

# Administration

## Procurement and Risk Management

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### LFB Summary Item for Which an Issue Paper Has Been Prepared

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2	Risk Management Insurance Premium Costs (Paper #160)

### LFB Summary Items Removed From Budget Consideration

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3	Transfer of UW Worker's Compensation Claims Administration
4	Historical and Fine Arts Collections





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June 8, 2023

Joint Committee on Finance

Paper #160

### **Risk Management Insurance Premium Costs (Administration -- Procurement and Risk Management)**

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#### **CURRENT LAW**

The Department of Administration (DOA) operates the state's risk management program, which provides insurance coverage for state property, liability, and worker's compensation losses. The risk management program is self-funded to insure state agencies against such losses. The state also purchases excess coverage from private insurance carriers for property and liability losses that exceed self-funded coverage limits.

Currently, both excess insurance premiums and program administration are supported through an annual sum certain appropriation, funded by assessments to state agencies. Base funding for the program's administration appropriation is \$16,634,000 PR and 16.45 PR positions annually.

#### **DISCUSSION POINTS**

1. The risk management program is funded by annual assessments to state agencies based on prior losses, current exposure, and administrative expenses. Expenditures are made from two appropriations: (a) risk management costs (a continuing PR appropriation under s. 20.505(2)(k) of the statutes); and (b) risk management administration (an annual PR appropriation under s. 20.505(2)(ki) of the statutes). The costs appropriation is used to pay claims for state property, liability, and worker's compensation losses. The administration appropriation is used to support program operations and is allocated base funding of 16.45 FTE positions and \$16,634,000 (\$3,964,700 for program administration and \$12,669,300 for excess insurance premiums).

2. In December, 2018, the Joint Committee on Finance approved a request from DOA to

increase expenditure authority for program administration by \$1,412,500 PR in 2018-19 to fund excess insurance premiums. However, the increase in expenditure authority was not included in the program's base budget for the 2019-21 biennium.

3. As introduced, the 2019-21 budget bill (2019 Assembly Bill 56/Senate Bill 59) would have changed the appropriation for risk management administration from an annual to a continuing appropriation. In addition, the bill would have increased the appropriation by \$1,412,500 PR annually to reflect the December, 2018, approval of funding for excess insurance premiums. In executive session, the Committee deleted the provision. As a result, 2019 Act 9 did not provide funding for increased premium costs and the appropriation remained structured as an annual sum certain appropriation.

4. In May, 2020, the Committee approved an increase in expenditure authority of \$2,269,000 PR in 2019-20 for excess insurance premiums and directed DOA to submit a request for 2020-21 funding once premium amounts were known. In February, 2021, the Department submitted a request for increased expenditure authority of \$5,637,600 PR in 2020-21 to fund excess insurance premiums and program costs. The Committee approved the request. In May, 2023, the Committee approved a one-time increase in expenditure authority of \$1,044,800 PR in 2023-23 to fund excess insurance premiums.

5. The Department indicates that excess insurance premiums have increased in recent years due to claims by the state and general market conditions. For example, several storms led to property losses throughout the state, including significant losses during the January, 2019, polar vortex. In addition, a liability claim of \$18.9 million involving the Department of Corrections was paid during 2017-18. In 2021-22, a significant fire loss occurred, which is projected to be reimbursed \$1.5 million from the insurers. According to DOA, premiums have also increased due to events affecting the domestic and international insurance markets more generally, including economic inflation, natural disasters, allegations of excessive use of force by law enforcement, incarceration liabilities, sexual misconduct claims, and athletics concussion injuries. Excess insurance premium costs from 2013-14 to 2022-23 are shown in Table 1.

**TABLE 1****Excess Insurance Premiums, 2013-14 to 2023-25**

<u>Fiscal Year</u>	<u>Property Excess Insurance Premiums</u>	<u>Liability Excess Insurance Premiums</u>	<u>Total Excess Insurance Premiums</u>	<u>Percent Change</u>
2013-14	\$4,686,900	\$682,800	\$5,369,700	
2014-15	4,728,700	682,800	5,411,500	0.8%
2015-16	5,866,200	691,200	6,557,400	21.2
2016-17	5,365,000	742,900	6,107,900	-6.9
2017-18	5,294,300	1,474,600	6,768,900	10.8
2018-19	5,899,800	2,805,200	8,705,000	28.6
2019-20	6,546,800	3,014,700	9,561,500	9.8
2020-21	7,957,500	4,566,200	12,523,700	31.0
2021-22	7,901,635	5,000,069	12,901,704	3.0
2022-23	8,450,098	5,306,709	13,756,900	6.6
2023-24*	9,295,100	5,731,400	15,026,500	9.2
2024-25*	10,224,600	6,189,900	16,414,500	9.2

\* Estimated costs for excess insurance premiums.

