



COMMONWEALTH OF KENTUCKY

Mike Harmon
AUDITOR OF PUBLIC ACCOUNTS

Daniel Cameron
ATTORNEY GENERAL

January 30, 2020

Honorable David Osborne
Speaker, House of Representatives
Kentucky General Assembly
State Capitol, Room 309
Frankfort, KY 40601

Honorable Robert Stivers
President, Senate
Kentucky General Assembly
State Capitol, Room 319
Frankfort, KY 40601

Re: Biennial Report to the General Assembly on Kentucky Employers' Mutual Insurance Authority

Gentlemen:

The Attorney General (AG) and the Auditor of Public Accounts (APA) are required by KRS 342.843(1) to monitor the operations of the Kentucky Employers' Mutual Insurance Authority (KEMI), and to jointly submit to the General Assembly, each year in which the General Assembly convenes in an even-numbered-year regular session, a report of the results of the monitoring activities. This constitutes our report as required by KRS 342.843(5).

During the calendar years of 2018 and 2019, AG and APA representatives monitored the operations of KEMI by attending regular bimonthly meetings, special meetings, and committee meetings of KEMI's Board of Directors (Board), and by reviewing various records related to KEMI.

Our offices have reviewed KEMI's quarterly and annual statements filed with the Kentucky Department of Insurance (KDOI) as required by statute. The independent certified public accounting firm, Dean, Dorton Allen and Ford, performed KEMI's annual financial audits for FY 2017 and FY 2018. We reviewed the annual audits and found that the audits reported no material weaknesses.

KEMI's Board retained the services of Conning Asset Management (Conning) as the investment manager to handle KEMI's portfolio. KEMI's Management continued to follow an established investment policy.

Throughout 2018 and 2019, KEMI's Internal Auditor (IA), who reports directly to the Board in accordance with KRS 342.811(3), performed numerous operational reviews and made monthly reports thereon.

In addition to monitoring activity of the KEMI Board, as outlined below, during this biennial time period, APA conducted a special examination of certain policies, procedures, controls, and financial activities of KEMI. This examination followed a request from the KEMI Board Chairman to audit and investigate concerns and issues identified by the Board. The APA's report contained ten findings, along with recommendations, to address issues identified related to governance, operations, and internal controls.

The APA's special examination report was issued on April 16, 2019, and is available at: www.auditor.ky.gov.

The following are the highlights of KEMI Board activity during 2018-2019, by Board meeting dates:

February 13, 2018

- KEMI's CEO reported to the Board a brief update on coal indicating that a large account he had previously discussed with them had obtained coverage elsewhere.
- KEMI's CEO reported to the Board that KEMI's new pension plan, since implementation in July 2016, had saved \$8.3M in pension costs.
- KEMI's CEO reported that KEMI's reinsurance program was renewed effective January 1, 2018, and explained how the program works in detail.
- KEMI's CFO reported to the Board a detailed review of KEMI's December 31, 2017, financial report. He discussed KEMI's investment portfolio and strategies employed by their asset management company and staff to monitor performance.
- The Board Chairman indicated that based on the information shared from the bylaws regarding the election of officers that nominations for KEMI board officer positions would be taken during the April Board Meeting.

February 26, 2018

- Members discussed the Board's role in the build vs. lease project. The Board decided to form a subcommittee for the purpose of conducting an RFI or RFP to determine space needs and direction and also to provide a long-term assessment and recommendation regarding the property that KEMI currently owns.
- The Board discussed its support of HB 2 and authorized KEMI's internal lobbyist to have discussions regarding the bill and express support on behalf of the Board.
- The Board Chairman asked legal counsel to discuss KEMI's Conflict of Interest Policy. Legal Counsel referred the Board to KEMI Bylaws which indicate pursuant to statute that the Manager/CEO, all officers, and employees shall comply with the Executive Branch Code of Ethics

- The Board discussed KEMI's current procurement process wherein KEMI prepares a budget which the Board approves and then the staff enter into contracts accordingly based on the Board's approval of the budget. They discussed the possibility of adding limits to the procurement policy which would require reporting to the Board and/or approval by the Board for specified procurement amounts.

March 13, 2018

- The Board discussed hiring a consultant to conduct a survey of total compensation, including salary, benefits, and incentive for similar entities in local, regional, and national markets.
- The Board Chairman asked for volunteers for the following standing committees: Human Resources Committee, Audit/Finance/Investment Committee, and the Bylaws & Legislative Relations Committee.
- The Board established an Executive Committee of the Board.
- The Board discussed the purchasing parameters established in the procurement policy and questioned who has authority to sign documents. The CEO indicated that budgetary approval levels exist. Members of the Board indicated they would like approval levels and signing authority to be reviewed with the Audit/Finance/Investment Committee meeting.

April 10, 2018

- Director of Assurance Services from KEMI's CPA firm (auditor), provided a detailed review of KEMI's 2017 independent audit.
- Details of personal service contracts and active operational contracts were discussed at length. The discussion included the types of contracts and how to procure, contracts over certain amounts and who should approve, and which contracts should go to the contract review committee. The Board did approve the contacts on the list contracts presented to the Board.
- KEMI's insurance & risk management coverages and the renewal proposal for the 2018-2019 term were discussed.
- KEMI's CEO provided a brief update on year-end financials, activity for the 1st quarter of 2018 with regard to premium and claims activity, status of KSBIT and status of the coal fund.
- The Board approved the engagement of the Auditor of Public Accounts to conduct a special examination of KEMI.

