PROGRAM EVALUATION

KENTUCKY STATE FIRE AND TORNADO INSURANCE FUND

Committee for Program Review & Investigation

Research Report No. 178

Legislative Research Commission

Frankfort, Kentucky

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PROGRAM EVALUATION: KENTUCKY STATE FIRE AND TORNADO INSURANCE FUND

KENTUCKY GENERAL ASSEMBLY
COMMITTEE FOR PROGRAM REVIEW AND INVESTIGATION

LEGISLATIVE RESEARCH COMMISSION STAFF

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Research Report No. 178

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FOREWORD

The General Assembly created the State Fire and Tornado Insurance Fund in 1936 to provide basic insurance protection for Commonwealth property. Since then expansion and inflation have escalated property values. As property appreciates, insurance against potential loss must keep pace. The Commonwealth needs a fiscally sound insurance program if it is to meet obligations arising in the event of a catastrophe.

The Committee for Program Review and Investigation, at its September 6, 1979, meeting, voted to conduct a review of the State Fire and Tornado Insurance Fund. In response to that request, this analysis reviews Commonwealth property valuation, premium development, insurance costs, the role of the insurance agent, fund investments, claims and fund administration.

Jay C. Moon was project manager and project staff included Brent Neiser and Linda Carroll. The cover was designed by University of Kentucky Art Department student, John Cox.

VIC HELLARD, JR.
Director

The Capitol
Frankfort, Kentucky
January, 1981

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SUMMARY

The State Fire and Tornado Insurance Fund was created in 1936. Since that time, inflation and expansion have increased overall property values; the Commonwealth's total insurable value has increased from $500 million in FY 1970 to approximately $1.5 billion in FY 1979. As property appreciates in value, insurance against potential loss should be increased proportionately. Recognizing the importance of adequately insuring Commonwealth property, the legislative Committee for Program Review and Investigation directed that a study be conducted of Fund operations.

This review focuses primarily on the administration of the Fund and the methods used to secure insurance coverage for the Commonwealth's property. Interviews were held with state employees, most of them being in some way responsible for the administration of the Fund in the Department of Insurance, the Department of Finance, or the State Treasurer's Office. Additional information was obtained from other state government insurance programs, members of the Kentucky business community and from a survey questionnaire sent to Kentucky state agencies.

The Kentucky State Fire and Tornado Insurance Fund insures publicly owned buildings and personal property used by state agencies against loss from fire, windstorm, hail, explosion, riot attending a strike, riot, civil commotion, aircraft, vehicles and smoke. All state agencies are required to secure insurance from the Fund against these perils. The Fund covers losses up to $300,000; damages in excess of this amount are insured by commercial reinsurance purchased by the Department of Insurance. Special insurance protection against other perils is purchased by the Department at the request of agencies needing it. In addition, contracts with private insurance companies may also be obtained to insure buildings financed by bonds.

Administration of the Fund is divided among three state agencies: the Department of Insurance, the Department of Finance and the State Treasurer. The Department of Insurance has primary responsibility. Its duties include an annual appraisal of state properties, establishment of rates, apportionment of premiums among state agencies and the settlement of claims. The State Treasurer maintains records of Fund transactions and invests idle Fund balances in statutorily specified securities. The Department of Finance is responsible for approving insurance and reinsurance contracts with commercial carriers, issuing warrants for the payment of premiums to commercial carriers and damage claims to state agencies, assisting in the selection of fire fund projects and approving administrative costs incurred for Fund-related business.

The major findings of the study are only briefly discussed here. Further details on these and other subjects are included in the main body of the report.

There needs to be an immediate effort made to bring the appraised value of all state real and personal property up to date. To do this the Department needs additional appraisers. Because most appraisals were conducted over three years ago, it is probable that the Commonwealth's insurance coverage is inadequate.

The Fund deductible should be increased from $300,000 to $500,000; also, the Fund reserve should be raised from two million dollars to five million dollars through reinvestments over a period of years. These suggestions reflect an adjustment for inflation and the increased value of property. An increase in the reserve and deductible will strengthen the Fund's financial position should a

large number of claims occur. Additionally, these actions should lead to a reduction in agency premium costs.

The state would save approximately $200,000 a year in independent insurance agent commissions, based upon 1979 reinsurance costs, if it purchased reinsurance through competitive bidding from qualified insurance companies. The Department of Insurance workload would be reduced, since policy preparation and payment transactions would be limited to a single company or a few companies instead of dozens of independent agents.

The Department of Insurance and the State Treasurer should meet and establish written procedures to secure the maximum investment return from Fund monies. Currently part of the Fund's investment income accrues to the Commonwealth's General Fund. All investment income should accrue to the Fund, so it is available to pay claims, and help build the reserve to five million dollars.

Finally, and most importantly, the Department of Insurance should exercise a leadership role in implementing the recommendations mentioned above and elsewhere in this report. To do this it will be necessary to establish a division director position classification for the Property and Casualty Division within the Department of Insurance and fill it with a qualified risk manager. Such an individual can help with the increased and more complex workload faced by the Division, while shouldering the leadership responsibility for updating Fund management and administrative practices.

CHAPTER I

INTRODUCTION

In 1945, the United States Congress enacted the McCarran Act, which delegated to the states the regulation of insurance companies. Every state created its own statutes regulating its domestic insurance companies, as well as setting forth standards which out-of-state insurance companies must meet to do business in that state. Most states have established insurance agencies or departments to administer their regulatory programs. Since then, controversy has surrounded these agencies, most often focusing on the degree of protection they provide to consumers. Charges of regulatory weakness, inconsistency and favoritism toward insurance companies have been commonplace.

In recent years similar concerns have been expressed regarding the methods used by states to secure insurance for state properties. Kentucky's Department of Insurance not only regulates insurance business in the state, but has primary responsibility for the insurance coverage of state property. Over the past ten years, the methods by which the Commonwealth insures property under its control have been scrutinized and their soundness questioned by the press and lawmakers alike.

For these reasons, the Committee for Program Review and Investigation, at its September 6, 1979, meeting, voted to conduct a review of the State Fire and Tornado Insurance Fund. Particular emphasis was to be placed on amounts paid by agencies in premiums to the Department of Insurance and the premiums paid to insurance companies for reinsurance and other insurance on state buildings and property.

This report contains ten chapters. The second chapter explains self-insurance programs in general and describes the Commonwealth's Fire and Tornado Insurance Fund. Chapters III through X examine major aspects of the Fund's operations. Recommendations are presented at the end of each chapter. The final section recapitulates the major conclusions of this study.

A questionnaire was designed to determine the working relationship between state agency personnel and Department of Insurance employees and sent to sixty-two state agencies. Of those surveyed, forty-seven (seventy-six percent) responded. Responses to many of the questions appear in relevant sections throughout the body of the report. Additional response data appears in Appendix A.

CHAPTER II

SELF-INSURANCE IN THE COMMONWEALTH

The earliest form of self-insurance was the Bank Quarterly Plan, begun in 1829 in New York City. This plan provided funds to cover the debt of insolvent banks. Since then, self-insurance programs have insured workmen's compensation plans, public pensions and public and private property. The first self-insurance programs at the state level were adopted around the turn of the century. A study by the Division of Risk Management of the State of Florida determined that of forty-three state insurance programs reviewed, thirty-five, or eighty-one percent, had some type of self-insurance.[1] A listing of insurance programs operated by other states is presented in Table 1.

A self-insurance program may be started by legislative appropriations but is usually built-up and maintained through a system of annual premium payments by the various participating government agencies. Administration of such a program, including valuation of properties, payment of claims, engineering and inspection services, and all other functions normally performed by insurance professionals, is entrusted to government employees. Establishment of a self-insurance program in state government constitutes the creation of a government insurance company.

TABLE 1

TYPES OF INSURANCE ARRANGEMENTS FOR STATE-OWNED PROPERTY

FY 1978

STATE	FUNDED SELF-INSURANCE[b] (YEAR ESTABLISHED)	UNFUNDED[a] SELF-INSURANCE, NO COMMERCIAL INSURANCE	COMMERCIAL INSURANCE, USUALLY WITH A DEDUCTIBLE
Alabama	X (1923)		X
Alaska		X	X
Arizona	X (1975)		X
Arkansas	X (1973)		X
California		X	
Colorado			X
Connecticut			X
Delaware	X (1953)		
District of Columbia		X	
Florida	X (1917)		X
Georgia	X (1965)		X
Hawaii		X	
Idaho			X
Illinois		X	
Indiana			X

TABLE 1 (continued)

STATE	FUNDED SELF-INSURANCE[b] (YEAR ESTABLISHED)	UNFUNDED[a] SELF-INSURANCE, NO COMMERCIAL INSURANCE	COMMERCIAL INSURANCE, USUALLY WITH A DEDUCTIBLE
Iowa		X	
Kansas	X (1963)		
KENTUCKY	X (1936)		X
Louisiana	X		X
Maine	X (1966)		X
Maryland	X		X
Massachusetts		X	
Michigan		X	
Minnesota		X	
Mississippi			X
Missouri			X
Montana			X
Nebraska			X
Nevada			X
New Hampshire		X	
New Jersey	X		X
New Mexico			X
New York		X	
North Carolina	X (1945)		X
North Dakota	X (1919)		X
Ohio		X	
Oklahoma		X	
Oregon	X (1946)		X
Pennsylvania	X (1915)		
Puerto Rico			X
Rhode Island			X
South Carolina	X (1900)		X
South Dakota		X	
Tennessee	X		
Texas		X	
Utah	X		X
Vermont	X (1964)		X
Virginia	X (1964)		X

SOURCE: Greene, Mark R. and Michael L. Murray, "Self-Insurance of State Owned Property", The Journal of Risk Management, March, 1978, page 114.

NOTE: Description of Program components may vary with the researcher.

[a]There usually are some exceptions in those "no insurance" states where, in some cases, commercial insurance is (1) mandated by law, (2) is purchased in connection with the use of federal funds, or (3) where a modest repair or replacement fund is maintained. The states of California, Hawaii, Iowa, Kansas, Ohio, and Washington are a few examples.

[b]States with funds under $100,000 are excluded from the list.

[c]Universities generally purchase commercial insurance.

Historical Development of the State Fire and Tornado Insurance Fund

The State Fire and Tornado Insurance Fund (the Fund) was created by the General Assembly in 1936 and is administered by the Department of Insurance. Governed by the provisions of KRS 56.065 through 56.180, the Fund initially provided insurance coverage against loss from fire to public buildings and personal property (contents) belonging to or under the control and use of the Commonwealth or any agency of the state.

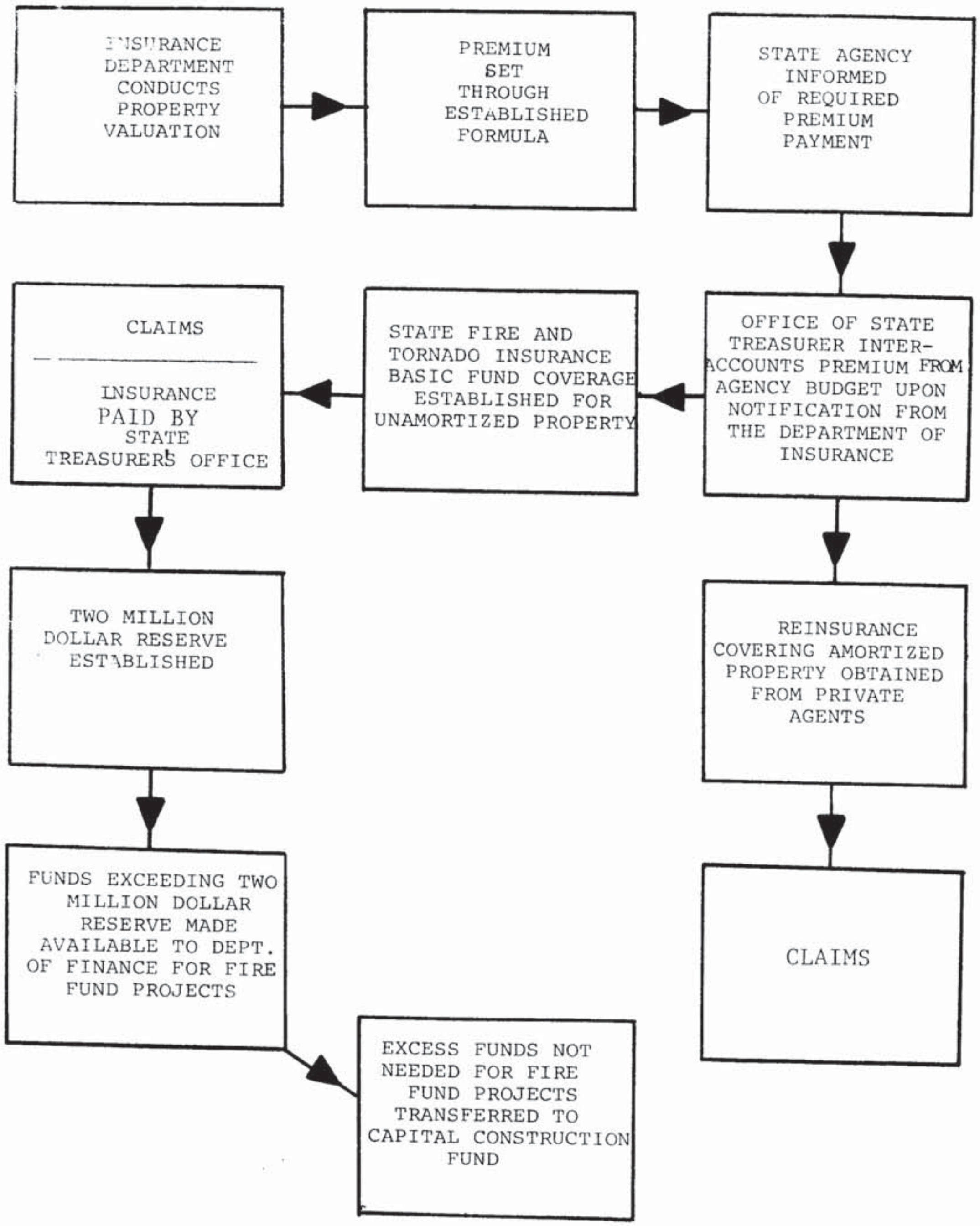
In 1950, as the national trend in insurance moved toward the adoption of broadened coverages, the legislature extended the Fund's coverage to include the perils of windstorm, hail, explosion, riot, riot attending a strike, civil commotion, aircraft, vehicles and smoke.

The Fund began operating within the Department of Insurance on July 1, 1936, with an advance from the General Assembly of one hundred thousand dollars. Operating funds (both administrative and for claims payment) were to be generated through the collection of premiums from the user agencies. The state assumed primary coverage, with excess liability being reinsured through commercial companies. The total premiums collected the first year of operations were $90,348; the FY 1979 total was $2,394,683. This increase reflects the growth in number of state-owned properties, inflation, and the addition of extended coverage protection. A flowchart outlining the operations of the State Fire and Tornado Insurance Fund is presented in Figure 1.

Administratively, the Fund is under the Property and Casualty Division of the Department of Insurance. Operationally, the Fund is part of the Insurance Pools and Plans Program. The Department's organizational and major program components are presented in Figures 2 and 3.

