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Cease Operations of the Local Government Property Insurance Fund (Insurance)

[LFB 2017-19 Budget Summary: Page 257, #2]

CURRENT LAW

The Office of the Commissioner of Insurance (OCI) administers a program to provide property insurance coverage to local units of government through the segregated local government property insurance fund (LGPIF). Policy premiums are deposited into the fund and the fund is used for paying claims and for the program's administrative costs.

GOVERNOR

Specify that no insurance coverage may be issued under the local government property insurance fund program on or after July 1, 2017, no existing coverage may be renewed after December 31, 2017, and no coverage may terminate later than December 31, 2018. Specify that all claims under the program must be filed by no later than July 1, 2019, and that no claim filed after that date will be covered by the fund. Require the manager of the fund to distribute any moneys remaining in the fund among the local governmental units that were insured under the fund on July 1, 2017. Repeal an obsolete provision related to a loan made by the local government property insurance fund to the general fund in 1992.

DISCUSSION POINTS

1. The state property insurance fund was created in 1903 to insure against losses for state-owned property and was extended to cover local government property 10 years later. In 1979, the fund was recreated as the local government property insurance fund, reflecting the decision to transfer coverage of state-owned property to a self-funded program administered by the Department

of Administration.

2. The bill would stop the issuance of new LFPIF policies and the renewals of existing policies to eventually phase out the program. No claims would be accepted after the 2017-19 biennium, although payments could continue until all are resolved.

3. The Governor also proposed the phase-out of the property fund in the 2015-17 budget bill, but the Legislature did not approve the elimination of the program at that time. Since the time of the Legislature's 2015 budget deliberations, most local governments that had been LGPIF policyholders have dropped their coverage, electing instead to purchase a policy through a commercial insurer. To illustrate the decline in LGPIR participation, the following table compares the number of policyholders by type of government in 2015 with the number that hold policies in 2017. The final row shows the total amount of insurance in force in both years.

LGPIF Policyholders by Type of Local Government, 2015 and 2017

Type of Local Government	2015	2017
Cities	126	1
Counties	68	3
Other (Special Districts)	133	46
School Districts	232	12
Towns	153	73
Villages	243	22
Total	955	157
Builders Risk	57	0
Insurance in Force ($ in Billions)	$ 51.1	$ 1.6

4. Various factors may have contributed to the decline in LGPIF participation, including uncertainty regarding the future of the program following its proposed elimination in 2015. However, an important reason for the decline appears to be significant premium increases enacted on July 1, 2015. According to representatives of local government associations, many local governments that switched to commercial insurers did so because the premiums for the commercial policies were less than the new rates charged by the LGPIF program.

5. In addition to the 2015 premium increases, OCI made various other program changes around the same time, including changes to deductibles and the method used to determine premiums for individual policyholders. These changes were enacted in response to a series of losses suffered by the fund between 2010 and 2014. As a result of these losses, the fund had a negative surplus of $1.4 million at the close of 2013-14. The property fund also suffered an annual loss in 2014-15, and although it had an annual surplus in 2015-16, the accumulative deficit for the fund was $6.6 million at the end of that year. The following table shows the financial information for the fund from 2009-10 to 2015-16. Following the table is an explanation of each of the data categories.

Local Government Property Insurance Fund Revenues, Expenditures and Balances, Fiscal Years 2009-10 through 2015-16 ($ in Millions)

	2010	2011	2012	2013	2014	2015	2016
Beginning Surplus	$41.2	$32.0	$20.1	$14.0	$14.1	-$1.4	-$8.7
Net Premiums	$16.1	$15.5	$14.9	$16.8	$18.0	$17.3	$4.9
Misc. Income and Adjustments	0.4	0.3	0.3	0.0	-0.5	-2.2	0.4
Dividend	-12.0	0.0	0.0	0.0	0.0	0.0	0.0
Subtotal of Income	$4.5	$15.8	$15.2	$16.8	$17.5	$15.1	$5.3
Net Losses and Expenses	$13.7	$27.7	$21.3	$16.7	$33.0	$22.4	$3.2
Annual Gain/Loss	-$9.2	-$11.9	-$6.1	$0.1	-$15.5	-$7.3	$2.1
Ending Surplus	$32.0	$20.1	$14.0	$14.1	-$1.4	-$8.7	-$6.6

