

Report 19-22
October 2019

Local Government Property Insurance Fund

FY 2014-15 through FY 2018-19

Office of the Commissioner of Insurance

STATE OF WISCONSIN



Legislative Audit Bureau ■

**Local Government
Property Insurance Fund**
FY 2014-15 through FY 2018-19

Office of the Commissioner of Insurance

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From the Office of the Commissioner of Insurance



STATE OF WISCONSIN | Legislative Audit Bureau

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Joe Chrisman
State Auditor

October 31, 2019

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

As required by 2017 Wisconsin Act 355, we have completed a final audit of the Local Government Property Insurance Fund (Fund), which is administered by the Office of the Commissioner of Insurance (OCI). The Fund provided property insurance to counties, cities, towns, villages, school districts, and other units of local government. To conduct this audit, we reviewed the activity of the Fund for the period from fiscal year (FY) 2014-15 through FY 2018-19 and the financial status of the Fund as of June 30, 2019.

2017 Wisconsin Act 59, the 2017-19 Biennial Budget Act, created a timeline to cease Fund operations. We found that coverage was terminated for all policyholders by December 31, 2018, and no claims were filed after July 1, 2019, as required. As of late October 2019, one claim had yet to be fully resolved, and we recommend that OCI provide periodic updates on the status of this claim to the Joint Legislative Audit Committee.

Beginning in FY 2015-16, the Fund did not have sufficient assets to pay claims. Therefore, as permitted by statutes, the Department of Administration transferred funds from the State's General Fund to the Fund to pay claims. From FY 2015-16 through FY 2018-19, a total of \$29.9 million was transferred from the General Fund to the Fund and the Fund repaid \$15.1 million. As of June 30, 2019, approximately \$2.2 million was available in the Fund to make final claim payments and pay additional administrative costs. Therefore, it is unlikely that the Fund will acquire sufficient assets to fully repay the General Fund or to make a statutorily required distribution of remaining funds to policyholders. We recommend that OCI provide periodic updates on the amounts transferred from and repaid to the State's General Fund. We also recommend that, upon cessation of all Fund operations, OCI report the total amount transferred from but not repaid to the General Fund.

We appreciate the courtesy and cooperation extended to us by OCI staff. A response from OCI follows the report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Joe Chrisman'.

Joe Chrisman
State Auditor

JC/KE/ss

Local Government Property Insurance Fund ■

The Local Government Property Insurance Fund was created from the State Property Insurance Fund in 1979.

The Local Government Property Insurance Fund (Fund), which is administered by the Office of the Commissioner of Insurance (OCI), was established in 1979 to insure government properties not owned by the State. It was created from the former State Property Insurance Fund, which made insurance coverage available to counties, cities, towns, villages, school districts, and library boards in 1911 and 1913 when it was difficult for these units of government to obtain reasonably priced coverage from the private sector.

During its operation, the Fund made property insurance available for local government property such as municipal buildings, schools, libraries, and motor vehicles. It covered property losses except, among other things, those resulting from flood, earthquake, wear and tear, temperature extremes, mold, war, nuclear reactions, and embezzlement or theft by an employee. Examples of covered property losses included large-scale wind damage to a building and minor accidental damage to a car. The Fund did not advertise or pay sales commissions to insurance agents and did not actively solicit business.

Statutes required coverage provided by the Fund to end no later than December 31, 2018, and claims to have been filed on or before July 1, 2019.

In report 15-16, we found the number of policyholders enrolled in the Fund had declined from 1,085 as of June 30, 2012, to 983 as of June 30, 2014. 2017 Wisconsin Act 59, the 2017-19 Biennial Budget Act, created a timeline to cease Fund operations. Under s. 605.03 (1) (f), Wis. Stats., coverage provided by the Fund was required to end no later than December 31, 2018, and all claims were required to be filed with the Fund on or before July 1, 2019.

