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

[LFB 2015-17 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.

OCI has established an LGPIF Advisory Committee to review matters related to the program, including fund finances, premiums, underwriting issues, and coverage policies. The Advisory Committee, which is composed 21 members who represent local governments that insure property through the program, meets twice each year. OCI also has an LGPIF Oversight Committee, which is composed of four OCI staff members and two members of the Advisory Committee. The Oversight Committee reviews recommendations of the Advisory Committee and, in turn, makes recommendations to the Insurance Commissioner, who has the final authority on program administrative matters.

GOVERNOR

Specify that no insurance coverage may be issued under the local government property insurance fund program on or after July 1, 2015, no existing coverage may be renewed after December 31, 2015, and no coverage may terminate later than December 31, 2016. Specify that all claims under the program must be filed by no later than July 1, 2017, and that no claim filed after that date will be paid. 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, 2015. Repeal an obsolete provisions 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 (LGPIF or "property fund" hereafter), 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. The administration indicates that at one time there were limited options to insure many local government properties, which necessitated the creation of the property fund. The administration believes that the continuation of the property fund is now unnecessary since, because Wisconsin's insurance market is highly competitive, there are sufficient commercial insurance companies to provide property insurance to local governments.

3. As of the end of calendar year 2014, the LGPIF insured property of 69 of the state's 72 counties, 128 of the 190 cities, 243 of the 407 villages, 156 of the 1,259 towns, 239 of the 447 school districts, and 134 other governmental entities (such as sewerage districts, public utilities, and library systems). In addition to providing coverage for existing buildings and contents, and automobiles, the fund offers builder's risk insurance for structures under construction. Total coverage in force was $52.3 billion as of December 31, 2014.

4. The LGPIF policy premiums are established with the intent of generating revenues sufficient to cover program administrative costs and pay claims. The LGPIF Advisory Committee's Rate Analysis Subcommittee reviews the information provided by program staff and an actuary in making recommendations on the rates. Generally, the Advisory's Committee's recommendations have been adopted by the Insurance Commissioner as the final rates.

5. Claims are paid from a SEG appropriation made from the property fund. In order to guard against losses associated with very large claims, the LGPIF program purchases a reinsurance policy (also called "excess-of-loss" insurance) from third-party insurers. Although the structure has varied over time, the current policy pays for all losses exceeding $1.8 million for any single claim and for all losses in one year that, in aggregate, exceed $22.0 million (policyholder deductibles still apply).

6. As with any insurance policy, the property fund losses may be more or less than the amounts collected in premiums in any given year. Also with other insurance, however, LGPIF premium revenue, along with investment earnings, is expected to be sufficient to cover losses and administrative expenses over the long term. The fund's surplus, accumulated in low-cost years, allows claims to be paid in high-cost years.

7. Over the course of the last five-year period, the LGPIF surplus has declined, ending fiscal year 2013-14 with a negative surplus of $1.4 million. The following table shows financial information for the LGPIF over the past 10 years. The notes following the table provide a description of each item.

Local Government Property Insurance Fund Revenues, Expenditures and Balance, Fiscal Years 2004-05 through 2013-14 ($ in Millions)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Beginning Surplus	$24.3	$34.5	$39.0	$41.0	$36.7	$41.2	$32.0	$20.1	$14.0	$14.1
Net Premiums	$21.0	$21.2	$17.6	$16.9	$17.2	$16.1	$15.5	$14.9	$16.8	$18.0
Misc. Income and Adjustments	1.1	2.1	2.9	2.3	0.8	0.4	0.3	0.3	0.0	-0.5
Dividend	0.0	0.0	0.0	0.0	0.0	-12.0	0.0	0.0	0.0	0.0
Subtotal of Income	$22.0	$23.3	$20.6	$19.2	$18.0	$4.4	$15.8	$15.2	$16.8	$17.5
Net Losses and Expenses	$11.8	$18.8	$18.6	$23.5	$13.4	$13.7	$27.6	$21.3	$16.7	$33.0
Annual Gain/Loss	$10.3	$4.5	$2.0	-$4.3	$4.5	-$9.2	-$11.9	-$6.1	$0.1	-$15.5
Ending Surplus	$34.5	$39.0	$41.0	$36.7	$41.2	$32.0	$20.1	$14.0	$14.1	-$1.4

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 (2010 only).
Net Losses and Expenses: The amount of direct claims paid, net of amount paid by excess-of-loss policy, plus administrative expenses.