FIGURE 1

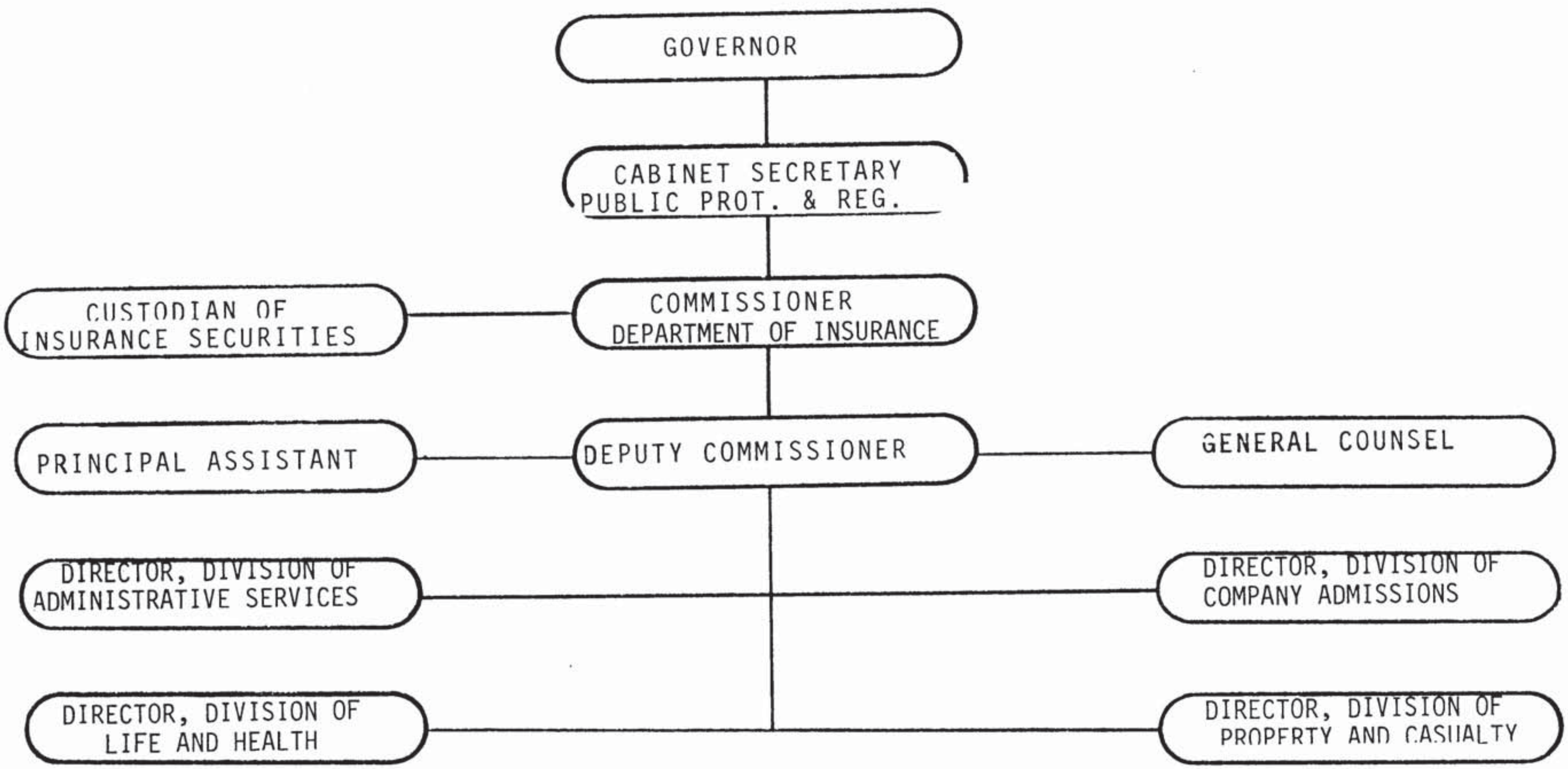
FLOWCHART INDICATING OPERATIONAL TRANSACTIONS PERFORMED FOR THE KENTUCKY STATE FIRE AND TORNADO INSURANCE FUND, FY 1980



SOURCE: Kentucky State Department of Insurance and Kentucky Revised Statutes Sections 56.080 through 56.100.

FIGURE 2

ORGANIZATION CHART FOR THE KENTUCKY STATE DEPARTMENT OF INSURANCE, FY 1979



SOURCE: Compiled by the Department of Insurance, Property and Casualty Division, October, 1979.

FIGURE 3

MAJOR PROGRAM COMPONENTS OF THE
KENTUCKY DEPARTMENT OF INSURANCE
FY 1979

GENERAL ADMINISTRATION AND SUPPORT PROGRAM	REGULATION OF INSURANCE COMPANIES PROGRAM	REGULATION OF INSURANCE AGENTS PROGRAM	REGULATION OF INSURANCE POOLS AND PLANS PROGRAM
1. Executive Policy and management	1. Approving or disapproving all policy filings, forms, and rates	1. Licensing of new agents	1. State Fire and Tornado Fund
2. Administration Services	2. Examine insurance companies	2. Renew agents licenses	2. Assigned Risk Pools and Plans
3. Legal Services	3. Admission of insurance companies	3. Investigation of agents	3. Kentucky Fair Plan
4. Data Processing			

SOURCE: Kentucky State Department of Insurance, Property and Casualty Division.

CHAPTER III

PROPERTY VALUATION

Timely and accurate property appraisals are crucial to the management of the Fund. All subsequent actions depend directly on this process. Inaccurate accounts of the value of the Commonwealth's properties render all activities more difficult and more susceptible to error.

State law requires the Department of Insurance to establish property values by subtracting depreciation from replacement costs. This method of determining property value is called actual cash value. Continuous depreciation is important, since by reducing the value of an object there is naturally less value to be insured. A reduction in value translates directly into a decrease in the premium charges.

However, property appraisal may also indicate the need to increase the overall value to be insured. An agency may lack sufficient coverage to meet a catastrophe. Replacing or repairing the damaged property will not be possible with inadequate insurance coverage.

Property Valuation in the Past

Until 1969, the Department of Insurance secured property valuation services from a commercial property appraisal company, the Industrial Appraisal Company (IAC) of Pittsburgh, Pennsylvania. Each year the IAC calculated the aggregate value of the Commonwealth's property, based upon the previous year's valuation, purchases and construction of additional buildings, risk reduction improvements and inflation in real estate values. On-site visits were made only for newly acquired buildings. Property values were determined by applying standard formulas to construction price indexes. However, the contract with IAC was terminated in 1969. Since then state agencies have assumed the primary responsibility for determining property values.

Current Method of Property Valuation

In a meeting on October 8, 1979, the former Commissioner of Insurance acknowledged that the Department of Insurance does not adhere to statutory requirements regarding the appraisal and valuation of public buildings and personal property. He explained that this is because the Department lacks the necessary time and personnel. In April or May of each year, the Commissioner requests the state agencies to review their insurance coverage. The agencies then inform the Department of any changes in the overall value they control. Each agency's premium for the following year is then calculated on the basis of its previous year's valuation, newly acquired property, and detailed information supplied by the agency.

Between 1969 and 1978, the Department of Insurance did not conduct property valuations. Since 1978, it has employed two inspectors, formerly with the State Fire Marshal's Office, to appraise buildings. These appraisors conduct on-site valuations throughout the year. Appraisals are based upon an analysis of the age of the bulding, its projected life, general condition and construction materials. The Department's property appraisers use the Marshall-Stevens Evaluation Service to calculate the value of each building. This is a packaged system providing value indexes and forms used to assemble necessary data and replacement cost. Property values are reported to the Supervisor of the Property and Casualty Division of the Department of Insurance. The report lists each property's name, the current insurance coverage, and recommended coverage. These reports are reviewed by the Supervisor and then forwarded to the individual agencies for their review and approval. At this time the agencies are also reminded that they are responsible for establishing the value of their buildings' contents. If the agency adopts the appraisal, the necessary insurance is purchased. If not, the premiums are negotiated between the Department of Insurance and the agency.

There are several problems associated with the property appraisals conducted by the Department of Insurance. First, is the infrequency of regular property appraisals. Since 1978, roughly one-third of the Commonwealth's buildings have been appraised. At this rate, each agency's buildings will be reappraised approximately every six years, which is not adequate to maintain correct property values for insurance purposes.

A second problem involves the notification given agencies by Department appraisers prior to their visits. The appraisers said they notified all agencies prior to conducting an appraisal. However, some agency spokesmen maintained that they never received any such announcement and that such an oversight is disturbing.

State Agency Involvement

With the exception of a few agencies, such as the Department of Transportation and the Department of Finance, the majority of state agencies lack the internal capability to conduct accurate appraisals of real and personal property under their control. Sixty-two agencies were asked in a questionnaire, "Who determines the value of your agency's property?" The forty-seven responses ranged from various agency employees to nobody. State agencies were also asked, "Is the person a qualified real estate appraiser?" The answsers were uniformly negative. Most often this activity, when conducted at all, is assigned either to the business manager or a junior administrative officer of the agency. According to employees of the Department of Finance, Office of Inventory Control, the relatively high turnover in agency employees assigned this function produces an inconsistent, and frequently erroneous, property valuation effort. Generally, more attention is given to appraising building contents, a result of the Department of Finance's inventory requirements. Consequently, the accuracy of these appraisals is considerably higher.

The questionnaire also asked, "How often are your properties reviewed for increase or decrease in valuation by your agency, and when was the last time this was done?" Responses included continuous updates on inventory, annual reviews of buildings, and no evaluations of either inventory or buildings. The major problems with property appraisal efforts can be categorized as follows:

Updates

While all state agencies are requested to submit updates of their property values, many fail to do so for real property. The Department for Human Resources, for example, has not reappraised its real property since 1968.

Misclassification

Misclassification occurs when an agency incorrectly reports the type of facility requiring insurance. For example, an agency reports a boat dock that it would like to insure. Site inspection determines, however, that is it not a boat dock but a small house on the water's edge. Misclassification may allow an agency to pay lower premiums on a facility, but it may also impede or prevent recovery in the event of a loss. Department of Insurance property appraisers do not always report property misclassifications.

Misidentification

Although less common, misidentification occurs when a building has several commonly used names, making it difficult for the Department of Insurance property appraisers to locate the building. Misidentification also impedes the compilation of a statewide real property inventory.

Depreciation

Building and personal property depreciation is not determined regularly by most agencies. In these cases property values submitted to the Department of Insurance remain the same from year to year.

Major Recommendations

• The Department of Insurance should hire additional state employees as property appraisers in order to complete more property valuations. The individuals should be given training or have experience in this field.

Since FY 1969 less than one-third of the Commonwealth's real property has been appraised. No personal property is being appraised by Department of Insurance employees. Additional appraisers would allow the Department to appraise all real property once every three years. It is estimated that each of these individuals could be hired for approximately $20,000 plus fringe benefits.

• Whenever a Department of Insurance property appraiser conducts a property appraisal of any state agency, that agency's central office, as well as the particular branch or local office that is to be appraised, should be notified before the appraisal takes place. Both groups should also be told why their insurance coverage is to be increased or decreased.

Currently, premium changes are forwarded only to the agency's central office. This is often done with no prior notification to the central office of the appraiser's visit.

• The Department of Insurance should prepare a memorandum to be sent to all state agencies concerning the timely notice to be given to the Department of Insurance regarding any property transactions.

This requirement will prevent an agency's insuring items no longer owned by the state or the charging of one agency for insurance on property owned by another.

Minor Recommendations

• Department of Insurance property valuators should be required to spot check agency personal property during building appraisals. Agency inventory records and inventory records sent to the Department of Finance should be compared to actual property locations at that time.

• The Department of Insurance and the Department of Finance should exchange information on the value and conditions of state property. Through this combined effort information on state agency property may be updated on a more consistent basis. Additionally, an informal review of Department of Finance inventory requirements should be undertaken by Finance and Insurance to see how well they might satisfy the personal property valuation needs.

• Property misclassifications identified by Department of Insurance property appraisers should be recorded after each appraisal. This procedure will assure adequate insurance protection on this property.

• When each state agency appoints its property control officer, this individual's name should be forwarded to the Department of Insurance. Insurance should then notify this individual of his or her responsibilities regarding property valuation as it relates to the agency's insurance needs, and include the appropriate method of applying depreciation to the agency's real and personal property. The latter could be accomplished through a memorandum or during agency visits by Department of Insurance personnel.

CHAPTER IV

PREMIUM DEVELOPMENT

An insurance premium is the price paid for a promise to cover a loss incurred and to provide specified services. Within the Department of Insurance, premium determination is the task of the Supervisor of the Property and Casualty Division. Premiums are calculated on the basis on yearly input from state agencies and some property appraisals done by Department employees. In developing premiums sufficient to cover the risks confronted by the Commonwealth's properties, the following factors are considered.

1. Potential losses.
2. Possible financial consequences.
3. Predictability of losses each year.
4. The extent, type and cost of insurance.

Insurance Costs

Premiums are determined according to the aggregate value of state property. Agencies are charged for basic Fund coverage, or self-insurance, on all property valued at or below three hundred thousand dollars. Property valued in excess of this amount must be reinsured through commercial insurance companies. Reinsurance is used to offset the potential loss of any one insurer. An insurer company may write a policy on the entire insurance needs of a particular business and then purchase reinsurance from one or more additional insurance companies. This method allows risk on large individual and cumulative loss to be spread over a wide range of insurers. Additionally, property under a lien must be reinsured to the amount of the lien or its reasonable value, whichever is less.

During the last ten years the number of state buildings has increased. Most of these buildings were built under lien and are reinsured through the purchase of commercial reinsurance. Between FY 1970 and FY 1979 the aggregate amount of self-insurance and reinsurance increased. Table 2 illustrates this ten-year increase, but it does not make obvious the actual rate of increase, because reinsurance is purchased in three-year policies. Each agency annually pays one-third of the total cost of the policy. Not all policies begin and end in the same three-year cycle. This circumstance produces the noticeable fluctuation in the annual premium cost figures. On the average, reinsurance represented forty-five percent of all Fund insurance costs between FY 1970 and FY 1979.

A strict financial comparison between the Commonwealth's program and the programs in other states cannot be made because of the varying amounts of insurable value and the distinctive operation of each program. However, for informational purposes, Table 3 is included to provide a general review of the financial operations in other state property insurance funds.

TABLE 2

SELF-INSURANCE AND REINSURANCE PREMIUMS AND LOSSES BY FISCAL YEAR
KENTUCKY STATE FIRE & TORNADO INSURANCE FUND
FY 1970 - FY 1979

FISCAL YEAR	TOTAL PREMIUM	PERCENT INCREASE OR DECREASE OVER PREVIOUS YEAR	TOTAL FIRE AND TORNADO FUND LOSSES	LOSS RATIO %	SELF INSURANCE PREMIUM	PERCENT INCREASE OR DECREASE OVER PREVIOUS YEAR
1970	$ 1,036,255	--	$ 423,579	41	$ 736,743	--
1971	1,145,638	11	111,599	10	364,465	(51)
1972	1,320,315	15	125,876	10	887,995	144
1973	1,585,357	20	433,986	27	1,024,285	15
1974	1,664,382	20	1,666,558	100	654,962	(36)
1975	1,744,196	5	296,894	17	1,196,110	83
1976	1,849,554	6	589,040	32	1,215,329	2
1977	2,103,366	14	354,284	17	471,280	(61)
1978	2,255,842	7	761,927[a]	34	1,362,588	189
1979	2,394,684	6	251,995[a]	11	1,347,210	(1)
TOTAL	$17,099,589		$5,015,738		$9,260,967	

SOURCE: Kentucky State Department of Insurance, FY 1979.