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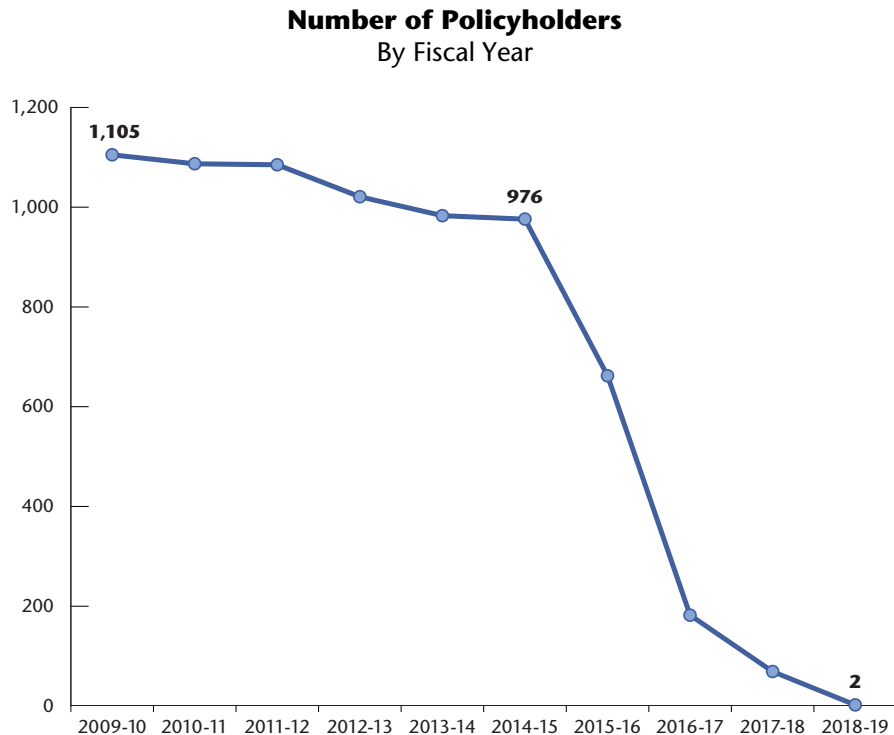
2017 Wisconsin Act 355 removed a requirement for the Legislative Audit Bureau to perform a financial audit of the Fund at least once every three years and instead required the Bureau to complete a final audit of the Fund. To conduct this final audit, we reviewed the activity of the Fund for the period from fiscal year (FY) 2014-15 through FY 2018-19 and the financial status of the Fund as of June 30, 2019. However, given the timeline to cease Fund operations, we did not specifically follow up on the internal control issues we identified or the recommendation we made in report 15-16.

Fund Participation

Beginning in FY 2015-16, participation in the Fund declined rapidly.

Participation in the Fund declined 11.7 percent over a six-year period, from 1,105 policyholders during FY 2009-10 to 976 policyholders during FY 2014-15. As shown in Figure 1, participation in the Fund declined rapidly beginning in FY 2015-16 and only two policyholders participated in the Fund during FY 2018-19.

Figure 1



The Governor’s 2015-17 biennial budget proposal included a timeline for ceasing Fund operations in the 2015-17 biennium. Although the Legislature removed these provisions during budget deliberations, the proposal may have prompted policyholders to seek other options for property insurance. The availability of other insurance options in the market and increasing Fund premiums also likely contributed to the rapid decline in Fund participation that began in FY 2015-16.

Coverage for all policyholders was terminated by December 31, 2018, as required.

As noted, 2017 Wisconsin Act 59 required coverage provided by the Fund to end no later than December 31, 2018. Although two policyholders continued to participate in the Fund during FY 2018-19, we found coverage for all policyholders was terminated by December 31, 2018, as required.