6. The rationale for purchasing excess insurance is to reduce the risk to the state and provide financial protection against large or catastrophic unplanned events. According to the Bureau of State Risk Management, the size of the state's property and liability risk portfolio and diverse operations inherently create a large loss exposure. Purchasing excess insurance creates a greater level of certainty and financial stability than what could be provided through a fully self-funded model. If the state did not purchase excess insurance, the full extent of large losses would be allocated directly to agencies for cost recovery.

7. Wisconsin is a member of the State Risk and Insurance Management Association, which serves as an educational and networking mechanism for state risk management professionals from 38 states. The director of DOA's Bureau of State Risk Management served on the association's executive committee for six years and as the committee president in 2016. The Department indicates that the vast majority of member states purchase excess insurance or reinsurance (the transfer of risk to another insurer to reduce the risk of large payouts for a claim) for state programs and DOA is not aware of any member states that fully self-insure liability or property risk portfolios. Further, other states have also experienced significant growth in premiums due to market conditions.

8. The Department has attempted to mitigate cost increases through coverage negotiations and program management changes. For example, in 2019-20, DOA increased the liability program's self-funded retention from \$4.0 million to \$5.0 million per occurrence. In 2020-21, in addition to maintaining the \$5 million per occurrence deductible, DOA agreed to share in 16.6% of each loss occurring in the \$6 million excess coverage. In 2022-23, the state increased its share to 33.3% for each loss. The Department has also increased the property program's self-funded aggregate retention amount (the annual aggregate amount which property losses must exceed for the use of excess

insurance), as shown in Table 2. As of 2022-23, the state pays a 10% quota share on claim amounts that either exceed the \$4 million self-funded per-occurrence deductible or the \$6.5 million annual aggregate deductible. According to DOA, such changes have helped to slow the annual growth in premiums.

**TABLE 2**

**Risk Management Property Program, Self-Funded Deductible History**

<u>Fiscal Year</u>	<u>Self-Funded Per-Occurrence Deductible</u>	<u>Self-Funded Annual Aggregate Deductible</u>
2013-14	\$3,000,000	\$5,000,000
2014-15	3,000,000	5,000,000
2015-16	3,000,000	5,000,000
2016-17	3,000,000	5,000,000
2017-18	3,000,000	5,000,000
2018-19	3,000,000	5,000,000
2019-20	4,000,000	6,000,000
2020-21	4,000,000	6,500,000
2021-22	4,000,000	6,500,000
2022-23	4,000,000	6,500,000

9. The Department indicates that the projected excess insurance premium costs for the 2023-25 biennium will be \$15,026,500 in 2023-24 and \$16,414,500 in 2024-25. Because the base budget for excess insurance premiums is \$12,669,300 annually, estimated costs would exceed base funding by \$2,357,200 in 2023-24 and \$3,745,200 in 2024-25. Under 2023 Assembly Bill 43/Senate Bill 70, \$2,357,200 PR in 2023-24 and \$3,745,200 PR in 2024-25 would be provided for the risk management administration appropriation to provide for estimated increases in the cost of excess property and liability insurance premiums.

10. Without funding sufficient to support the costs of excess insurance premiums, the Department indicates that policy cancellations would result. According to DOA, a cancellation could create a negative perception of the reliability and stability of the program. The number of carriers that provide excess insurance to public entities is limited, and the relationship with carriers is developed over the course of coverage. Therefore, a policy cancellation could reduce the number of carriers willing to provide coverage and further increase the rates charged by carriers in subsequent years.

11. Cancellation of excess insurance coverage could further expose the state to increased risk in the case of potential losses, hinder the state's ability to negotiate subsequent contracts for excess insurance coverage, and increase costs for state agencies including the University of Wisconsin System. In the event of a policy cancellation, the state would be responsible for any losses that occur, including losses above the state's self-insured retention amounts.

12. Given that premiums are required for excess insurance coverage and loss of coverage

could have an adverse financial impact on the state, the Committee could provide \$2,357,200 PR in 2023-24 and \$3,745,200 PR in 2024-25 to the risk management administration appropriation for estimated increases in the cost of excess property and liability insurance premiums. [Alternative 1]

13. If the Committee wishes to maintain the current funding level for the risk management administration appropriation, it could take no action. Expenditure authority for the risk management administration annual appropriation would continue to be \$16,634,000 PR annually including the costs of excess insurance. [Alternative 2] Under this alternative, DOA would not have funding to support the estimated increase in excess insurance premiums. The Department could, however, submit a passive review request for increased expenditure authority to the Committee under s. 16.515 of the statutes, as was done in May, 2023.

### **ALTERNATIVES**

1. Provide \$2,357,200 PR in 2023-24 and \$3,745,200 PR in 2024-25 for the annual risk management administration appropriation to provide for actual and estimated increases in the cost of excess property and liability insurance premiums.

<b>ALT 1</b>	<b>Change to Base</b>
PR	\$6,102,400

2. Take no action.

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