[a] Losses total incomplete due to outstanding claims pending.

TABLE 2A

SELF-INSURANCE AND REINSURANCE PREMIUMS AND LOSSES BY FISCAL YEAR
KENTUCKY STATE FIRE AND TORNADO INSURANCE FUND
FY 1970-FY 1979

FISCAL YEAR	SELF INSURANCE LOSSES	LOSS RATIO %	TOTAL RE-INSURANCE PREMIUM	PERCENT INCREASE OR DECREASE OVER PREVIOUS YEAR	TOTAL RE-INSURANCE LOSSES	LOSS RATIO %
1970	$ 360,907	50	$ 299,512[b]		$ 62,272	21
1971	76,731	21	781,173	161	34,868	4
1972	91,641	10	432,320	(45)	34,235	8
1973	370,444	36	561,072	30	63,542	11
1974	153,379	23	1,009,420	80	1,513,179	170
1975	266,636	22	548,086	(84)	30,257	6
1976	498,905	41	634,225	16	90,135	14
1977	308,554	65	1,632,086	157	45,730	3
1978	539,673	40	893,254	(45)	222,254[a]	25
1979	180,910	13	1,047,475	17	71,085[a]	7
TOTAL	$2,847,780		$7,838,623		$2,167,957	

SOURCE: Kentucky State Department of Insurance - FY 1979.

[a] Losses total incomplete due to outstanding claims pending.

[b] Annual reinsurance premiums represent roughly one-third of the premium cost of the standard three year reinsurance insurance contract.

TABLE 3

FINANCIAL OPERATIONS OF STATE PROPERTY INSURANCE FUNDS
FY 1976

STATE		TOTAL ASSETS (A) OR SURPLUS (S)	ANNUAL PREMIUMS CHARGED STATE AGENCIES	ANNUAL LOSSES	ANNUAL OPERATING EXPENSES	ANNUAL INVESTMENT INCOME	PREMIUMS PAID FOR EXCESS PRIVATE INSURANCE
South Carolina	(S)	$ 48,224,756	$ 4,364,703[o]	$ 1,329,005[v]	$ 173,839	$ 2,868,181	$ 689,462[z]
Alabama	(S)	18,886,922	3,422,456[p]	596,596	195,941	1,948,499	391,184
North Dakota	(A)	14,559,240	1,366,117	899,000	56,607	922,835	78,000
Florida	(S)	8,843,503[a]	1,020,033	395,253	80,848[x]	442,846	400,567
North Carolina Schools	(S)	8,738,183	1,514,061	776,109	133,800	575,858	212,965
Oregon[b]	(S)	8,803,434	1,167,122	422,390	48,600	704,407	160,699
North Carolina State Property	(S)	7,329,000	560,700	337,900	192,500	550,000	305,600
Wisconsin[c]	(S)	8,417,697	4,478,912	3,989,089	286,922[y]	871,563	none
Georgia[d]	(S)	7,100,000	775,004	578,278	94,323	452,699	135,372
Louisiana	(A)	5,990,183	4,351,451[q]	-	-	479,358	909,843[r]
Arkansas	(S)	2,781,473[e]	738,861	352,068	88,731	219,757	95,002
Maine	(S)	2,775,771[f]	329,159	64,164	-	160,996	128,114
Virginia[g]	(A)	2,365,000	909,611	24,000	50,000	156,000	909,611
KENTUCKY	(S)	2,000,000[h]	1,800,000[s]	289,266[w]	-	-	-
Kansas[i]	(S)	1,800,000	-	-	-	-	-
Maryland	(S)	1,639,559	59,875[t]	-	-	-	-
Delaware	(S)	1,200,000[j]	1,623,729[u]	788,683	-	-	-
Arizona	(S)	1,000,000[l]	435,000	-	-	-	321,000

TABLE 3 (continued)

STATE		TOTAL ASSETS (A) OR SURPLUS (S)	ANNUAL PREMIUMS CHARGED STATE AGENCIES	ANNUAL LOSSES	ANNUAL OPERATING EXPENSES	ANNUAL INVESTMENT INCOME	PREMIUMS PAID FOR EXCESS PRIVATE INSURANCE
Tennessee	(S)	1,000,000	-	-	-	-	510,000[k]
West Virginia	(A)	600,000	668,001	302,383	50,072	-	365,618
Pennsylvania[m]	(S)	311,029	319,761[n]	-	-	-	-
Utah	(S)	300,000	-	-	-	-	-
TOTALS		$154,679,721	$29,904,555	$11,164,184	$1,452,183	$10,352,999	$5,613,037

SOURCE: Greene, Mark R. and Michael L. Murray, "Self-Insurance of State Owned Property", The Journal of Risk Management, March, 1978, page 114.

[a] Includes "Catstrophe Reserve" of $2.5 million
[b] Most figures are biennial averages
[c] 12-31-76
[d] 7-1-77
[e] "Net Worth"
[f] "Fund Balance" 12-31-76
[g] 12-31-75
[h] Statutory Limit and Current Size
[i] 12-31-76
[j] "Available Funds" Fiscal 1977
[k] Includes Boiler Coverage
[l] Approximately
[m] 3-31-77
[n] 12-31-76
[o] Does not count hospital professional liability premiums

[p] After deducting "discounts" of $2,281,645
[q] Includes workers' compensation premiums
[r] Ending 7-1-77
[s] Estimate - "In excess of $1.8 million"
[t] Automobile premiums only
[u] Referred to as "assessments for self-insurance and insurance premiums"
[v] Fire, Extended Coverage, and Difference in Conditions
[w] 1975
[x] Loss and underwriting expense
[y] Loss adjustment and underwriting expenses
[z] Fire, EC, DIC, and Boiler

Insurance Rate Formulation

Rate formulation relies upon certain general rules: (1) rates should be adequate and equitable, and (2) rates should measure accurately the relative probability of loss of the subjects of risk. A rate is adequate if it is sufficiently high to enable the average insurer to meet his losses and expenses of doing business and realize a normal or fair profit. Two separate coverage rates are calculated on Commonwealth property. The first rate is for fire coverage and the second rate is for extended coverage.

A rate is generally formulated at the cost of one hundred dollars of insurance for one year. The total value of the insurable property of an agency is divided by one hundred dollars. This figure is multiplied by the applicable rate to determine the premium the agency pays.

After July 1 of each year, the Supervisor of the Property and Casualty Division calculates the insurable value of each state-owned building. These values are used to determine a rate to be charged the agencies' self-insurance coverage, using guidelines supplied by the Insurance Services Organization (ISO).

The ISO, formerly the Kentucky Inspection Bureau, is a professional rating organization representing the majority of insurance companies doing business in the Commonwealth. ISO is paid for its services by the insurance companies it represents. The functions performed by ISO on behalf of the Fund include establishing fire protection classifications, as well as individual and composite ratings on separate locations. Additionally, ISO submits to the Department of Insurance an annual report that includes adjusted values for new properties acquired by the state.

After the self-insurance rate for each agency is determined each rate is reduced by ten percent. This reduction is based solely on an internal departmental policy and bears no relation to the condition of the property or the claim history of the agency. These rates are then averaged for a particular group of buildings. The rates charged for reinsurance are generally determined in the same manner as the self-insurance rates, but they are calculated by ISO.

Following these calculations, ISO reduces the reinsurance rates by thirty percent. The rate of reduction is largely dependent upon the amount of risk ($300,000) assumed by the Fund on each reinsured claim and the aggregate reinsured property claims volume. This thirty percent rate reduction has not changed since the mid-1960's. ISO takes all of the reduced reinsurance rates and develops one average reinsurance rate. The current rate per million dollars of reinsurance coverage is $2,850.

For property under lien a different procedure is followed. Reinsurance is secured for the full value of the lien (first dollar coverage). The Commonwealth then insures the property for the first three hundred thousand dollars and reinsures the remaining value with commercial insurers. If a loss occurs, the reinsurance on the unpaid lien is paid in advance by the insurers. The state then pays the first three hundred thousand dollars of the loss and the reinsurers pay the remainder of the loss up to the total value of the policy.

Options Affecting Rates

There are three major options by which a state self-insurance system may reduce the cost of insurance. These are the deductible, the reserve and the loss sharing treaty.

The Deductible

Deductible insurance is a method of coverage under which a policyholder agrees to contribute a specified sum per claim toward the total amount of the insured loss. In state insurance programs the size of the deductible is generally based upon the reserve size and the total aggregate loss the Fund could absorb during a year. The deductible helps lower the cost of insurance because the state assumes part of the risk of any loss.

The Fund's $300,000 deductible is applicable on a per occurrence basis according to an opinion by Attorney General Beshear (Appendix D). A "per occurrence" deductible applies to a particular loss situation, e.g., a thunderstorm or tornado, regardless of whether it involves one building or a dozen buildings and the deductible would apply to the aggregate loss.

Deductibles applied in other state insurance programs range from one hundred and twenty-five dollars in South Carolina to $1,500,000 in Georgia. Factors that affect the size of a state's deductible are the concentration of state property, the state's ability to absorb a certain amount of loss and the state's decision whether to absorb a larger degree of potential risk to secure a reduction in premium costs. Additional information on the size and type of deductible used by other state programs is presented in Table 4.

TABLE 4

PROPERTY INSURED AND DEDUCTIBLE LEVELS,
GOVERNMENT PROPERTY. SELECTED STATES
(data as of 6-30-76 except where noted)

STATE	VALUE OF GOVERNMENT PROPERTY INSURED	FUND SIZE	DEDUCTIBLE ON FIRE AND EC REINSURANCE	
			Per Loss or Location	Annual Aggregate
	(000/s ommitted)			
Wisconsin[a]	$6,930,313	$ 8,417	$ none	$ none
South Carolina[b]	2,196,571	48,224	175,000	1,500,000
West Virginia	2,196,000	00	10,000	1,200,000
Georgia[c]	2,000,000	7,100	1,000,000	2,500,000
Alabama[d]	1,832,275[e]	18,886	none	2,150,000
Tennessee[f]	1,787,586	1,000	none	1,500,000
Virginia	1,700,000	2,365	1,000	none
North Carolina State Prop.	1,650,000	7,329	750,000	none
Oregon	1,556,368	8,803	10,000	3,000,000
North Carolina School	1,287,393	8,738	400,000	-
North Dakota	812,000	14,559	500,000	none
Maine[g]	470,331	2,775	500,000	none
Arkansas[h]	252,640	2,781	200,000	1,000,000
Maryland	1,039,000[i]	1,639	100,000[j]	750,000
Florida[m]	1,659,677	8,843	none	2,500,000
Arizona	923,000	1,000	100,000[k]	1,000,000
Idaho	-	-	1,000	100,000
KENTUCKY	-	-	300,000	none
Louisiana	-	-	125,000[l]	300,000
Montana	-	-	5,000	50,000
Utah	-	-	50,000	none
Wyoming	-	-	none	50,000
TOTALS	$28,293,154	$143,059		

SOURCE: Greene, Mark R. and Michael L. Murray, "Self-Insurance of State Owned Property", The Journal of Risk Management, March 1978, page 114.

a—12-31-76
b—6-30-75
c—12-31-76
d—9-30-76
e—total value of property insured for only $1,479,836,000
f—1975
g—12-31-76
h—12-31-76
i—auto, marine, personal property
j—buildings
k—$50,000 on university buildings
l—$500,000 on windstorm losses
m—6-30-77

The Reserve

Reserve funds are maintained to pay a state's share of any losses. The reserve allows a state to begin a new fiscal year with a pre-established amount of funds, which would be available to cover any incoming claims if premium revenue were insufficient to cover losses.

The Kentucky Department of Insurance is required to establish a two million dollar Fund reserve at the end of each fiscal year. The reserve is built up by any monies available at the close of the fiscal year after all claims for that year are paid. While the reserve is supposed to be used for claims payment, roughly one-half is used to purchase reinsurance. This practice jeopardizes the ability of the Fund to make payment should a large volume of claims occur during the first part of the fiscal year.

The two million dollar reserve requirement was established in 1946 when total state property value was less than half of what it is now. The Fund reserve is now inadequate. The size of the reserve should reflect the aggregate value of the property insured. Some states have reserves which may be adjusted to the size of the program. Alabama, Delaware and Florida have no limit on the size of their reserves. North Carolina and South Carolina use an escalating reserve that is set at five percent of the total amount of insurance in force. North Dakota has a reserve of twelve million dollars. Moreover, a larger reserve allows for greater investment opportunities. The additional investment income may be used to reduce state property risk.

With the increase of reserves in state insurance programs there has been a rise in their use for purposes other than those for which they were intended. Many states, most notably Wisconsin, have experienced serious financial difficulties because their reserves were depleted by other state government needs. In 1980, Alabama transferred ten million dollars of its reserve to support its Medicaid program. The inviolability of reserve funds should be safeguarded. The consequence of using insurance reserves for other purposes can be severe. A state may be unable to recover claim awards for a time; it may be without needed services for extended periods; and its legislature may have to convene to appropriate funds. Any of these actions could reflect negatively on a state's financial reputation. (Additional information on the state's reserve provisions is presented in Appendix C.)

Loss Sharing Treaties

A loss sharing treaty is an arrangement between the insured and the insurer to limit the total amount the insured will have to pay on losses. Loss sharing treaties are used by fourteen states. The most commonly used treaty is the annual aggregate loss form. The annual aggregate sets a ceiling on the total claims cost submitted during any fiscal year. Claims are paid as they are submitted until they reach the specified maximum and then commercial insurance companies will pay the remaining claims. Annual aggregate loss limits range from $50,000 in Wyoming to $3,500,000 in Georgia.

Another loss sharing treaty is the stop loss provision. This provision establishes a ceiling on loss payment on a per occurrence basis. Alabama uses a one million dollar stop loss provision. This treaty is similar to a deductible.

Nine states have programs that combine annual aggregate loss provisions and deductibles, based on a per occurrence basis. Under this combination the deductible helps the program to secure a better rate, the per occurrence stipulation tends to keep claims from exhausting the program reserve, and the annual aggregate loss provision keeps total claims payments below a fixed limit.

Major Recommendations

• The Department of Insurance should increase the Fund's $300,000 deductible to $500,000.

An increase in the deductible would probably result in a premium rate reduction. Based upon the Fund's historically low claims rate this change would involve little risk to the Fund.

• The Department of Insurance should increase the Fund reserve from $2,000,000 to $5,000,000. This increase should come about through slow growth and not a General Assembly direct appropriation. Once this is done the reserve should not be used for any purpose unrelated to Fund operations.

The reserve increase is predicated on the condition that the deductible be increased as well. A larger reserve will be needed if the Fund assumes a greater fiscal responsibility for the Commonwealth's risk. The reserve can be built up by allowing it to remain untouched until the $5,000,000 figure is reached. The reserve would then be restricted to payment of claims.

• The Department of Insurance should consider adopting an aggregate annual loss provision limiting the annual loss the Fund may incur. This stipulation should also be included in reinsurance bid specifications.