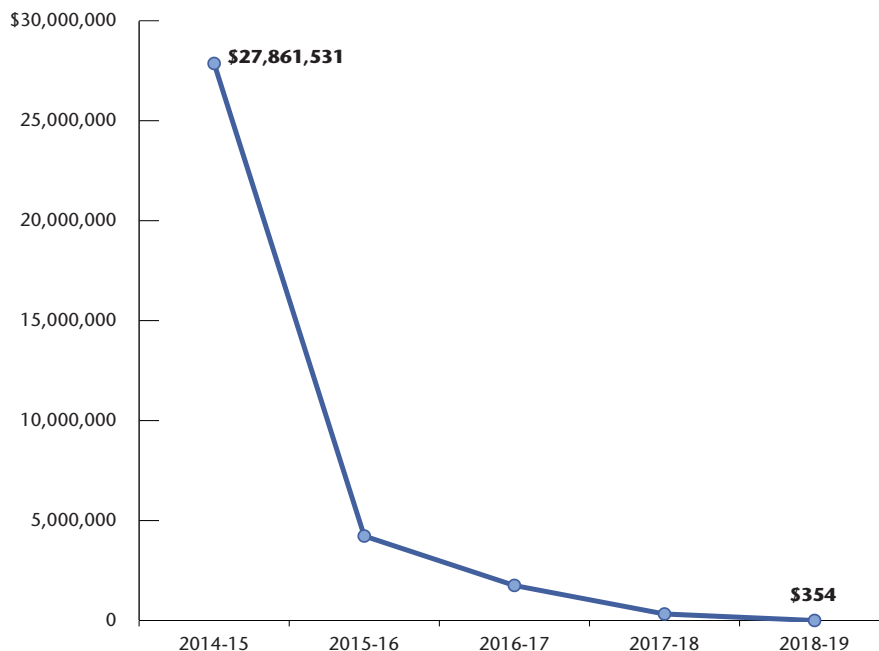
Premiums

Premium revenue decreased from \$27.9 million in FY 2014-15 to \$354 in FY 2018-19.

Policyholders enrolled in the Fund paid annual premiums based on the value of their insured property. Premiums accounted for nearly all of the revenue received by the Fund. The decline in policyholders that began in FY 2015-16 also resulted in a decline in revenue. As shown in Figure 2, premium revenue decreased from \$27.9 million in FY 2014-15 to \$354 in FY 2018-19.

Figure 2

Premium Revenue By Fiscal Year



In August 2019, OCI paid refunds totaling \$38,200 to 41 policyholders that were overcharged for premiums in FY 2014-15.

We found that OCI overcharged some policyholders for premiums in FY 2014-15. After we shared our concerns, OCI reviewed the premiums charged in that year and calculated the amounts to refund. However, we identified errors in OCI’s initial calculation of the refund amounts and OCI revised its calculation to correct the errors. In August 2019, OCI paid refunds totaling \$38,200 to 41 policyholders.

Expenditures

Fund expenditures declined from \$34.2 million in FY 2014-15 to \$2.5 million in FY 2018-19.

The Fund incurs expenditures for claim-related activity and administrative costs. Claim-related activity includes payments made by the Fund for claims and premium payments to the Fund’s excess-of-loss insurance provider. The Fund’s expenditures are offset by reimbursements received from both the excess-of-loss insurance provider and other parties determined to be at least partially at fault for the loss. As shown in Table 1, expenditures declined from \$34.2 million in FY 2014-15 to \$2.5 million in FY 2018-19.

Table 1

Fund Expenditures
(in millions)

	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18 ¹	FY 2018-19
Administrative	\$ 1.2	\$ 1.2	\$ 0.8	\$ 0.5	\$ 0.2
Claim-Related	33.0	13.1	11.5	(8.4)	2.3
Total Expenditures	\$34.2	\$14.3	\$12.3	\$(7.9)	\$2.5

¹ Claim-related expenditures of \$8.2 million were reduced by a \$16.6 million reimbursement for a claim-related expenditure from a prior year. This results in a negative claim-related expenditure amount for FY 2017-18.

Negative claim-related expenditures occurred in FY 2017-18 because the Fund received \$16.6 million in reimbursement for the claim-related expenditure from a prior year for Milwaukee County. Claim-related expenditures for FY 2017-18 were nearly \$8.2 million before considering that reimbursement.

Claim Activity

Some claims required more time to fully resolve.

Claims filed with the Fund ranged from smaller losses, such as damage to a vehicle, to more substantial losses, such as those caused by a fire or wind. The Fund also maintained excess-of-loss insurance to limit its exposure to significant losses during its operation. While some claims were fully resolved quickly, other claims required more time to fully resolve because the Fund may have needed to involve its excess-of-loss insurance provider, seek repayment from other parties determined to be at least partially at fault for the loss, or participate in litigation related to the loss. For example:

- *Milwaukee County*—In report 15-16, we reported that the Fund received \$5.0 million from its excess-of-loss insurance provider during FY 2013-14 related to an estimated \$20.0 million loss from a Milwaukee County Courthouse fire in July 2013. We also reported that the Fund was in litigation to collect further payment from the same provider. This litigation was settled in December 2017. As a result, the Fund's provider paid \$16.6 million to the Fund during FY 2017-18. In February 2019, the Fund made a final payment of \$265,000 related to this loss.
- *Wisconsin Rapids Public Schools*—During FY 2018-19, the Fund paid \$3.3 million for actual known costs and estimated remaining costs related to losses from wind and hail damage that occurred in July 2014. This amount was in addition to an initial \$500,000 that the Fund paid on this claim in FY 2014-15. The Fund typically would establish a period during which a claim was to be resolved through repair or replacement and withhold final payment until the claim was resolved. This claim was not fully resolved by the end of that period, and the Fund sought to close the claim through payment of the estimated remaining costs at the end of the claim period. Without taking such actions to resolve the claim, it is possible that the claim period would have been further extended and affected how and when operations of the Fund may cease. We note that, as a result of resolving this claim, the Fund received nearly \$611,000 from its excess-of-loss insurance provider during FY 2018-19.

- *Palmyra-Eagle Area School District*—The Fund paid almost \$1.9 million in FY 2017-18 and approximately \$63,700 in FY 2018-19 on a claim for losses related to a fire that occurred in July 2017. In November 2018, the Fund filed a case in court against potential at-fault parties associated with this claim. This case is currently scheduled for pre-trial in early 2020. The resolution of this litigation may affect how and when operations of the Fund may cease. OCI indicated that it chose to not involve the Fund’s excess-of-loss insurance provider in this litigation because OCI anticipated any potential payment it received from the provider would be small.

As of late October 2019, one claim had yet to be fully resolved.

As noted, 2017 Wisconsin Act 59 required all claims to be filed with the Fund on or before July 1, 2019. OCI indicated no claims were filed after July 1, 2019, and a Fund report indicated that all 11 claims open as of July 2, 2019, were reported prior to July 1, 2019. As of late October 2019, only the Palmyra-Eagle Area School District claim had yet to be fully resolved.

Recommendation

We recommend the Office of the Commissioner of Insurance report to the Joint Legislative Audit Committee by May 15, 2020, on the status and outcome of the claim not fully resolved as of late October 2019, including additional amounts paid or received related to this claim, and continue to report every six months to the Joint Legislative Audit Committee on the current status of the claim until it is fully resolved.

General Fund Transfers

If the Fund does not have sufficient assets to pay claims, amounts are required to be transferred from the State’s General Fund.

Under s. 605.30, Wis. Stats., if the Fund does not have sufficient assets to pay claims, the Department of Administration is required to transfer amounts from the State’s General Fund to the Fund to pay the claims. This statute also requires the Fund to repay the General Fund as soon as there are assets in the Fund.

The Fund paid approximately \$131,000 in interest to borrow funds through a private entity in FY 2014-15 rather than seek a transfer from the State’s General Fund.

As assets of the Fund have declined, sufficient resources have not consistently been available in the Fund to pay claims. We found that the Fund borrowed funds through a private entity during FY 2014-15 in order to pay claims in that year instead of seeking a transfer of the necessary funds from the State’s General Fund. As a result, the Fund paid approximately \$131,000 in interest on the borrowed funds. OCI explained that it approved borrowing through a private entity because the Fund experienced a cash flow issue due to a number of large claims for which OCI indicated payment was necessary before a transfer from the General Fund could have been fully processed. We question OCI’s decision to borrow through a private entity and incur interest charges for the Fund rather than obtaining funds from the General Fund, as permitted by statute, because documentation OCI provided to us did not indicate that funds from the General Fund could not have been transferred in a timely manner. If OCI had instead obtained the needed funds from the General Fund, an additional \$131,000 would have been available to the Fund for other purposes and reduced the amount subsequently transferred from the General Fund.

From FY 2015-16 through FY 2018-19, \$29.9 million was transferred from the State’s General Fund.

Beginning in FY 2015-16, the Fund did not have sufficient assets to pay claims and transfers were made from the State’s General Fund to the Fund to pay claims. As shown in Table 2, from FY 2015-16 through FY 2018-19, a total of \$29.9 million was transferred from the General Fund to the Fund and the Fund repaid \$15.1 million.