8. OCI staff point to the $12 million policyholder dividend provided in 2010 as a key reason for the current negative surplus. In response to an accumulated surplus of over $40 million at the end of 2008-09, the Assembly unanimously passed a bill requiring OCI to provide a dividend, as a credit on 2010 policy renewals. Although this bill had not been taken up in the Senate, OCI announced that it would provide a dividend in December of 2009. On average, the dividend reduced 2010 premiums by 57%, and, in combination with claims paid in that year, reduced the surplus to $32.0 million.

9. Although a part of the decrease in the size of the surplus can be attributed to the 2010 dividend, most of the reduction in the surplus can be attributed to net losses in three of the past four years. In particular, sizable losses due to weather-related events and fires in 2010-11 and 2013-14 contributed significantly to the decline in the fund surplus.

10. 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. This event is the subject of a suit filed in December of 2014 by the state against the issuer of the property fund's reinsurance policy. As noted above, under the terms of the property fund's reinsurance policy the issuer is responsible for any loss in excess of $1.8 million for any single event. Although the property fund has paid $19.1 million for the courthouse damages, the insurance company has withheld most of the payment to the state because it disputes the cause of the event. If the state prevails in its case, it could recover the reinsurance payment for the property fund. In addition, if the company is required to pay this claim,

the state would also be entitled to recover payments on other claims since total damages would then exceed the aggregate deductible on the policy. OCI estimates the property fund could recover as much as $30 million in the event of a favorable ruling.

11. 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. Although the fund shows an accounting deficit, OCI indicates that there have been sufficient cash balances to pay claims to date, so no general fund transfers have been required.

12. In the event that local governments lose the option to insure property through the LGPIF, they would have to turn to commercial insurance options. The alternative coverage options could take several forms, and representatives of local government associations indicate that various options remain under discussion. Some local governments would seek coverage from a stock company offering property insurance policies. It is also possible that the existing mutual insurance companies associated with local government associations could add or expand property insurance options for their members. Currently, the mutual insurance companies established for school districts, municipalities, and counties are licensed to sell property insurance policies, but generally only offer worker's compensation and liability insurance, or, in some cases, vehicle property damage insurance.

13. Although stock or mutual insurance companies may offer a viable alternative to the property fund for many local governments, representatives of local government associations have expressed concern that their members would face higher premiums than they are currently paying for coverage through the property fund. One of the advantages of the property fund insurance program cited by local governments is its low overhead costs, which they believe allows premiums to be lower than those offered by commercial insurance companies. The property fund has just one state employee in OCI to manage contracts for the administration of claims and policy management. The program also does not pay sales commissions (there are no sales agents), and does not incur commercial advertisement costs.

14. Commercial insurance policies would not necessarily charge higher premiums than the property fund for all local governments, and may have certain advantages for some. Because commercial insurers may offer several lines of insurance (as opposed to just property insurance) and may have policyholders with greater geographic distribution (beyond the state of Wisconsin), they may have the benefit of a lower overall risk profile than the property fund. Furthermore, since commercial insurers are not required to insure all properties, they can exclude high-risk local government property, to the benefit of local governments that do not have such properties. Many local governments that are not insured through the property fund already have policies through commercial insurers, which suggests that there are policies that are competitive with the property fund coverage for those local governments.