CHAPTER V

INSURANCE COVERAGE

The level of insurance coverage relative to property value varies among agencies. Some agencies purchase too much coverage and others not enough. A few agencies purchase no insurance on certain pieces of property. Often these decisions are purposeful but sometimes they are simply due to an oversight by senior management. For example, the Bureau of Corrections in the Department of Justice decided not to insure six of its buildings and to overinsure others. The negative consequences of such unwise decisions were clearly demonstrated in the case of the Eastern Kentucky Career Development Center. Corrections insured the Center for $600,000. The building was destroyed by fire and declared a total loss by the insurance companies holding the policies on the building. Corrections submitted a claim for the full $600,000, which was turned down because the insurance companies felt that the building was not worth that much. After much arbitration, Corrections received $275,626 from the Fund in a claims settlement.

The decision to limit insurance coverage to selected buildings is made primarily to reduce an agency's overall premium charges. The Department of Transportation, which owns or controls approximately 750 buildings, insures only 300 of them. The Department's rationale is that many of these buildings are only used for storage purposes and insuring against their loss is therefore not cost-effective. However, should one of these buildings be destroyed, replacement funds would have to be made available from some source to construct a new building. That source would be the Commonwealth of Kentucky. Such agencies are taking the chance that their buildings will never suffer damage. Yet they believe that if they do experience a loss on their uninsured property, the state will absorb the cost of replacing or repairing the building.

One significant point should be addressed concerning insurance coverage. The statutes creating the Fund do not require an agency to insure any or all of the property under its control. The law says that if an agency decides to purchase fire and extended coverage insurance it must purchase this insurance from the Fund. However, the decision to obtain coverage rests with the agency. The optional nature of this requirement provides the excuse with which some state agencies justify not insuring all of their property.

Special Coverage Insurance

Basic Fund insurance is provided by the standard fire and extended coverage policy. Since the Fund's inception, however, the Commonwealth has acquired additional equipment and facilities which require specialized insurance coverage. Often new facilities and equipment are uninsured. For example, separate special coverage policies should be purchased for computers, bridges and inland marine protection. The Department of Insurance views the identification of special coverage needs as the responsibility of the agencies. Agencies must advise the Department of special insurance needs and amounts. The Department will then purchase this insurance for the agencies.

Sixty-two agencies were asked in a questionaire, "Does your agency obtain insurance coverage in addition to state fire and tornado insurance coverage?" Of the forty-seven agencies that responded, twenty-seven, or fifty-eight percent, indicated that they do obtain some type of special coverage insurance. Table 5 presents summary data on special coverage insurance, by type of coverage, purchased by the Department of Insurance from FY 1970 to FY 1979. Premium payments for allied line (special) coverage totaled $4,039,936 from FY 1970 through FY 1979. Total losses paid during the period were $1,768,581.

TABLE 5

LOSS HISTORY ON COMMERCIAL (SPECIAL) INSURANCE PURCHASED BY THE KENTUCKY DEPARTMENT OF INSURANCE FOR KENTUCKY STATE AGENCIES BY YEAR AND TYPE OF COVERAGE

KENTUCKY STATE FIRE & TORNADO INSURANCE FUND

FY 1970 - FY 1979

TYPE OF COVERAGE	1970	1971	1972	1973	1974	1975	1976
Aircraft-Liability, Hull & Hangerkeepers Liab.	$ --	$ --	$ --	$ --	$ 724	$ --	$ --
Auto-Comp., Collision & Liability	16,466	13,317	38,592	17,205	21,302	32,390	54,545
Blanket Bond on Employees	13,241	3,533	71,080	--	--	88,061	40,000
Boat-Hull & Liability	37,648	--	3,000	--	--	--	--
Boiler & Machinery	37,648	23,109	22,796	1,133	10,164	41,681	33,519
Business Interruption-Used & Occupancy & Rental	36	--	--	--	51,284	--	--
Cargo	--	--	--	--	--	--	--
Computer Coverage	--	--	167	2,274	--	--	--
Crop Hail	--	--	--	--	372	--	273
Elevator Liability	--	--	--	--	--	--	--
Fire, EC, V&MM, (Other than transportation)	--	--	--	135,206	--	408	252
Flood	--	--	--	--	--	--	--
Livestock Mortality	--	--	--	--	--	--	--
Master Marine, Inland marine & Fine Arts	5,526	7,596	3,193	95,406	10,759	11,871	14,626
Mercantile Burglary, Robbery Money & Securities	5,444	385	4,120	13,507	800	3,449	1,490
Miscellaneous[a]	--	--	--	--	34	--	--
Plate Glass	196	--	67	--	184	863	--
Transportation[b]	--	--	--	--	1,030	--	3,168
Voting Machine	1,500	3,000	4,105	3,421	4,500	140	500
TOTALS	$117,705	$ 50,904	$147,120	$268,152	$101,153	$178,863	$148,373

TABLE 5
(continued)

1977	1978	1979	TOTAL TEN YEAR LOSSES	TOTAL TEN YEAR PREMIUMS	TOTAL TEN YEAR LOSS RATIO
$ --	$ 3,196	$ 1,300	$ 5,220	$ 160,457	3%
103,045	282,335	23,616	603,014	1,630,050	19
6,370	--	--	222,285	266,688	83
--	--	120	3,120	19,057	16
15,653	20,951	1,376	208,030	830,787	25
2,082	--	--	53,402	27,754	(192)
--	--	--	--	8,498	0
3,067	4,596	29,812	39,917	239,266	17
--	--	--	645	31,276	2
--	--	--	--	16,352	0
--	--	--	136,518	22,020	620
--	Unknown	Unknown	--	5,816	0
5,000	103,500	--	108,500	10,785	1006
25,379	92.635	25,029	292,021	610,309	48
5,881	365	368	35,809	188,344	19
--	40	--	75	2,725	3
--	--	--	1,308	76,654	2
2,702	4,269	6,680	17,850	845,167	2
23,521	--	--	40,867	45,866	89
$192,700	$511,887	$ 88,501	$1,768,581	$4,039,936	44%

SOURCE: Kentucky State Department of Insurance - FY 1979.

NOTE: The purchase of any "special" insurance coverage is solely dependent upon the request of the respective state agencies.

[a]Includes Parcel Post, Bank Account, Registered Mail, Safe Deposit and Property Floater

[b]Includes Toll Facilities, Bridge PD, Fire, EC, V&MM, Inland Marine, Money and Securities

There are two important factors preventing state agencies from purchasing adequate special coverage insurance. The first is that most state agencies lack the internal expertise to identify all of their special coverage needs. Thus some property remains unprotected against certain risks. The second problem is that some agencies, though aware that portions of their property should be protected, regard full protection as too expensive. Some agency officials said that they felt the annual increase in their fire and extended coverage policies was too great. Their responses to these increases were to limit their total insurance costs by undervaluing their agencies' properties or by deciding not to obtain or renew special coverage policies. Again, the result is inadequate coverage of state property. Special coverage insurance purchased by other states is similar to that purchased by the Commonwealth. Detailed data on other states' special coverage insurance is presented in Table 6.

Alternative Methods of Obtaining Special Coverage Insurance

While selected states insure against such perils as flood and earthquake, of particular significance are the fourteen states that purchase all-risk coverage. This coverage generally applies only to buildings and insures against losses from any cause. The main value of all-risk coverage is that it eliminates the need for agencies to secure several types of special coverage. If all-risk coverage is purchased for all state agencies, economies of scale can make it a cost-effective method of fulfilling special insurance requirements, with the additional important benefit of guaranteeing that no single agency will inadvertently or purposefully fail to secure necessary insurance.

Bulk buying or insurance pooling is another cost-effective method of purchasing special coverage insurance. Total special coverage insurance costs may be reduced by combining all agencies' needs in a given category under one policy. For example, using this approach to obtain insurance on the Commonwealth's data processing equipment, the Department of Insurance secured a single policy that costs less than the total of several individual policies for the same coverage.

Major Recommendations

• The Department of Insurance should consider including "all-risk" insurance coverage as part of the state's insurance policy.

In the aggregate, state agencies purchase approximately eighteen different types of special coverage insurance. All-risk coverage may be a less costly alternative and it would help guarantee that all state buildings would be insured against perils not covered under the Fund's basic policy.

• If the all-risk insurance coverage policy recommendation does not prove to be cost-effective, the Department should then consider purchasing special coverage insurance by group policy.

The Department would have to determine how many agencies require the same types of special coverage insurance. If sufficient numbers were present for any one type of coverage the Department would be in a favorable position to negotiate with the commercial insurance companies for a single rate for one group policy, generating a cost-effective rate.

• The Department of Insurance should have the authority to determine what property will or will not be insured for fire and extended coverage. This recommendation will require that KRS

TABLE 6

SUMMARY OF PERILS COVERED BY SELECTED STATE INSURANCE PROGRAMS
FY 1978

STATE	PERILS COVERED: FIRE	LIGHTNING	EXTENDED COVERAGE	REMOVAL	FLOOD	INLAND MARINE	EARTH QUAKE	BOILER	VANDALISM AND MALICIOUS MISCHIEF	RADIATION CONTAMINATION	ALL RISKS
Alabama	*	*	*	*							*
Alaska[a]											
Arizona	*	*	*	*	*	*	*				
Arkansas[b]											
California[c]											
Colorado			*								
Connecticutt	*	*	*	*							
Delaware	*	*	*	*		*		*			
Florida	*	*	*	*	*						
Georgia	*	*	*	*	*			*	*	*	
Hawaii	*	*	*	*	*		*				*
Idaho											
Illinois[d]											
KENTUCKY	*	*	*	*							
Louisiana	*	*	*	*	*						
Maine	*	*	*	*	*	*					
Massachusetts[e]											
Minnesota[f]											*
Missouri											*
Montana											
Nebraska[g]											
New Hampshire	*	*	*	*							
New Jersey	*	*	*	*							*
New Mexico[h]	*		*		*		*				
New York[i]											
North Carolina	*	*		*		*					*
Ohio[j]	*	*	*	*		*					
Oklahoma[k]											*
Oregon											
Pennsylvania[l]	*	*	*	*							
Rhode Island					*						
South Carolina	*	*	*	*	*		*				*
South Dakota											*
Tennessee[m]						*					
Texas	*	*	*	*							

TABLE 6A

SUMMARY OF PERILS COVERED BY
SELECTED STATE INSURANCE PROGRAMS

FY 1978

Utah	*	*	*	*				
Vermont	*	*	*	*				
Virginia[n]	*	*	*	*			*	*
Washington[o]	*	*	*	*	*	*		*
West Virginia[p]					*	*	*	*
Wisconsin[q]	*	*	*	*	*	*	*	*
Wyoming[r]						*		*

SOURCE: Division of Risk Management. Department of Insurance, State of Florida, 1978

[a]Personal property only
[b]all property uninsured
[c]all property uninsured
[d]all property self-insured
[e]all property uninsured
[f]all property uninsured
[g]only property under revenue bond insured
[h]provides for all-risk coverage on select property
[i]all property uninsured
[j]provides for all-risk coverage on buildings only
[k]all property uninsured
[l]only property under revenue bond insured
[m]provides for all-risk coverage on buildings only
[n]provides for all-risk coverage on buildings only
[o]provides for all-risk coverage on buildings only
[p]provides for all-risk coverage on buildings only
[q]provides for all-risk coverage on buildings only
[r]provides for all-risk coverage on buildings only

56.070 be amended to repeal the authority of state agencies to decide whether their property should be insured.

Some state agencies arbitrarily decide what property they want to insure. This decision should be made by qualified representatives of the Department of Insurance rather than state agency personnel.

Minor Recommendation

• The Department of Insurance should require any state agency that purchases special coverage insurance to maintain that coverage until the agency can satisfy the Department that the reason for securing the coverage no longer applies.

State agencies should not be allowed to add or drop special coverage insurance whenever they choose. The opportunity to secure favorable group rates for a particular type of coverage would be lost if agencies could arbitrarily choose to purchase the coverage one year and not the next.

CHAPTER VI

INSURANCE AGENTS

There are three types of insurance agents operating in the Commonwealth, independent, captive and direct writer agents. The majority of agents are independent. The independent agent usually establishes an agency relationship with numerous commercial insurers and owns all policy records relating to clients. He retains the right to collect premiums from his clients and renew their policies with alternative insurers. The independent agent receives a commission from the insurer on all policies in force, from which he pays operating expenses and from which he earns a profit.

Captive agents have an exclusive contract with and represent only one or a group of insurance companies. Insurance companies represented by captive agents retain control over all policy records and billing. The client's policy is held by the insurer rather than the agent.

Under the direct writer insurance system the insurance company has direct contact with the insured through salaried agents. Such an agent works as an employee of a single company.

Between FY 1970 and FY 1979, the State Fire and Tornado Insurance Fund paid $7,838,623 of reinsurance premiums to over four hundred insurance agencies that represent over fifty insurance companies. More than ninety percent of all reinsurance is purchased through independent insurance agents. A small amount of reinsurance, usually less than five percent of the business during any single year, is purchased from two large groups known as the Professional Insurance Agents Association and the Independent Agents Association. Both organizations represent groups of independent insurance agencies. Insurance is written by both organizations and is then distributed to the member agencies. All commissions are retained by the associations for administrative costs.

Selection of Insurance Agents

The method of selecting those insurance agents who receive Fund business does not appear to follow any standard procedure. Any agent may request some of the Fund's business, but the allocation of Fund contracts is determined by the Governor, the Commissioner of Insurance and the Supervisor of the Property and Casualty Division. The manner in which these policies are awarded has the potential for political interference.

This process usually adheres to the following format. Near the end of each fiscal year the Commissioner of Insurance decides whether certain insurance agencies having contracts in the previous year or years will retain them. He also decides who shall receive new business. These selections may reflect his or the Governor's personal desires.

Examination of the agencies that are awarded Fund business shows a dispersion of contracts across the Commonwealth. However, certain agencies consistently receive large shares of the state's reinsurance purchases. This method of awarding reinsurance contracts has produced considerable controversy.

Several studies by the University of Kentucky and past insurance commissioners addressed this costly, politically-oriented method of purchasing reinsurance. A 1967 report on the Fund conducted by the Department of Insurance condemned the inefficiencies of the system and recommended that the use of independent agents cease. The Department further recommended that the state purchase reinsurance directly from insurance companies. Competitive bidding for insurance contracts was encouraged by former Insurance Commissioner Woodall in 1967, but no changes occurred. Criticism has been particularly harsh concerning the fifteen to twenty-five percent commission that agents receive from the Commonwealth's premium payments. A July 8, 1960, article appearing in the *Louisville Times* noted that:

> Every state administration has spread its property insurance purchases among many agencies. It is a form of financial patronage. Under Governor Lawrence Weatherby (1951-1955) the insurance was bought in blocks of $500,000 to $1,000,000. A. B. Chandler's administration (1955-1959) split its purchases into smaller blocks, $100,000 to $200,000, in most cases.

All insurance contract's are awarded on a three year basis. Over the FY 1979 to FY 1982 period, forty-five percent of those contracts were awarded in $1,000,000 amounts, twenty-four percent in $500,000 amounts, and seventeen percent in $2,000,000 amounts. The balance was awarded in contracts of varying amounts. The amount of Fund business awarded to each insurance agency range from $100,000 to $10,000,000 per individual policy. This method of purchasing insurance produces an average of 354 contracts per year. For a listing of Fund reinsurance contracts between FY 1979 and FY 1982, see Table 7.

