by the primary insurer for any portion of future medical expenses for which they are liable. The accounts are managed by the Fund and earn a proportionate share of the Fund's interest. Any account balance remaining when a claimant dies reverts back to the Fund.

E. Contributions Being Held Liability

A primary insurer may voluntarily present a nonrefundable payment to the Fund generally equal to the amount of primary coverage in effect for the related claim. This payment from the primary insurer is negotiable with the Fund in exchange for a release of payment for any future defense costs that may be incurred on the claim. This amount is held as a liability on the Fund's financial statements until the time a payment is made on the claim. There were no contributions held as of June 30, 2018, while contributions of \$1.0 million were being held as of June 30, 2017, and June 30, 2016.

F. Loss Liabilities Balances and Activities (in thousands)

	Fiscal 2018	Fiscal 2017	Fiscal 2016
Total loss liabilities, beginning of the year	\$357,113	\$424,483	\$486,039
Incurred losses and related expenses for the current year and changes in the estimated liabilities for prior year losses and related expenses	22,337	(58,188)	(51,713)
Less: Current year payments for losses, LAE, and FME incurred in the current and prior years	<u>(12,900)</u>	<u>(9,182)</u>	<u>(9,843)</u>
Total loss liabilities, end of the year	366,550	357,113	424,483
Less: Current portion	<u>(68,822)</u>	<u>(58,661)</u>	<u>(52,262)</u>
Noncurrent portion	<u>\$297,728</u>	<u>\$298,452</u>	<u>\$372,221</u>

6. Medical Mediation Panel Fees

Section Ins. 17.27 (3), Wis. Adm. Code, requires the fees collected for the administration of the Medical Mediation Panel be included in the Fund's financial reports, but that they should not be regarded as assets or liabilities of the Fund or otherwise taken into consideration in determining assessment levels to pay claims. Panel fees are charged providers with Fund assessments, based upon estimates for services provided the Fund by the Supreme Court. For fiscal 2018, the Supreme Court estimated a \$ 207,000-panel fee obligation. The Fund remitted panel fees to the Supreme Court of \$280,556 in fiscal 2018, \$123,500 was remitted in fiscal 2017 and \$185,960 was remitted in fiscal 2016.

7. Claim Annuities

The settlement of a claim may result in the purchase of an annuity. Under specific annuity arrangements, the Fund may have ultimate responsibility for annuity payments if the annuity company defaults on annuity payments.

One of the Fund's annuity providers defaulted on \$119,863 in annuity payments through June 30, 2018, which the Fund subsequently paid. The annuity provider is currently making the majority of these annuity payments, but the Fund continues to make monthly annuity payments of \$130, and additional lump-sum payments due every five years through 2025, to cover defaulted payments. Through June 30, 2018, the Fund has received a total reimbursement of \$114,038, which includes interest. It is unclear when the annuity provider will be able to make the remaining annuity payments and whether the Fund will be able to recover the remaining annuity payments made on the behalf of the annuity provider.

The total estimated replacement value of the Fund's annuities of which the Fund remains the owner was \$32.8 million as of June 30, 2018, June 30, 2016, and June 30, 2015. Of this amount, \$651,753 represents the replacement value of the annuity in default as of June 30, 2018.

8. Audit Adjustments

There are no audit adjustments in OCI's annual reports to the Governor and the Legislature.