Surplus: The amount available to pay claims at the beginning or end of the fiscal year.
Net Premiums: The premium amount collected from policyholders, net of premium paid for reinsurance coverage (does not include impact of policyholder dividend).
Miscellaneous Income and Adjustments: The amount of net investment income plus accounting adjustments to income.
Dividend: The amount of surplus balance paid to policyholders upon policy renewal in 2010.
Net Losses and Expenses: The amount of direct claims paid, net of amount paid by excess-of-loss policy, plus administrative expenses.

6. The program suffered significant losses in 2010-11 and 2013-14 due to storm-related claims. In addition, a significant portion of the loss in 2013-14 was due to damages suffered in a fire at the Milwaukee County Courthouse in July of 2013. These single-event losses account for a large share of the net losses in those years.

7. Under current law, if the property fund does not have sufficient assets to pay claims that are due, the DOA Secretary is required to transfer moneys from the general fund to cover all claims. Once there are sufficient assets in the property fund, the Secretary is required to repay the general fund the amount that was transferred. Starting in September of 2015, DOA has approved a series of transfers from the general fund to allow the LGPIF to make claim payments. Presently, the LGPIF owes $17.5 million to the general fund in repayment. Of this amount, $9.1 million results from transfers that occurred in 2016-17, and so are not reflected in the fund balance table shown above.

8. The LGPIF's current financial condition is contingent, in part, on the outcome of litigation between the fund and the fund's excess-of-loss provider concerning the responsibility for costs of the 2013 Milwaukee County Courthouse fire. The amount in dispute in this case is $13.2 million. Since this amount is included in the fund's financial statements, an unfavorable decision would increase the fund's deficit. Likewise, a ruling in the LGPIF's favor would not reduce the fund's deficit, but may allow for the repayment of a portion of the general fund cash transfer. The case is scheduled for trial in September of 2017.

9. At the time that the Legislature considered the proposed elimination of the LGPIF in 2015, one of the concerns was that some local governments would have difficultly insuring certain properties due to their age or condition, unique characteristics, or fire risk. Since the LGPIF does not refuse coverage to any applicant, no local government is left without an insurance option if a commercial insurer refuses to issue a policy for a property.

10. The fact that most local governments have dropped their LGPIF coverage suggests that there are commercial coverage options for most local governments. However, just because many local governments have dropped their LGPIF coverage does not mean that doing so would be feasible for all. The Fiscal Bureau contacted local government associations and individual local governments in an attempt to determine if some current policyholders have concerns about their ability to secure commercial coverage or the affordability of that coverage. Some current LGPIF policyholders indicated that they had explored alternative coverage, but elected to continue their LGPIF policies because the alternative policies had higher premiums or had other features, such as higher deductibles, that were considered undesirable. One school district, in particular, indicated that because of the distance of their school building from the nearest fire station, they would be considered to be a high risk, and their premiums would be considerably higher than the LGPIF policy. In order to reduce its fire risk, the district was told that they would have to build a water tower near the building.

11. Based on these responses, a small number of current LGPIF policyholders may need to commit funds to building and infrastructure improvements in order to obtain property insurance coverage from a commercial insurer at a reasonable cost. The Committee could determine that, despite the potential costs, it would be desirable that all local governments examine their property risks and make improvements necessary to manage those risks to the extent necessary to obtain commercial property insurance. In this event, the Committee could approve the recommendation to approve the proposal to eliminate the LGPIF (Alternative A 1).