TABLE 7

NUMBER OF REINSURANCE CONTRACTS, COMPANIES AND INSURED VALUE
KENTUCKY STATE FIRE AND TORNADO INSURANCE FUND
FY 1979-FY 1982

FISCAL YEAR	NUMBER OF REINSURANCE CONTRACTS	NUMBER OF REINSURANCE COMPANIES	INSURED VALUE
1979	446	55	$516,700,000
1980	269	44	299,900,000
1981	332	53	355,000,000
1982	367	48	535,800,000

SOURCE: Property and Casualty Division, Department of Insurance, Commonwealth of Kentucky.

Agent Service Delivery

The independent insurance agent generally performs a number of services for his client, including:

1. A professional analysis of hazards in order to design an insurance program tailored for optimum protection;

2. Analysis of governmental property appraisals and recommendations as to amounts of protection;

3. Analysis of physical hazards and recommendations for improvements designed to result in the greatest possible premium reduction;

4. Frequent consultations with rating authorities and checks into fire protection facilities, to enable a governmental unit to take advantage of further improvements which could reduce rates;

5. Consultation during the planning stages of new construction, which may result in suggestions leading to sizable savings in fire insurance costs;

6. Promotion of fire and safety accident prevention programs, carried out through state and local agents associations; and

7. Assistance in expediting prompt and fair settlement of losses, facilitating rapid repair of property and restoration of services.

None of these services is currently provided to the Fund by the agents receiving Fund business.

When sixty-two agencies were asked in a questionnaire, "Have you ever been in contact with anyone or any group other than the Department of Insurance for any matter relating to your state fire and tornado policy coverage?" thirty-nine, or eighty-three percent of the forty-seven agencies that responded, indicated that they had not. Further, when asked, "Has your agency ever been involved in the selection of your insurance agent?", ninety-two percent, or forty-three of those respondents, said no. In the same questionnaire the agencies were asked, "Does your agency have any direct contact with parent insurance companies?" Of the forty-seven agencies that responded, forty, or eighty-six percent, said that they had no contact with these companies.

No arguments surfaced in the course of the present research effort that could point to any special benefits the Commonwealth receives by securing Fund reinsurance through independent agents. The only service provided by these agents is signing the policies, a measure which is required by law.

Agent Commissions

Agents awarded Fund reinsurance contracts receive compensation in the form of a commission. This commission ranges from fifteen to twenty-five percent, depending on the type of policy. Nationally, an average of 20.9 percent of every premium dollar is spent on commissions.

Agent Reduction

An argument regarding agent reduction is that by removing or reducing the number of agents all premium monies leave the state. Commissions now retained by local insurance agencies are reduced and local economies suffer. Based upon a 20.9 percent commission rate, the amount of commission revenue derived from the FY 1979 reinsurance charge of $1,047,475 would be $218,922. On an individual agent basis the loss of this commission would hardly be noticed. Employees of the Department of Insurance contend that the agents want state insurance business not because of the commission, but because of the prestige factor. In general, the agent's business is favorably affected by receiving some state contracts.

Another argument is that agent elimination is unlawful, because all insurance policies must be signed by an agent. However, according to KRS 304.9-130, "[a] firm or corporation may be licensed as an agent." Therefore, it would be possible for an insurance company to become a licensed agent and deal directly with the state. Purchasing coverage by competitive bidding would be the most cost-effective way to obtain reinsurance. This practice would save money because no commissions would be paid. Based on the FY 1979 reinsurance premium payment of $1,047,475, savings of approximately $218,922 could be realized.

Eliminating the use of independent agents would have the additional benefit of reducing the workload of Department employees, because all policy preparation and payment transactions would be conducted with a few insurance companies. Competition, encouraged by the bid process, would promote good service. It would be in the economic interest of these companies to broaden their assistance to state agencies. With reduced costs of coverage and such services as accurate property valuations the Commonwealth would be securing the best coverage at the lowest cost.

Major Recommendation

- The Department of Insurance should consider purchasing reinsurance by competitive bidding from qualified insurance companies.

The current method of purchasing reinsurance through dozens of independent insurance agents is not cost-effective and has the potential for political abuse. The state receives no benefit from this practice but does pay more for reinsurance. The advantages of purchasing reinsurance through competitive bidding include lower cost, improved coverage, technical assistance and a reduction in Department employee workload.

CHAPTER VII

FUND ADMINISTRATION

Fund-related business is conducted by eight Department of Insurance employees on a full or part-time basis. In the chain of command, the Commissioner is the signatory authority for all Fund operations. However, the Supervisor of the Property and Casualty Division is the employee most responsible for Fund administration. Assisting the Supervisor are two secretaries, two property valuators, the Assistant Director in charge of the Claims Payment Division, and the Department of Insurance business manager. Only the Supervisor of the Property and Casualty Division, the two secretaries and the two property valuators devote their primary attention to Fund business.

Personnel Deficiencies

The workload associated with insuring the Commonwealth's property has escalated since the program began in 1936. The present staff cannot carry out Fund activities in a timely, efficient manner. The Property and Casualty Division is understaffed and its members are insufficiently trained for the work they perform. The personnel classifications in use are not appropriate to the working titles assigned to the employees. A division is usually headed by a non-merit director, which allows for a reasonable salary to be paid for the background and qualifications appropriate for the position. This level of responsibility and professionalism in turn allows for adequate sublevels of supervision and appropriate levels of secretarial assistance and technical competence.

There is no written policy outlining employee responsibilities. Daily operating policy is made by line staff because department commissioners have traditionally had little direct input into this process.

The program requires more staff and a greater commitment of resources. In order to improve Fund administration the Department should conduct a comprehensive evaluation of Fund operations to address the following questions.

1. What functions should the Department of Insurance perform regarding Fund business?
2. What policies and procedures are necessary to administer the Fund?
3. What organizational structure would best serve to administer Fund activities?
4. What qualifications should Fund staff have?

Purchasing insurance is becoming more complex. Operation of the Fund requires knowledgeable, well-trained employees who can devote their full attention to Fund problems. Property and Casualty Division staff currently perform other departmental activities unrelated to Fund operations. To implement the many recommendations made in this report, and to administer such an increasingly complicated and growing program the Department should consider hiring a qualified risk manager. A risk manager is an insurance professional who has expertise in designing insurance programs for a client's individual needs. Risk managers supervise loss-prevention programs, assure that adequate property valuations are conducted, and purchase commercial and special coverage insurance. Approximately sixteen other states have hired risk managers to administer their insurance programs.

Administrative Funding

The Department of Insurance and the State Treasurer's Office may incur administrative expenses equal to ten percent of the Fund's annual income. However, Department of Insurance employees who work on Fund-related matters are not paid from Fund receipts. They are paid from the department's General Fund appropriation. No Fund monies have ever been used for Fund administration. The rationale for this procedure originated in the Office of Policy and Management (OPM) within the Department of Finance. It is OPM's contention that the ten percent administrative allowance is a second reserve which should not be used for administrative purposes. This view is not supported by law.

According to KRS 56.150, expenses may be incurred "as are necessary to carry out the purposes of KRS 56.070/KRS 56.180," which govern the administration of the Fund. It was apparently the intent of the General Assembly to provide for a self-sustaining program. Administrative expenses are of even higher priority than loss claim awards. KRS 56.150 provides that:

> If such expenses (administrative) are incurred at a time when there is not a sufficient amount in the fund to pay them, they shall constitute a prior claim to be paid out of the first receipts of the fund thereafter before any damages on account of insured losses are paid.

While none of the allowable ten percent has been used for Fund administration, in 1979 a portion of these monies were used for other Department expenses. High legal fees associated with the Beverly Hills Supper Club fire case resulted in the use of $130,000 of Fund receipts for Department expenses unrelated to Fund business. This transfer was approved by OPM because the Department was paying the salaries and support of its employees working on the Fund. In this instance, KRS 56.150 was interpreted to read that the allowable ten percent could be used for general administration and support. The use of Fund receipts for this purpose, while denying similar application for needed administrative improvement, appears contradictory.

Accurate budgeting is one way to eliminate the inconsistencies in the application of Fund revenues for administrative expenses. The Department of Insurance's biennial budget request should include monies needed for administrative expenses instead of using the ten percent allowed through KRS 56.150.

Major Recommendations

• The Department of Insurance should conduct a comprehensive evaluation of Fund administrative operations.

The current administrative system is not adequate to provide necessary insurance protection for Commonwealth property. Both Fund operating policy and supporting organizational structure need to be changed if a more cost-effective and responsive program is to be achieved.

• The Department of Insurance should consider creating a Division Director position for the Property and Casualty Division, to be filled with a qualified risk manager.

• The Department of Insurance should develop a Fund information system that can supply accurate data on all Fund operations upon request.

There is a lack of readily accessible information on Fund operations. Most Fund business is performed manually according to administrative procedures developed by the Supervisor. An improvement in operating and administrative procedures will help insure better agency insurance coverage at a lower cost. It will also provide the capability to generate accurate data in a timely fashion. The proposed information system will be an invaluable management tool. It should contain the following elements.

a. **Risk Analysis**. Risk analysis is a two-fold process involving risk identification and risk evaluation. All loss exposures including uninsurable risks should be identified.

b. **Loss Control**. In order to control losses effectively, loss patterns should be identified. The nature, frequency and severity of losses should be recorded, so that remedial action (risk reduction efforts) can be taken in weak areas. Some agencies, such as the Bureau of Corrections, have higher claim rates than other state agencies.

c. **Administration**. For the proper administration of a self-insurance program, accurate records should be maintained on all facets of administration. Cost data should be readily available for each line of coverage, so that expense ratios (expenses as a percentage of premiums) and loss ratios (losses as a percentage of premiums) can be identified.

d. **Financial Management**. Accurate records should be maintained for all reserves, Fund investments and premium payments. Readily accessible up-to-date figures are essential to the maintenance of a financially sound program.

• The Commissioner of Insurance should submit an annual report on Fund activities to the Secretary of the Public Protection and Regulation Cabinet and the Legislative Research Commission. The report should include but not be limited to the following:

a. Total administrative costs for the Fund.

b. Current data on self-insurance and reinsurance losses incurred for each line of coverage.

c. Data on such loss characteristics as type, severity and frequency, including a review and evaluation of losses experienced by individual agencies.

d. Financial statements including all revenue, expenses, interest income and an explanation of the annual flow of funds.

e. A brief explanation of the State Fire and Tornado Fund's purpose and operations.

• The Department of Insurance should budget for administrative expenses like any other agency or bureau. This recommendation requires an appropriate change to KRS 56.150 eliminating the ten percent allowable use of Fund revenues (insurance premiums) for administrative expenses.

Minor Recommendations

• Department of Insurance employees working on Fund-related matters should receive continuing in-service training in their particular work area.

- An operations manual for the Fund, outlining methods and procedures for insurance purchasing, rate calculation and other Fund administrative activities, should be prepared.
- Department of Insurance data processing personnel should develop a computer data base of Fund statistical information to support the proposed information system.

CHAPTER VIII

INVESTMENTS

The State Treasurer invests most Fund monies in U.S. Treasury bills, bonds or notes. These are generally purchased for short periods to maintain fund liquidity. A small percentage of Fund monies is invested in Kentucky municipality and school district revenue bonds. These bonds yield a low return and cannot now be liquidated advantageously. No more Fund monies will be invested in similar bonds.

Table 8 lists the amount and types of investments made between FY 1969 and FY 1979. Over the eleven-year period the annual average invested for the Fund was $1,741,642. The annual average interest was $91,532, representing a simple return of 5.3 percent per year.

In an audit of the Fund covering fiscal years 1973 and 1974, the Auditor of Public Accounts reported that:

> The Department of Insurance should show more interest in its securities. Insurance did not know what investments it held, simply assuming it was Treasury's job to administer investments. Regardless of what Treasury's duty is in the matter, the investments belong to the Department of Insurance. It is Insurance's duty and responsibility to see that the investments are handled and accounted for properly.[2]

The Department operated on the belief that all Fund monies in excess of the two million dollar reserve were automatically invested by Treasury. However, Treasury continued to seek direction from the Department regarding amounts of Fund monies to invest and in what securities. Because the amounts were small, in comparison to other investment programs, the Fund's investment program received little attention from Treasury officials. The result was that substantial sums remained invested in the Treasurer's cash accounts at Farmers Bank. Interest on these accounts was not credited to the Fund.

This practice continued until 1978, when Harold McGuffey, former Commissioner of Insurance, requested the State Treasurer's Office to invest all Fund monies exceeding the two million dollar reserve. Treasury followed this procedure until the end of 1979. After the change of administration and subsequent staff changes at Treasury, this directive was forgotten and Fund investment returned to its previous method of operation. Appendix E is a copy of the memorandum from former Insurance Commissioner Harold McGuffey to former State Treasurer Frances Jones Mills.

There are several problems with the investment program. The Supervisor of the Property and Casualty Division and the Investments Officer at the State Treasurer's Office are unsure of their responsibilities and they communicate infrequently. The Department of Insurance apparently does not understand what Fund monies may be invested. The restriction of Fund investment to all monies over the two million dollar reserve is not required by the statutes and it appears to be based only upon the decision of former Insurance Commissioner McGuffey. Large amounts of Fund monies are maintained in Treasury's cash accounts and are not invested to the benefit of the Fund. Between FY 1970

TABLE 8

ANNUAL REVIEW OF INVESTMENTS, INVESTMENT INCOME AND CASH IN BANKS

KENTUCKY STATE FIRE & TORNADO INSURANCE FUND

FY 1969 - FY 1979

INVESTMENTS BY THE STATE	FISCAL YEARS					
	1969	1970	1971	1972	1973	1974
U.S. Treasury Bills	$ -	$ -	$ 657,745	$ -	$ -	$ 697,174
U.S. Treasury Bonds	1,078,000	908,000	783,000	783,000	683,000	483,000
U.S. Treasury Notes	175,000	252,000	252,000	252,000	252,000	252,000
REVENUE BONDS ISSUED BY:						
Kentucky Municipalities	138,000	135,000	135,000	135,000	135,000	135,000
Kentucky School Districts	224,000	169,000	154,000	139,000	129,000	114,000
Agencies of the Commonwealth	142,000	43,000	18,000	18,000	18,000	16,000
TOTAL INVESTMENTS	$1,757,000	$1,507,000	$1,999,745	$1,327,000	$1,217,000	$1,697,174
TOTAL INTEREST EARNED ON INVESTMENTS	$ 95,071	$ 65,758	$ 73,745	$ 66,558	$ 56,701	$ 56,552
Cash in Banks[b]	$ 431,438	$1,152,723	$ 202,840	$1,003,189	$1,645,231	$ 884,208

TABLE 8 (continued)

INVESTMENTS BY THE STATE	FISCAL YEARS 1975	1976	1977	1978	1979
U.S. Treasury Bills	$1,144,332	$1,282,111	$1,083,987	$1,128,115	$1,437,719
U.S. Treasury Bonds	483,000	400,000	400,000	400,000	400,000
U.S. Treasury Notes	256,879	252,000	77,000	77,000	77,000
REVENUE BONDS ISSUED BY:					
Kentucky Municipalities	102,000	85,000	85,000	85,000	65,000
Kentucky School Districts	110,000	95,000	65,000	50,000	10,000
Agencies of the Commonwealth	2,000	-	-	-	-
TOTAL INVESTMENTS	$2,098,212	$2,114,111	$1,710,987	$1,740,115	$1,989,719
TOTAL INTEREST EARNED ON INVESTMENTS	$ 102,017	$ 107,767	$ 124,213	$ 184,352	$ 74,117
Cash in Banks[b]	$ 948,569	$ 390,859	$ 917,030	$1,547,134	$ 965,205

SOURCE: Financial Reports FY 1969 - FY 1979. Department of Finance, Commonwealth of Kentucky.