15. In addition to concerns over the possibility of higher premiums in the commercial market, representatives of the local government associations have also expressed concern that if the coverage under the LGPIF program were not available, some properties could be uninsurable. As

an example, they note that older school or other government buildings in rural areas, because they often lack automatic sprinkler systems and are situated far from fire department stations, present a risk too great to insure on the commercial insurance market. Also, some government buildings have unique characteristics that would make them difficult to insure. The LGPIF program does not refuse to ensure properties due to these factors, and so functions as a stopgap insurance option that they fear may be lost if the property fund is eliminated.

16. OCI staff believe that if coverage through the property fund were eliminated, additional commercial insurance companies will offer policies to meet the resulting increase in demand for property insurance from local governments. That is, although some local governments could find it difficult to insure their property in the current market, they may be able to secure coverage if additional policies are offered in the future. It is also possible, however, that these policies will be more expensive than the LGPIF policies.

17. In response to recent fund losses, OCI has worked with the Advisory Committee to enact various changes to the program with respect to the method used for calculating premiums and requirements for minimum policy deductibles. Historically, premiums have been based on losses averaged across all policyholders. Beginning in 2014-15, premiums for each policyholder are based partially on the previous loss experience of the policyholder. This change has the effect of increasing the cost for policyholders with a history of high losses and decreasing the premium for those with low losses. In addition, the program now establishes certain minimum deductibles for policyholders with a history of high losses. These changes are designed to encourage local governments to adopt sound risk management policies, with the intention of limiting overall losses.

18. In addition to the changes described in the previous point, the Advisory Committee has proposed other changes, including property appraisal procedures, and rate increases to restore the fund to solvency. A set of recommendations was passed by the Committee on April 9 that would result in an average premium increase of 45%, effective July 1, 2015. The Insurance Commissioner has not yet acted on the Advisory Committee's recommendations.

19. Since the changes to premiums and deductibles have been enacted only recently or are yet to take effect, their long-term impact on the program is uncertain. It is possible that by encouraging better risk management, the condition of the fund will improve over time. It is also possible, however, that the higher premiums needed to restore a positive surplus in the fund will encourage some local governments to look for commercial insurance options, which could further destabilize the fund.

20. The Legislative Audit Bureau is required to conduct a financial audit of the LGPIF at least once every three years. LAB is currently conducting such a review, and is currently scheduled to complete its report for publication in the summer of 2015. The LAB report, when it is released, will provide additional information on the current fiscal condition of the fund. The report may also provide information that the Legislature could use to judge the sustainability of the program. Given that the LAB report will not be likely be available until after the 2015-17 budget has been enacted, the Committee could consider delaying any decision on the future of the fund. In this case, the bill could be amended to remove the Governor's provision, thereby retaining the fund as it is [Alternative #2]. Upon completion of the LAB report and the review of the report by the Joint

Legislative Audit Committee, the Legislature could decide whether the elimination of the fund is warranted.

21. In its budget request, OCI included increases to the SEG appropriation for the payment of claims in anticipation of an increase in claims activity during the 2015-17 biennium. The requested increases of $6,272,300 in 2015-16 and $9,901,500 in 2016-17 were based on estimates assuming no change in the program. The bill did not include this adjustment, on the assumption that the base level in the appropriation would be sufficient to pay claims during the biennium on the remaining policies. In the event that the Governor's provision is deleted, it is possible that actual claims would exceed the base level of funding provided for claims payment. However, it is also possible that with the proposed premium increase and other program restructuring, the base level of funding would be sufficient. If actual claims exceed the amount appropriated and there are sufficient unappropriated balances in the fund, OCI could submit a request to the Committee under s. 13.10 of the statutes for an appropriation supplement to allow for the payment of all claims.

22. Subsequent to the introduction of the bill, the Department of Administration submitted a technical erratum to the Committee regarding this item. Instead of prohibiting the renewal of coverage after December 31, 2015, the administration indicates the date should be January 1, 2016.

ALTERNATIVES

1. Adopt the Governor's recommendation, as modified in accordance with the technical erratum described in Point #22 to limit renewals and the issuance of new policies under the local government property insurance fund in order to phase out the program.

2. Delete provision.

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