Table 2

Transfers between the Fund and the State’s General Fund
(in millions)

	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	Total
Transfers In ¹	\$0.0	\$10.4	\$11.1	\$ 5.2	\$3.2	\$29.9
Transfers Out ²	0.0	(2.0)	0.0	(13.1)	0.0	(15.1)
Net Transfers	\$0.0	\$8.4	\$11.1	\$(7.9)	\$3.2	\$14.8

¹ Amounts transferred into the Fund from the General Fund.

² Amounts transferred from the Fund to repay the General Fund.

For FY 2017-18, the Fund’s receipt of a \$16.6 million reimbursement of a prior year claim-related expenditure enabled the Fund to repay the State’s General Fund a portion of the amounts previously transferred to it and resulted in negative net transfers for that year.

Because the Fund did not fully resolve all claims by the end of FY 2018-19, it is possible that additional claims payments may be needed. The resources available in the Fund and amount of claims payments required will determine whether the Fund will need to obtain additional funds from the State's General Fund as well as the amount the Fund will ultimately repay to the General Fund.

Recommendation

We recommend the Office of the Commissioner of Insurance:

- *report to the Joint Legislative Audit Committee by May 15, 2020, on any additional amounts transferred from the State's General Fund to the Local Government Property Insurance Fund and repaid to the General Fund; and*
- *continue to report every six months until all operations of the Local Government Property Insurance Fund have ceased.*

Fund Financial Position

It is unlikely that the Fund will acquire sufficient assets to fully repay the State's General Fund.

As of June 30, 2019, the Fund had an available fund balance of approximately \$2.2 million to make final claim payments and pay administrative costs. According to 2017 Wisconsin Act 59, amounts remaining in the Fund upon cessation of operations are to be distributed to the units of government that were participating in the Fund on July 1, 2017. However, as noted, statutes require the Fund to repay the State's General Fund as soon as there are assets in the Fund. Based on the financial position of the Fund as of June 30, 2019, and considering that \$14.8 million had yet to be repaid to the General Fund as of June, 30, 2019, it is unlikely that the Fund will acquire sufficient assets to either fully repay the General Fund or make a distribution to policyholders. Statutes do not directly address what actions, if any, should be taken if the Fund does not have sufficient assets to fully repay the General Fund.

Recommendation

We recommend the Office of the Commissioner of Insurance report to the Joint Legislative Audit Committee the total amount obtained from but not repaid to the State's General Fund, upon cessation of all operations of the Fund.

■ ■ ■ ■

Response ■



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Injured Patients and Families Compensation Fund

Tony Evers, Governor
Mark V. Afable, Commissioner

Wisconsin.gov

October 28, 2019

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Legislative Audit Bureau
Attn: Joe Chrisman
22 E Mifflin St, Ste 500
Madison WI 53703

Re: Final Audit of the Local Government Property Insurance Fund

Dear Mr. Chrisman,

I am in receipt of the final audit report for the Local Government Property Insurance Fund FY 2014-15 through FY 2018-19. LAB has recommended that the Office of the Commissioner of Insurance report back to the Joint Legislative Audit Committee by May 15, 2020 regarding the following:

- Any additional funds transferred to/from the State General Fund; and
- The total amount obtained from, but not repaid to, the General Fund upon cessation of all operations.

Currently, the Fund holds a balance of approximately \$1.9 Million to make final claims and administrative payments. The Fund has one outstanding claim in litigation, and no significant outstanding administrative expenses. The Fund does not anticipate needing any further funds from the General Fund to conclude the outstanding claim.

OCI would like to provide some clarification regarding the interest charges incurred when the Fund utilized a private line-of-credit to fund claims activities. At the time that the Fund utilize the revolving line-of-credit there were 3 new large losses (losses larger than \$5 million) actively being adjusted at that time, along with a few older large losses that were being finalized. These active losses involved schools that had no flexibility in their deadline for re-opening. Availability of funds to accomplish the work within the deadlines was critical, and the private sector was best able to accommodate the Funds needs. The \$131,000 in interest was paid with Fund money, it was not paid for with monies subsequently borrowed from the General Fund.

OCI will report back to the Joint Legislative Audit Committee by May 15th, 2020, or sooner if the outstanding claim is resolved prior to the May 15th, 2020 deadline.

Should LAB have any additional questions or concerns, please do not hesitate to contact us.

Sincerely,

Mark V. Afable
Commissioner of Insurance
Office of the Commissioner of Insurance – State of Wisconsin

Cc: Brynn Bruijn-Hansen