[a]Investment figures are listed by book value.

[b]Any interest that accrues to these funds goes to the Commonwealth's General Fund. It is not transferred to the Kentucky State Fire & Tornado Insurance Fund.

and FY 1979 the Fund ended the fiscal year with an average of $917,130 in cash in banks. While these deposits earn interest, the interest accrues to the Commonwealth's General Fund and not to the Fire and Tornado Insurance Fund. However, the statutes require that all investment income credited to the Fund accrue to the Fund. The failure to secure the maximum rate of return possible from Fund investments represents poor financial management and limits the money available to pay claims.

Major Recommendation

- The Department of Insurance and the State Treasurer's Office should meet and establish written procedures to be followed regarding the Fund's investment program. If a formal agreement or change in the regulations or statutes is necessary to clarify duties and responsibilities, the Department should take the initiative in promoting these changes through the proper channels.

CHAPTER IX

FIRE FUND PROJECTS

Prior to 1948, there was little effort by state agencies or the Department of Insurance to inspect state properties to identify potential risks. Recognizing this deficiency, the Department of Insurance began, in 1948, to employ fire inspection engineers to inspect state property regularly and identify conditions hazardous to life and property. According to KRS 56.170:

> The Department of Insurance shall annually have an inspection made of each building and its contents owned by the state or any agency thereof, for the purpose of determining the unnecessary causes of fire hazard therein, and shall make recommendations to the agency having control or custody of the building relative to the removal or correction of the hazard. Reasonable differences in the premium chargeable against the agency on account of the building and its contents may be made contingent upon compliance with such recommendations.

In a further effort to promote risk identification and reduction, limited Fund monies were made available to state agencies to help pay for capital improvements to existing structures. Recommendations for improvements (fire fund projects) generally originate in one of these ways:

- State agencies may submit any project recommendation for consideration to the Department of Insurance.
- The senior property appraiser for the Department may suggest projects brought to his attention during his property valuation visits.
- Any inspector from the State Fire Marshal's Office may propose a project when a hazard is identified during inspection of a state building. Such hazards are usually pointed out to the agency by the inspector and the agency makes the request to the Department.

Between FY 1969 and FY 1979, the average annual amount available for fire fund projects was approximately $640,000.

Project Availability

A review of fire fund projects awarded between FY 1975 and FY 1980 indicates that several state agencies have never received any monies for risk reduction from the Department. Conversely, it appears that a small number of agencies, most notably the Bureau of Corrections, the Department of Finance, and the universities, have consistently been awarded project monies. A partial listing of fire fund projects by agency and year of award is found in Table 9.

TABLE 9

FIRE FUND PROJECT EXPENDITURES BY AREA AND FISCAL YEAR
KENTUCKY STATE FIRE AND TORNADO INSURANCE FUND
FY 1975 - FY 1980

AREA OF EXPENDITURE	FY 1975 NUMBER OF PROJECTS[a]	FY 1975 TOTAL FUNDS OBLIGATED	FY 1976 NUMBER OF PROJECTS[b]	FY 1976 TOTAL FUNDS OBLIGATED	FY 1977 NUMBER OF PROJECTS	FY 1977 TOTAL FUNDS OBLIGATED	FY 1978 NUMBER OF PROJECTS
Corrections, Dept.	N/A	$ 22,700	N/A	$ ---	0	$ ---	2
Eastern Ky. Univ.	N/A	---	N/A	---	0	---	0
Education, Dept.	N/A	---	N/A	---	0	---	0
Emergency Hold Fund (All agencies)	N/A	---	N/A	---	1	15,000	0
Emergency Sighting (All agencies)	N/A	---	N/A	15,000	0	---	0
Finance, Dept.	N/A	2,500	N/A	60,000	1	25,000	2
Fire Extinguishers	N/A	---	N/A	20,000	0	---	0
Human Res., Dept.	N/A	86,000	N/A	---	7	402,000	0
Kentucky, Univ. of	N/A	25,000	N/A	---	0	---	1
Library & Archives, Department of	N/A	---	N/A	---	0	---	0
Louisville, Univ. of	N/A	40,000	N/A	---	0	---	0
Morehead St. Univ.	N/A	---	N/A	---	0	---	0
Murray St. Univ.	N/A	---	N/A	---	2	130,000	0
Northern Ky. Univ.	N/A	48,700	N/A	---	0	---	0
Sprinkler Sys. Inspec.	N/A	11,000	N/A	18,000	1	20,000	0
Transportation, Dept.	N/A	30,000	N/A	---	0	---	0
Western Ky. Univ.	N/A	9,000	N/A	---	1	195,000	2
TOTALS		$ 274,900		$ 113,000	13	$ 787,000	7

TABLE 9 (cont'd)

AREA OF EXPENDITURE	FY 1978 TOTAL FUNDS OBLIGATED	FY 1979 NUMBER OF PROJECTS	FY 1979 TOTAL FUNDS OBLIGATED	FY 1980 NUMBER OF PROJECTS	FY 1980 TOTAL FUNDS OBLIGATED	TOTAL
Corrections, Dept.	$100,000	6	$130,000	4	$309,800	$562,500
Eastern Ky. Univ.	---	3	39,000	1	95,500	134,500
Education, Dept.	---	4	315,000	1	75,000	390,000
Emergency Hold Fund (All agencies)	---	0	---	0	---	15,000
Emergency Sighting (All agencies)	---	0	---	0	---	15,000
Finance, Dept.	212,000	4	236,000	3	250,000	785,500
Fire Extinguishers	---	0	---	0	---	---
Human Res., Dept.	---	0	---	1	87,500	575,500
Kentucky, Univ. of	3,000	1	45,000	7	367,700	440,700
Library & Archives, Department of	---	0	---	1	3,000	3,000
Louisville, Univ. of	---	0	---	1	76,000	116,000
Morehead St. Univ.	---	3	51,000	0	---	51,000
Murray St. Univ.	---	1	50,000	2	61,200	241,200
Northern Ky. Univ.	---	2	112,000	0	---	160,700
Sprinkler Sys. Inspec.	---	0	---	1	16,400	65,400
Transportation, Dept.	---	0	---	1	80,000	110,000
Western Ky. Univ.	171,000	3	23,500	0	---	398,500
TOTALS	$ 486,000	27	$1001,500	23	$1422,100	$4084,500

SOURCE: Kentucky State Department of Insurance - FY 1979.

a & b The number of Fire Fund projects that were funded by the Department of Insurance in FY 1975 and FY 1976 by area of expenditure was requested from the Department of Finance. This information was not provided in time for publication purposes.

There are several reasons why only certain agencies have received fire fund project monies. Some state agencies are unaware of the existence of these monies and others did not know that they could request a portion of these funds. Of sixty-two agencies asked in a questionnaire, "Are you aware that your agency may submit safety improvement projects for funding to the Department of Insurance?" fifty-four percent (twenty-five of the forty-seven agencies that responded) said they were not.

The policy of the Property and Casualty Division is to restrict the widespread knowledge of the availability of these monies. It is felt that too many projects are already being submitted for the resources available.

Finally, the employees of the Department of Insurance and Department of Finance who decide what projects will be supported explained that the projects that take priority are those that present a potential life hazard. State buildings with a high concentration of people represent such a hazard and thus have higher priority. Consequently, an agency using a significant proportion of its buildings for storage or maintenance probably will not receive many of these project awards.

This method of distributing fire fund project monies imposes an unfair burden on those agencies that do not receive a project award. This is because a premium rate reduction may be given to an agency that eliminates a fire hazard. Therefore, agencies that regularly receive fire fund project monies are generally in a better financial position to correct any hazards. Some of the agency representatives interviewed indicated that they never expect to receive any project monies and are instituting risk reduction measures with agency funds. Of sixty-two agencies asked in a questionnaire, "Has your agency made any safety improvements . . . that were not funded by the State Fire and Tornado Insurance Fund?" fifty-two percent (twenty-four of the forty-seven agencies that responded) said they had made improvements using their agencies' funds. However, it is likely that some agencies are not diverting funds toward risk reduction efforts and are not acting to eliminate identified hazards.

Project Selection

Fire Fund project funding requests are forwarded to the senior property appraiser in the Department of Insurance prior to the end of the fiscal year. The appraiser, in conjunction with the senior engineer of the Department of Finance, selects the projects to be funded. The engineer establishes an approximate cost for each project. These project costs are submitted to the Office of Policy and Management. OPM sets up individual accounts to monitor project progress and funding flow. This Fire Fund project monitoring system has only recently been implemented and is still incomplete.

State agencies are requested to begin their projects during the year they receive the award. However, Fund cash flow problems usually delay availability of monies. This delay hampers project planning and prolongs project completion. Consequently, the completion rate of the projects has suffered.

All project monies are awarded for a particular job and may only be used for that purpose. Any project monies remaining after a project is completed revert to the Fund for reallocation. On-site visits to monitor project progress are made by both the State Fire Marshal's Office and the Department of Insurance to insure results consistent with project requirements and specifications.

In its present form, the program for Fire Fund projects is unable to accomplish its statutory goals because of the scarcity of Fire Fund monies and the inconsistent allocation of Fire Fund projects. The practice of awarding Fire Fund projects should therefore be eliminated. Risk reduction measures should be handled through the normal budgetary process as they currently are for most agencies.

Major Recommendation

- The Department of Insurance and the Department of Finance should cease awarding surplus Fund revenues for the purpose of minimizing fire and safety hazards. This recommendation requires an appropriate statutory change to KRS 56.180.

CHAPTER X

CLAIMS

Insurance claims result from any loss on insured property due to the perils specified in an insurance contract. The Commonwealth's insurance claims are made against two sources, the Kentucky State Fire and Tornado Insurance Fund and the numerous insurance companies that reinsure part of the state properties.

Claims Reporting

Following a loss, the agency which manages the property is required to report the event within thirty days of occurrence to the Department of Insurance. The Department has a claims form for this purpose but not all agencies use it. The Department requests agencies to contact it rather than to notify insurance agents directly in the event of a loss. Table 10 illustrates the annual losses of the Fund between FY 1970 and FY 1979.

Claims Payment and Adjustment

An inspection of the damage is required before claim payment can be made. This review process is commonly known as claims adjustment. Some agencies have employees who can conduct claims adjustments that are acceptable to the Department of Insurance. Other agencies' claims are adjusted by Department staff or commercial adjusters.

Losses not exceeding $300,000 in value, or on property not under a lien, are adjusted by the Department's Deputy Director in charge of claims. After the agency that experienced the loss submits specific claims information, the Department requests the State Treasurer to transfer the claim payment directly to the agency's account. Losses on property in excess of $300,000 or property under a lien are adjusted by the General Adjustment Bureau (GAB). The GAB is a private company that adjusts insurance losses for many insurance companies. A GAB employee always conducts an on-site appraisal of the damage. The GAB will pay an agency directly for any claim not exceeding $100,000. In these cases, GAB assumes the responsibility of collecting the claim payments from the various insurance companies. If a claim exceeds $100,000, the Department of Insurance must collect the claim payment from the individual insurance companies and forward it to the agency.

The amount each insurance company pays per claim is prorated according to its share of total reinsurance coverage. On claims below $100,000, each company is billed by GAB for its portion of reinsurance coverage. In this instance a separate charge is included for GAB's services. If the loss exceeds $100,000, GAB will submit a bill for its services to the Department, which forwards the charge to the agency, and the agency pays GAB for its services.

Since 1970 GAB has received an average annual payment of $3,000 for its services to the Department. GAB is the only commercial property adjuster used by the Department of Insurance.

TABLE 10

A REVIEW OF PREMIUM & CLAIMS PAYMENT
KENTUCKY STATE FIRE & TORNADO INSURANCE FUND
FY 1970 - FY 1979

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
PREMIUM PAID ($)										
FUND	$ 736,743	$ 364,465	$ 887,995	$1,024,285	$ 654,962	$1,196,110	$1,215,329	$ 471,280	$1,362,588	$1,347,210
REINSURANCE [a]	299,512	781,173	432,320	561,072	1,009,420	548,086	634,225	1,632,086	893,254	1,047,475
TOTAL	$1,036,255	$1,145,638	$1,320,315	$1,585,357	$1,664,382	$1,744,196	$1,849,554	$2,103,366	$2,255,842	$2,394,685
PREMIUM PAID (% OF TOTAL)										
FUND	71%	32%	67%	65%	39%	69%	66%	24%	60%	56%
REINSURANCE	29%	68%	33%	35%	61%	31%	34%	76%	40%	44%
TOTAL	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
CLAIMS PAID ($)										
FUND	$ 360,907	$ 76,731	$ 91,641	$ 370,444	$ 153,379	$ 266,636	$ 498,905	$ 308,554	$ 539,673	$ 180,910
REINSURANCE	62,672	34,868	34,235	63,542	1,513,179	30,257	90,135	45,730	222,254	71,085
TOTAL	$ 423,579	$ 111,599	$ 125,876	$ 433,986	$1,666,558	$ 296,894	$ 589,040	$ 354,284	$ 761,927 [b]	$ 251,995 [b]
CLAIMS PAID (% OF TOTAL)										
FUND	85%	69%	73%	85%	9%	90%	85%	87%	71%	72%
REINSURANCE	15%	31%	27%	15%	91%	10%	15%	13%	29%	28%
TOTAL	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

SOURCE: Property and Casualty Division, Department of Insurance, 1979.

[a] Annual reinsurance premiums represent roughly one-third of the premium cost of the standard three-year insurance contract.

[b] Claims total is incomplete due to pending claims.

However, GAB is not operating under a personal service contract with the Department. This practice would appear to be in conflict with the laws and regulations requiring personal service contracts.

Major Recommendation

• The Department of Insurance should require all state agencies to file claims on the Department's designated claim forms. The forms should be sent to the agencies with an explanatory memorandum.

The Department needs to receive accurate information on agency losses. Currently many agencies, instead of using the Department's forms, file claims by telephone or on forms of their own design. For management purposes all claims information should be on standard forms.

Minor Recommendation

• The Department of Insurance should be required to explain why it uses the adjustment services of the General Adjustment Bureau exclusively. Also, the Department should explain why no personal service contract exists with the Bureau.

CONCLUSIONS

In 1936, the General Assembly created the Commonwealth's self-insurance program, on the assumption that the Commonwealth could manage the program's administrative requirements and thereby lower the cost of insurance. Since then, compliance with statutory mandates has increasingly diminished. The Department of Insurance, which has primary responsibility for administering the Fund, has not assumed a proper leadership role, especially in regard to providing sufficient oversight of program-related tasks performed by other agencies. As a result, the state's self-insurance program may not be able to meet its responsibilities to the agencies it insures. Several problems must therefore be solved to put the State Fire and Tornado Insurance Fund on an administratively and financially sound footing.