June 12, 2018

- The Board approved and adopted the revisions and additions to the Investment Policy as presented by KEMI Management.
- The Board approved personal service and operational contracts from the list provided to the Board.
- KEMI's CEO provided background and explained financials related to KSBIT Loss Portfolio Transfer as an assumptive reinsurance transaction.

August 14, 2018

- The Board approved signature authorities for financial institutions for which KEMI conducts business.
- The Board approved a revised list of personal service and operational contracts.
- KEMI's CEO advised that staff was working on the actuarial review and that recommendations regarding rates would be presented at the October board meeting.
- Monthly financial reports and monthly variance reports for 05/31/2018 and 06/30/2018 along with 6/30/2018 investment reports were included in the board meeting packet. Clarification regarding legal and actuarial expenses was requested and provided.

October 9, 2018

- KEMI's CEO discussed the announcement of KEMI's credit rating.
- The Board approved a recommendation from the HR Committee to adopt and implement a new compensation structure.
- The Board approved recommendations of the actuary and management regarding rates, commissions, and the dividend.
- The Board approved a revised procurement policy and procurement flow chart as recommended by the Executive Committee.
- The Board approved the 2019 budget as proposed under the condition that incentive pay and executive compensation would come back to the board for approval before being executed.

December 11, 2018

- KEMI's CEO provided an update on statistics related to premium, retention, policy count, payroll written, claims, and litigated claims. He reported that the Department of Insurance audit and the Auditor of Public Accounts audit were ongoing.
- KEMI's CEO briefly discussed the monthly financial reports, quarterly yellow book, and budget variance reports.
- The Board approved personal service and operational contracts.
- The Board approved an Internal Audit Charter.

February 12, 2019

- The investment firm provided the Board with a detailed update on investment strategy changes implemented in summer 2018.
- KEMI's CEO provided a detailed review of the balance sheet as of 12/31/2018.
- KEMI's CEO continued by discussing that one area being focused on for 2019 is ERM, or the managing and mitigating of risks.
- KEMI's CEO discussed policyholder equity for year-end 2018 and the income statement.
- Financial statements for KSBIT and KCWPF were reviewed in detail.
- KSBIT refund was approved by the Board

April 10, 2019

- The Board discussed the response to the Auditor of Public Accounts special examination.
- KEMI's CEO provided a detailed discussion of the 2018 Statement of Actuarial Opinion.
- KEMI's CEO provided a high level review of the financial reports.
- The Board approved the acceptance of the FY 2018 financial statement audit by their CPA firm.
- The Board approved Officers for the 2019-2020 term.

April 19, 2019

- The Board empowered the Executive Committee to draft and execute a probationary contract with the CEO moving forward for presentation to the Board for final approval at the next full Board meeting.

April 23, 2019

- The Board approved the new contract for the new CFO.

June 11, 2019

- The Board approved the full response in regards to the special examination by the Auditor of Public Accounts.
- The Board approved the contract listing as presented to the Board.
- KEMI's CFO proposed a change in approach to financial reporting for board meetings indicating that a summary would be provided at each board meeting and a more detailed review would be provided to the Audit/Finance/Investment Committee.
- The Board adopted an Executive Committee charter, Audit/Finance/Investment charter, Human Resources Committee Charter, Bylaws and Legislative Relations Committee Charter, and a Space Planning Committee Charter.

August 13, 2019

- The Board approved the following documents: 2019 KEMI Compensation Administrative Guidelines, KEMI EIP Administrative Guideline, KEMI Strategic Scorecard Overview, KEMI Total Rewards Philosophy, and the KEMI Career Path Guide.
- KEMI's CEO indicated that the initial review of the financials for the first six months indicated 2019 is one of KEMI's better years.
- KEMI staff then provided a presentation regarding KEMI's current book of business and KEMI's strategic initiative to grow KEMI.
- The Board approved contracts on the Board Contract Approval listing.
- KEMI's CFO advised the members to review the summary financial report showing actuals for the first 2 quarters and projected proforma numbers.
- The Board approved procurement policy changes.
- The Board approved their new external auditor based on the results of an RFP.

- The Board approved executive employment contracts for the general counsel, vice president of strategy, and vice president of underwriting.

October 1, 2019

- KEMI's CFO reviewed the July and August financial reports.
- KEMI's CEO discussed the Terrorism Risk Insurance Reauthorization Act.
- KEMI's CEO provided the Board with an update on a previously discussed coal bankruptcy and the potential impact due to the recent purchase of the business by another entity and the possible layoff of employees.
- KEMI's CEO reported that only three claims inherited in the coal fund loss portfolio transfer remain in adjudication; all others have been settled.
- The Board approved the Contract Approval List.
- The Board approved the Risk Appetite Statement, 2020 Proposed Budget, and Internal Auditor Smart Goals as presented.
- The Board approved the proposed Benefits, CEO SMART Goals, the Performance management and compensation structure update, the proposed amendment to KEMI Pension Plan regarding Application of Airtime/Service, proposed travel and business expense policy revision, and the proposed weapons policy revision, each as presented.

December 6, 2019

- KEMI's CEO discussed the aggregate stop loss and adverse development cover.
- The Board approved the Contract Approval list.
- KEMI's CFO discussed the October 31, 2019 financials and also discussed the year end proforma statements.
- The Board approved procurement policy changes and revisions to the Executive Committee Charter.

KEMI continues to cooperate with our two offices. As directed by statute, the AG and the APA will continue to monitor the operations of KEMI. Please let us know if additional information is required.

Sincerely,



DANIEL CAMERON
ATTORNEY GENERAL



MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

cc: Jay Hartz, Director, LRC