12. For some local governments, the level of building or infrastructure improvements needed to obtain commercial insurance may not feasible, particularly in the amount of time prior to the proposed phase-out of the LGPIF program. Rather than leave those local governments with no other options for property insurance, the phase-out proposal could be modified to allow policyholders that have a policy through the fund on July 1, 2017, to renew the policy if the policyholder demonstrates, to the satisfaction of the Insurance Commissioner, that obtaining property insurance from another insurer would mean substantially higher costs, or would not be possible without an unreasonable level of building or infrastructure improvements. Since the purpose of this provision would be to provide backstop insurance for a limited number of local entities, rather than to maintain an actuarially sustainable program, any increase to the premiums for these policyholders could be limited to the industrywide rate of increase for property coverage. Finally, in order for the Legislature to be able to assess the extent and impact of this provision, OCI could be required to prepare a report with its 2019-21 budget request on each of the local entities for which coverage was extended under this provision, including premiums paid, value of property insured, amount of any claims submitted, and the barriers to obtaining property insurance coverage from another insurer (Alternative A 2).

13. Under the alternative described in the previous point, the premium revenue collected from remaining policyholders may be insufficient to pay claims. In this case, additional general fund transfers may be needed to pay claims. However, the number of local entities for which coverage is extended under this provision, as well as the total insured value, would likely be small, even in relation to the current size of the program. The report included in the alternative would allow the Legislature to reassess the need and potential cost of the extension in the 2019-21 biennial budget.

14. Despite the reduced size of the LGPIF program, the Committee could determine that it serves an important role for local entities and that the best chance of providing a stable source of coverage for local entities that would otherwise have difficulty purchasing property insurance from a commercial insurer would be to maintain the program open to all local governments. In this case, the Committee could delete the proposal to eliminate the LGPIF (Alternative A 3).

15. Given that the fiscal year 2015-16 ending LGPIF deficit was about five times the amount of premium payments from current policyholders, it is unlikely that the deficit would be resolved without action by the Legislature. However, since the bill would specify that the LGPIF would continue to receive claims through the end of 2018-19, the final deficit would not be known until the 2019-21 biennium. At that time, the Legislature would likely need to address the deficit and modify or eliminate the requirement that the LGPIF repay the amounts transferred from the general fund.

16. Another issue that would affect current policyholders, regardless of whether or not the proposal to phase out the fund is approved, relates to premium and fund surplus requirements that were included in 2015 Act 325. Under that act, LGPIF establishes minimum requirements for the premium in relation to the size of the surplus, and a requirement for the levying of assessments in the event of a fund deficit. Although these provisions do not take effect until July 1, 2018, it appears that they may require OCI to levy an assessment on any remaining policyholders to eliminate the fund deficit. Because of the steep decline in LGPIF participation, the responsibility for paying assessments would fall on just a few remaining policyholders, to eliminate a deficit that accrued when there were nearly 1,000 policyholders. In order to avoid imposing an unreasonable and disproportionate burden on the remaining policyholders, the Committee could repeal the Act 325 requirements (Alternative B 1).

ALTERNATIVES

A. Local Government Property Insurance Fund -- Cease Operations

1. Approve the Governor's recommendation to cease operations of the local government property insurance fund by specifying that no insurance coverage may be issued under the local government property insurance fund program on or after July 1, 2017, no existing coverage may be renewed after December 31, 2017, and no coverage may terminate later than December 31, 2018. Specify that all claims under the program must be filed by no later than July 1, 2019, and that no claim filed after that date will be covered by the fund.

2. Modify the Governor's recommendation by specifying that any policyholder that holds a policy through the fund on July 1, 2017, would be allowed to renew the policy if policyholder demonstrates, to the satisfaction of the Insurance Commissioner, that obtaining property insurance from another insurer would mean substantially higher costs or would not be possible without an unreasonable level of building or infrastructure improvements. Specify that OCI may not increase the premiums for such a policyholder by more than the rate of increase for industrywide average increase for the same type of coverage. Require OCI to prepare a report, to be included in its 2019-21 budget request, on each of the local entities for which coverage was extended under this provision, including premiums paid, value of property insured, amount of any claims submitted, and the barriers to obtaining property insurance coverage from another insurer.

3. Delete provision.

B. Local Government Property Insurance Fund -- Premium Requirements and Assessments

1. Repeal 2015 Act 325, which relates to the local government property insurance fund premium levels and assessments to address an insufficient surplus, in order to prevent these provisions from applying to the remaining policyholders after July 1, 2018.

2. Maintain current law.

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