The need for adequate and timely property appraisals should be addressed immediately. This important function, as the present study shows, affects virtually all other Fund activities. Most importantly, inadequate property appraisals cast doubt on the adequacy of the state agencies' insurance coverage. The process by which agency premium rates are formulated should be improved. The current system is time consuming and cumbersome and it produces cash flow problems that may hamper the Fund's ability to pay claims. Fulfilling the requirement to pay for agency Fund coverage and reinsurance at the beginning of each fiscal year is hindered by a lack of assets. Because agency premium charges are not completed in a timely fashion, revenue collection is slow and the Fund reserve is used to pay for reinsurance coverage.

Because of the increase in the Commonwealth's total insured value the two million dollar reserve and the $300,000 deductible may not be sufficient to pay the costs, should a series of large claims be made against the Fund. Increasing the deductible to $500,000 would probably enable the Fund to secure a reduction in the cost of reinsurance. Increasing the reserve to five million dollars would help to insure that the Fund could meet its financial obligations.

The use of dozens of insurance agents to secure agency reinsurance coverage is wasteful. Premium payments include agent commissions, for which those agents do no more than sign the policies. Eliminating this approach should reduce insurance costs by roughly the amount of the agent's commission; in FY 1980, the savings could be approximately $250,000. Additionally, purchasing agency reinsurance through a bidding procedure would reduce the Property and Casualty Division's administrative duties because numerous contracts now in effect with dozens of independent insurance agents would be eliminated.

The process by which special insurance needs are identified and purchased is disjointed. Most state agencies lack the internal expertise to identify areas of risk not insured under the Fund's policy coverage. Even in cases where need is established, high cost often prohibits securing the additional coverage. Reduction in the cost of these types of insurance might be obtained through blanket rates; however, such savings are not presently explored by the Department of Insurance.

Many state agencies decide arbitrarily what sections or pieces of their property should be insured. Such decisions should not be left to agency officials untrained in risk management.

Fund investments do not receive sufficient attention from the Department of Insurance.

The investments program is impaired by a lack of communication between the State Treasurer's Office and the Department of Insurance.

Because of inconsistent allocation of Fire Fund projects and the scarcity of Fire Fund monies, the statutory goals of this risk reduction program cannot be accomplished. Therefore, the practice of awarding Fire Fund projects should be eliminated and responsibility for risk reduction efforts left with the state agency.

The general administration of the Fund is inadequate. Statutory requirements are not fulfilled, and communication with state agencies is minimal. The benefits of such contemporary procedures as all-risk insurance and annual aggregate loss provisions are not being investigated by the Department of Insurance. This failing is partly due to the lack of professional training of the employees who administer the Fund. Additionally, the workload performed by these employees leaves no time for program change or development. Virtually all of the problems identified in this analysis point to a lack of professional management.

Administration of the Fund by a qualified risk manager would help to eliminate many of the problems enumerated above. The risk manager would provide the professional expertise necessary to operate the Fund in a cost-effective manner more closely aligned with the regulations outlining the Fund's operations.

GLOSSARY

Actual cash value: the cost of repairing or replacing damaged property with other of like kind and quality in the same physical condition; commonly referred to as replacement cost less depreciation.

Agent: the *independent agent* is an independent businessman who represents two or more insurance companies under contract in a sales and service capacity and who is paid on a commission basis; the *exclusive agent* represents only one company, usually on a commission basis; the *direct writer* is the salaried or commissioned employee of a single company.

Allied lines: a term for forms of insurance allied with property insurance, covering such perils as sprinkler leakage, water damage and earthquakes.

Annual aggregate: a provision of some state insurance programs that establishes an annual maximum that will be paid by the state regardless of the total value of any claims filed during a specified twelve-month period.

Assets: all funds, property, goods, securities, rights of action or resources of any kind owned by an insurance company, less such items as are declared non-admissible by state laws, including deferred or overdue premiums.

Catastrophe: a term applied to an incident or series of related incidents involving a loss of more than one million dollars.

Commission: the financial remuneration collected by an independent or exclusive agent for securing business for a specific insurance company. The commission is generally figured as a percentage of the insured's premium charge agreed to by the agent and the insurance company. Depending on the size of the policy (value insured) and the type of insurance, the commission may equal ten to twenty-five percent of the total premium charge.

Conflagration: a term applied to any large, destructive fire.

Deductible insurance: a method of coverage under which a policy holder agrees to contribute up to a specified sum per claim or per accident toward the total amount of the insured loss. Insurance written on this basis has lower premiums.

Direct appropriation: method of funding a state insurance program involving the direct allocation of a specific amount of revenue necessary to secure commercial reinsurance and to support state self-insurance coverage on all state property. Depending on the state, this method may or may not remove the necessity of billing the respective state agencies individually for their property coverage.

Extended coverage insurance: protection for the insured against loss or damage to his property caused by windstorm, hail, smoke, explosion, riot, riot attending a strike, civil commotion, vehicle and aircraft. This is provided in conjunction with fire insurance policy and the various "package" policies.

Fire insurance: coverage for losses caused by fire and lightning plus the resulting damage caused by smoke and water.

Inland marine insurance: a broad type of insurance, generally covering articles that may be transported from one place to another as well as bridges, tunnels and other instrumentalities of transportation. It includes goods in transit as well as numerous "floater" policies on such items as personal effects, personal property, jewelry, furs, and fine arts.

Liability limits: the stipulated sum or sums beyond which an insurance company is not liable to protect the insured.

Package policy: a single insurance policy that includes several coverages (such as extended coverage).

Per occurrence deductible: the application of a specified deductible being on the total amount of loss caused by a single accident or occurrence.

Premium: the sum paid for an insurance policy. Net premiums written represent premium income retained by insurance companies, direct or through reinsurance, less payments made for business reinsured. Direct written premiums are the amounts actually paid by policyholders. Premiums may be paid annually or for the duration of the policy.

Reinsurance: assumption by one insurance company of all or part of a risk undertaken by another insurance company.

Reserve: the retention by an insurance program of any or all funds remaining after all liabilities are deducted from all assets, for the protection of the program against unexpected or catastrophic losses. The reserve amount may be unlimited, it may represent a specific dollar amount, or it may represent a percentage of the total insurance in effect or the total value of the property insured.

Risk manager: a title given to an individual who has received training in various facets of the operation of an insurance program. Such an individual's duties may include the supervision of loss-prevention programs, maintenance of records, loss payment assistance, and matching both commercial and special insurance with the needs of the program.

Stop loss provision: such a provision establishes a maximum or upper limit that a partially self-insured program will pay toward a loss on a per-occurrence basis.

FOOTNOTES

1. State of Florida, Division of Risk Management of the Department of Insurance. October, 1978.

2. Kentucky Auditor of Public Accounts, *Audit of the Department of Insurance for FY 1973 and FY 1974*. December 30, 1975.

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APPENDICES

A. Select Responses of Kentucky State Agencies to a State Fire and Tornado Insurance Questionnaire

B. A Summary Description of the Insurance Practices of the States Regarding the Self-Insuring of Public Property

C. Reserve Provisions by Selected State Government Insurance Programs, FY 1980

D. Letter from Attorney General Steven L. Beshear to Rep. Buddy Adams, analyzing the meaning of "subject of risk" as it appears in KRS 56.100-160

E. Memorandum from Insurance Commissioner Harold B. McGuffey to State Treasurer Frances Jones Mills, November 13, 1978

APPENDIX A

SELECT RESPONSES OF KENTUCKY STATE AGENCIES TO A STATE FIRE AND TORNADO INSURANCE QUESTIONNAIRE

1. Are all of your agency's properties insured under the state Fire and Tornado Insurance Fund?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT.)
Yes	34	72
Nc	10	21
Not Applicable	3	6
No Responce	0	
TOTAL	47	100

Valid Cases 47 Missing Cases 0

2. If your agency's premiums are increased or decreased, are you notified as to the reason?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT.)
Yes	20	42
Nc	18	38
Not Applicable	4	
No Response	5	10
TOTAL	47	100

Valid cases 42 Missing Cases 5

3. Has any part of your agency ever been visited by a representative of the Department of Insurance?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT.)
Yes	19	40
No	23	49
Not Applicable	2	4
No Response	3	6
TOTAL	47	100

Valid Cases 44 Missing Cases 3

4. Is all of the property under your agency's control presently insured for its full estimated value?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT.)
Yes	26	56
No	14	30
Not Applicable	5	10
No Response	2	4
TOTAL	47	100

Valid Cases 45 Missing Cases 2

5. Have you ever received any advice concerning risk reduction or prevention for your agency by anyone other than an employee of the Department of Insurance or the State Fire Marshall's Office?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT.)
Yes	4	8
No	39	84
Not Applicable	2	4
No Response	2	4
TOTAL	47	100

Valid Cases 45 Missing Cases 2

6. Does your agency obtain insurance coverage in addition to state fire and tornado insurance coverage?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT.)
Yes	27	58
No	15	32
Not Applicable	3	6
No Response	2	4
TOTAL	47	100

Valid Cases 45 Missing Cases 2

7. Does your agency receive a description of property damage from the adjustor or the Insurance Department?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT.)
Yes	13	28
No	17	36
Not Applicable	13	28
No Response	4	8
TOTAL	47	100

Valid Cases 43 Missing Cases 4

8. Does your agency submit an annual inventory of building contents to the Department of Finance?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Yes	45	96
No	1	2
Not Applicable	1	2
No Response	0	0
TOTAL	47	100

Valid Cases 47 Missing Cases 0

9. Does the Department of Finance ever spot check your inventory?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Yes	23	49
No	17	36
Not Applicable	1	2
No Response	6	13
TOTAL	47	100

Valid Cases 41 Missing Cases 6

10. Does your agency have a safety program for fire and wind damage prevention?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Yes	18	39
No	23	49
Not Applicable	3	6
No Response	3	6
TOTAL	47	100

Valid Cases 44 Missing Cases 3

11. Has your agency made any safety improvements that were not funded by the State Fire and Tornado Insurance Fund?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Yes	24	52
No	17	36
Not Applicable	4	8
No Response	2	4
TOTAL	47	100

Valid Cases 45 Missing Cases 2

12. Are you aware that your agency may submit safety improvement projects for funding to the Department of Insurance?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Yes	16	34
No	25	54
Not Applicable	4	8
No Response	2	4
TOTAL	47	100

Valid Cases 45 Missing Cases 2

13. Has your agency ever submitted safety improvement projects to the Insurance Department for Funding?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Yes	13	28
No	28	60
Not Applicable	4	8
No Response	2	4
Total	47	100

Valid Cases 45 Missing Cases 2

14. Has the Finance Department's Division of Purchases ever performed a quality control inspection of repair materials you or your agency purchased with money from the Fire and Tornado Insurance Fund for fire safety repairs or improvements?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Yes	4	8
No	30	64
Not Applicable	8	17
No Response	5	11
Total	47	100

Valid Cases 42 Missing Cases 5

15. Does your agency have any contact with the State Fire Marshall's Office?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Yes	33	70
No	10	22
Not Applicable	3	6
No Response	1	2
Total	47	100

Valid Case 47 Missing Cases 0

16. How would you rate the overall level of cooperation between your agency and the Department of Insurance?

CATEGORY LABEL	ABSOLUTE FREQUENCY	RELATIVE FREQUENCY (PCT)
Good	36	77
Adequate	9	19
Poor	0	0
Not Applicable	2	4
No Response	0	0
Total	47	100

Valid Cases 47 Missing Cases 0

APPENDIX B

A SUMMARY DESCRIPTION OF THE INSURANCE PRACTICES OF THE STATES REGARDING THE SELF-INSURING OF PUBLIC PROPERTY

Alabama	Created in 1923. Purchase commercial insurance with a $2,500,000 annual aggregate deductible and $1,000,000 stop loss per occurrence. Covers buildings and contents. Coverage provided for fire, lightning, and removal, and extended coverage. Coverage for state agencies, city-county school districts. Use independent adjusters. Funded by premium charges to user agencies. Coverage written on actual cash value. Insurance purchased through insurance broker. Risk manager salary is $28,600.
Alaska	Purchase commercial insurance with a $10,000 deductible per occurrence and/or a $1,000,000 annual aggregate deductible. Coverage for buildings, contents, non-owned buildings, non-owned personal property, and use and occupancy. State covered for all risks on buildings, flood, and earthquake. Independent adjusters used. Funded by payment of premiums by insured entities. Coverage written on replacement cost for buildings and contents Risk manager's salary is maximum of $50,000. Reinsurance purchased through brokerage firm. Total property value estimate is one billion dollars.
Arizona	Purchase commercial insurance with a $100,000 deductible per occurrence. Coverage for buildings, contents, and use and occupancy. Coverage for fire, lightning, and removal, extended coverage, all risks on buildings, inland marine floater, flood, and earthquake. Coverage is provided for the state. In-house and independent adjusters who work also as risk managers, salary from $21,000-$28,000 Funded by direct appropriation only. Coverage is written on actual cash value. Agency pays $100 per any one loss. Property insured for 90% property value. State property value: $3 billion.

Arkansas	No program.
California	No funded program. Commercial policies when required by bond requirements. All other properties uninsured. Major losses require direct appropriation.
Colorado	Commercial policy with $100,000 deductible per occurrence except self-maintenance properties, i.e., college dorms, etc. (These have a $1,000 deductible.) Insure buildings and contents for extended coverage. Cover state owned property. Commercial insurer adjusts claims. Each agency pays its premium directly to the agent of record. Replacement costs. Boiler Insurance: first dollar coverage by a commercial company.
Connecticut	Purchase commercial insurance with $10,000 per occurrence and $100,000 annual aggregate deductible. Covers buildings and contents for fire, lightning, and removal, and extended coverage. Insure state agencies. Use insurer adjusters, attorney general's office and Insurance Purchasing Board (IPB). IPB performs same function as risk manager. Funded by direct appropriation. Coverage written on actual cash value.
Delaware	Purchase first dollar commercial insurance for boiler and machinery. Self-insure with no excess buildings and contents. State, school districts, and higher education covered for fire, lightning, and removal, extended coverage, inland marine floater on equipment, and explosion on boilers. In-house adjusters and independent adjustment companies used. Risk manager salary approximately $28,000. State agency has $500 deductible. Property value equals $1 billion. Funded by direct appropriation only. Coverage written on actual cash value on property other than real property and replacement cost for buildings.

Florida	Purchase commercial insurance with a $2.5 million annual aggregate deductible. Coverage is for buildings, contents, non-owned buildings, use and occupancy, and floods. Coverage is for fire, lightning, and removal, and extended coverage. Coverage is provided for state. In-house adjusters. Funded by payment of premiums by insured entities. Coverage is written on actual cash value. Property value $2.5 billion.
Georgia	Commercial insurance with $1.5 million deductible per occurrence and $3.5 million annual aggregate. Covers buildings and contents for fire, lightning, and removal, extended coverage, flood, V and MM, radioactive contamination, and boiler and machinery. Covers state and authorized properties. Claims adjusted by staff. Insure replacements costs.
Hawaii	Self-insured: no excess. Commercial insurance for some buildings because of loan and bond covenants. Buildings and contents of state insured for fire, lightning, and removal, extended coverage, flood, and earthquake. Funded by direct appropriation only. Coverage is written on replacement cost for buildings and original acquisition cost on contents. Attorney general involved in all claims settlements. Property value has never been updated.
Idaho	Purchase commercial insurance with a $100,000 annual aggregate deductible. Coverage for state. Coverage for buildings, contents, non-owned buildings, and non-owned personal property. Coverage for all risks on buildings, contents, and all insurable property. In-house and independent adjusters used. Salary is $16,000 annually. Funded by payment of premiums by insured entities. Coverage is written on replacement cost for buildings and contents. Property value is $500,000,000.
Illinois	No program.
Indiana	No program.
Iowa	No program.

Kansas	Reserve maintained within state emergency fund for property under Regents' control.
KENTUCKY	Purchase commercial coverage for properties that exceed $300,000 value and those that are authorized. Covers buildings and contents for fire, lightning, and removal and extended coverage. Insure state owned properties. In-house and independent adjusters. Funded by premiums charged to user agencies. Coverage is written on 90% of sound insurable value.
Louisiana	Purchase commercial insurance with a $125,000 deductible per occurrence and/or a $350,000 annual aggregate deductible. Agency has $8,000 deductible. Coverage provided for buildings, contents, non-owned buildings, non-owned personal property, and use and occupancy. Coverage for fire, lightning, and removal, extended coverage, and flood. Coverage provided for State. In-house and independent adjusters used for claims under $8,000; salary is $22,000-$24,000. Funded by payment of premium by insured entities. Coverage written on actual cash value. Property value is $1.4 billion.
Maine	Commercial insurance with $500,000 per occurrence deductible and $1 million annual aggregate. Agency has $250 deductible per occurrence. Insure buildings and contents including non-owned for fire, lightning, and removal, extended coverage, inland marine, and flood. Insure State agencies. General Adjustment Bureau settles all claims. Coverage written on actual cash value and replacement cost as per statement of values. (Approximately one-third of value replacement cost.) Property value $700 million insured for $.024 per $100.
Maryland	Self-insurance fund covers approximately $28 million in property. State-owned buildings are insured subject to a $100,000 deductible. Funded through general revenues.
Massachusetts	No program.

Michigan	Self-insurance fund originated in 1913. Described as a "classic example" of the failure of state funds. (1-p. 9a) Statutory limit of $1.75 million accumulated by 1951. Losses in 1951 and 1952 totaled more than $7 million, exceeding the capacity of the fund and placing it in precarious position for many years. Fund abolished by legislature in 1965. Presently most state property is not insured. There is an automatic annual appropriation to cover losses up to $50,000 if caused by Fire or Extended Coverage perils. Other losses require special appropriations from legislature. Universities are autonomous and generally purchase private insurance.
Minnesota	No program.
Mississippi	No program.
Missouri	Commercial insurance. Per subject of risk. Buildings and contents. Standard policy with extended coverage. Commercial adjustor. State agencies are billed for premiums. Actual cash value. Rates calculated by commercial insurers. Insurance purchased directly through companies.
Montana	Commercial. Claims paid on a per occurrence basis. $10,000 deductible is paid by each agency per claim. Buildings and contents are insured for 90% valuation. Standard policy with earthquake and flood insurance. Commercial and independent adjusters. Actual cash value. $100,000 annual aggregate deductible. Companies calculate rates. Commercial insurance purchased through agents and brokers.
Nebraska	Insurance is purchased only for bonded property. All other risks are assumed by the State.
Nevada	No program.
New Hampshire	No insurance of state property or contents, except those few properties turned over to the state as gifts whose previous owners required insurance coverage.

New Jersey	Commercial and self-insurance Per occurrence. Deductibles are \$1,000-\$10,000 per agency, if the agency has not implemented safety measures. Replacement cost is used on buildings and actual cash value is used for contents. Standard policy with extended coverage. Independent adjusters. In-house risk manager; salary: \$40,000. Agencies are charged for premiums. All agencies are discounted at one time. This state acts as its own broker for commercial insurance.
New Mexico	Commercial (bid). Claims paid on a per occurrence basis. Buildings and contents, occupancy and use insured for 90% of replacement value. Standard policy with earthquake and flood. Commercial and independent adjusters. In-house risk manager (\$30,000 salary) Direct appropriation of premium charges. Actual cash value and replacement costs. Insurance is presently secured through agents, but over the next few years agents will no longer handle this business as the state uses direct writer companies. \$700 million of insurance is in force on state property. No insurance companies failed to renew policies as a result of the New Mexico Prison riot in Santa Fe.
New York	All state agencies must absorb all losses out of their own funds or get special appropriation. The Attica Prison Riot was New York's biggest loss to date. No centralized risk manager.
North Carolina	Self-insurance. Claims are paid on per subject of risk. Buildings and contents 100% valuation Fire and extended coverage. In-house adjuster. In-house risk manager (\$34,000 salary) Direct appropriations for premium charges. Replacement costs. All reinsurance is purchased through the North Carolina Insurance Agents Association. \$2 billion of insurance is in force.

North Dakota	Combination of commercial and self-insurance. Claims paid per occurrence. Deductible of $100 on vandalism. Building and contents. Standard policy. In-house adjuster. In-house risk manager. Each state agency is billed for premiums Actual cash value. Agents bid for commercial insurance business. They provide no services. $1.5 billion of insurance is in force.
Ohio	Combination of commercial insurance and self-assumption of risk. Claims paid per occurrence. Buildings and contents. Fire, lightning, extended coverage, boiler, inland marine and vandalism. In-house and commercial adjusters. In-house risk manager ($23,000 salary) Direct appropriation. Actual cash value and replacement costs.
Oklahoma	No program for state insurance. Currently planning for a risk manager's office.
Oregon	Combination of commercial and self-insurance. Claims paid per occurrence. $500 deductible on first dollar coverage. Buildings and contents. Standard policy with vandalism, storm and flood, and earthquake. Business manager of each agency conducts property valuation and claims adjusting. Risk manager in-house; salary of $23,500. Agencies are invoiced for premiums. Replacement cost. Catastrophic insurance policy $35,000,000 No limit on fund. $2.4 billion insurance in force.
Pennsylvania	Primarily self-insurance with a few commercial policies. Claims paid per occurrence. $1,000,000 annual aggregate deductible. Buildings and contents (90% valuation). Standard policy with extended coverage. In-house and commercial adjusters. In-house risk manager ($35,000) Agencies are invoiced for premiums. Actual cash value and replacement cost.

Pennsylvania (cont'd.)	Direct writer companies for commercial insurance. $4 billion insurance in force. No problems with the insurance system as a result of the Three Mile Island Disaster.
Rhode Island	Commercial insurance. Claims paid per occurrence. $25,000 deductible. Buildings and contents (90% of valuation) Standard policy with flood insurance. Independent and in-house appraisers State agencies are invoiced. Actual cash value. Rates are calculated by commercial companies. Direct writer.
South Carolina	Combination of commercial and self-insurance. Claims are paid per occurrence. $125-150 deductible per building. Buildings and contents. Standard policy with extended coverage, flood, and earthquake. Commercial and in-house adjusters. State agencies are invoiced for premiums. Replacement cost. Agents supply commercial insurance through a bid process. All monies stay in the Fund. $4 billion of insurance in force.
South Dakota	Commercial insurance and self-assumption. Claims are paid per occurrence. $1,000 deductible. Building and contents. Fire, lightning, flood, earthquake, marine, boiler and extended coverage. Independent adjuster. In-house risk manager ($24,000 salary) Agencies are billed for premiums. Actual cash value. Agents bid for commercial insurance business.
Tennessee	Commercial insurance. $15,000 deductible. Claims paid per occurrence. Buildings and contents, occupancy and use (90% valuation) All perils are covered. Commercial adjuster. In-house risk manager ($21,000-$24,000 salary) Direct appropriation. Replacement cost. Direct writer (CNA) $2.5 billion insurance in force.

Texas	Bonded buildings need commercial insurance; all other state property is not insured. Claims are paid per occurrence. $100,000 deductible. Building and contents. Standard policy with extended coverage. Commercial adjuster. Agencies are billed for premiums. Actual cash value. Agents bid for insurance business.
Utah	Commercial insurance. Claims paid per occurrence. $25,000 deductible. Buildings and contents (90% valuation) Standard policy with extended coverage. Independent adjuster. In-house risk manager ($30,000 salary) Each agency is billed for insurance premiums. Actual cash value. Agents provide commercial insurance. $1.3 billion insurance is in force.
Vermont	Commercial insurance. Claims paid per occurrence. $50,000 deductible for property insurance. Building and contents (90% valuation) Earthquake, fire, lightning, boiler, and extended coverage. Commercial adjuster. Actual cash value. Direct writer. $220 million of insurance in force.
Virginia	Self-insurance and commercial policies with various deductibles. Coverage for buildings, contents, non-owned buildings, use and occupancy, fine arts, tuition fees, valuable papers, and floaters. Coverage provided for fire, lightning, and removal, extended coverage, all risks on buildings, inland marine, and flood. Insuror and independent adjusters. Direct appropriation. Actual cash value and replacement. $100,000 risk retention on July 1, 1980.

Washington	Self-insured with no excess. Coverage for buildings for fire, lightning, and removal, extended coverage, all risk on buildings, inland marine floater, flood, and earthquake. Coverage for State. In-house and commercial adjusters. Funded through direct appropriation and catastrophe reserves. Coverage written on replacement cost for buildings and contents. Property value is $3.5 billion.
West Virginia	Purchase commercial with $25,000 deductible per occurrence and/or $1,200,000 annual aggregate deductible. $2,000 deductible assumed by agency. Coverage is for buildings, contents, non-owned buildings (net lease), non-owned personal property (if required by lease), use and occupancy (if required by bond issue), aircraft hull (ground cover), and specific inland marine coverage. Coverage provided for all risks on buildings and contents, flood purchased from Federal Flood Program when required. State is insured. In-house, commercial, and independent adjusters used. Funded by direct appropriation and investment income. Coverage is written on replacement cost for buildings and contents.
Wisconsin	System becomes effective July 1. Self-insurance fund: $2.5 million per occurrence. $5 million annual aggregate. Agency assumes $250 deductible GAB settles claims. Funded by direct appropriation. Agency pays for special coverage. Risk managers earn from $21,000-$36,000. Property value: $3,500,000,000.
Wyoming	Commercial insurance. Claims paid per occurrence. $50,000 annual aggregate deductible. Building and contents (90% valuation) Fire, lightning, earthquake, marine (inland) vandalism and boiler. Commercial and independent adjusters. Direct appropriation. Replacement cost. Insurance agents bid for state business. $130 million insurance in force.

SOURCE: Insurance Faculty of the State University of Iowa--FY 1977 and telephone survey conducted by the Legislative Research Commission, FY 1980.

APPENDIX C

RESERVE PROVISIONS BY SELECTED STATE GOVERNMENT INSURANCE PROGRAMS
FY 1980

STATE	RESERVE PROVISION
Alabama	No limit on surplus or reserve funds has been established in Alabama.
Delaware	In creating the Delaware Program, the legislature set aside $1,000,000 in the Capital Investment Fund to be drawn upon in the event that losses exceed accumulated reserves. However, provision is made for this excessive loss reserve to be decreased to $500,000 when the accumulated reserves in the State Self-Insurance Fund reaches $1,000,000 and for the reserve to be released when the State Self-Insurance Fund reaches $2,000,000. Any monies drawn from the Capital Investment Fund are to be reimbursed by the Self-Insurance Fund according to a schedule fixed by the Insurance Coverage Committee.
Florida	No limit on surplus or reserve funds has been established in Florida. Some funds are diverted toward the reduction of risk in state government properties.
Georgia	No limit on surplus or reserve funds has been established in Georgia.
KENTUCKY	The accumulation of reserves in the fund is limited to $2,000,000. When reserves exceed this amount, the excess is to be made available to the Department of Finance for the purpose of improving conditions relating to life and fire safety in state properties.
North Carolina	When the reserves of the fund reach five percent of the total amount of insurance in force, the premiums are to be reduced to such a level as to maintain the reserve at the five percent figure.
North Dakota	Accumulated reserves in the fund are limited to $12,000,000. In the event this limitation is reached, premium rates are to be reduced in sufficient proportion as to maintain the reserve at its maximum level.
Oregon	The accumulation of reserves is limited to an amount equal to two percent of the valuation of all covered property. When the reserves exceed

Oregon (continued)	this limit, premiums are to be reduced so as to maintain the fund at its maximum limit.
South Carolina	When the accumulated reserves reach an amount equal to five percent of the insurance in force, premiums are to be reduced to a rate which will maintain the reserve at the five percent level. Some funds are diverted toward the reduction of risk in state government properties.
Wisconsin	When accumulated reserves reach $2,000,000, the collection of premiums on state property is to be discontinued until such time as the accumulated reserves drop below the specified amount.

SOURCE: Interim Committee on State Self-Insurance, Arizona Legislative Council, December, 1970, and Telephone Survey.

APPENDIX D

COMMONWEALTH OF KENTUCKY
OFFICE OF THE ATTORNEY GENERAL

STEVEN L. BESHEAR
ATTORNEY GENERAL

CAPITOL BUILDING
FRANKFORT 40601

October 22, 1980

Mr. Buddy Adams, Chairman
Program Review & Investigation
Committee
Legislative Research Commission
Capitol Building
Frankfort, Kentucky 40601

Dear Mr. Adams:

In your letter dated October 13, 1980, you requested an opinion of this office as to the meaning of the term "subject of risk" as it appears in KRS 56.100, 56.120 and 56.160. You expressed concern that should there be a multiple loss to state property, the state Fire and Tornado Insurance Fund would have to pay the required deductible on each individual loss.

As you noted in your letter, the term "subject of risk" is defined in KRS 56.065(1) as "any or all property reasonably considered to be subject to loss or damage by any single occurrence of any event insured against." The term, for example, would cover a situation where one (1) tornado caused multiple damages. This would be not unlike the case where a vehicle struck an oncoming vehicle and then ricocheted off and struck a second vehicle. Hartford Accident and Indemnity Company v. Wesolowski, N.Y., 305 N.E.2d 907 (1973). Although there were two (2) separate collisions, there was but a single occurrence in that the second collision had its origin in the first collision. By the same token, if there is but one (1) fire which spreads to several buildings or one (1) tornado which damages or destroys several buildings, there is but a single occurrence as contemplated by the statute.

Because the term "subject of risk" is statutorily defined, this office is of the opinion that there is no ambiguity in the above statutes. Finding no ambiguity, this office can find no reason to amend the statutes.

Sincerely,

Steven L. Beshear
Attorney General

Joseph R. Johnson
Assistant Attorney General

JRJ:sc

APPENDIX E

MEMORANDUM FROM INSURANCE COMMISSIONER HAROLD B. McGUFFEY TO STATE TREASURER FRANCES JONES MILLS, NOVEMBER 13, 1978

M E M O R A N D U M

TO: Frances Jones Mills
State Treasurer

FROM: Harold B. McGuffey, Commissioner
Department of Insurance

DATE: November 13, 1978

SUBJECT: State Fire and Tornado Insurance Fund Investments

I have been informed as of today concerning the above mentioned subject from my Administrative Services Division and a representative from the State Auditor's Office, there is a considerable amount of available cash to be invested.

It is my understanding that out of the $2,000,000 fund, some $800,000 is invested. Therefore, I am requesting that you invest any available amount at your discretion as per KRS 56.140 and that any other bonds or treasury bills or notes that mature at any time in the future be invested as soon as possible.

If this meets with your approval, I would appreciate copies of any transaction as to this fund from your office.