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Department of Administration

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Fiscal Year 2002

Risk Management Division

Annual Report

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Mission Statement

State of Minnesota
Department of Administration
Risk Management Division

Promote . . .
proactive risk management techniques in state government;

Provide . . .
the mechanism to minimize the adverse impacts of risks and losses for state agencies;

Absorb . . .
risk while maintaining a stable financial profile; and

Ensure . . .
the long-term financial security of the State of Minnesota and its agencies.

Department of Administration

COMMISSIONER'S STATEMENT

Turning challenges into opportunities through creative and proactive problem solving is second nature for the Risk Management Division. In spite of significant challenges posed by the continuing fallout from the September 11, 2001 terrorist attacks, an over-priced reinsurance market, and two large property losses, the division proves its value daily to customers and to Minnesota.

Since its founding in 1987 as the only viable solution for automobile liability insurance for the state, the division's role as Minnesota government's internal non-profit insurance company has expanded into other fields as well. The division helps assure that Minnesota's many and varied operations and activities face the least risk at the lowest cost, that loss prevention is key in making effective decisions, and that citizens are receiving the best value for their dollar. To date, the Risk Management Division has returned $6.6 million in premium payments to customers in the form of dividends.

In the last year, the division successfully leveraged an alternative rate structure for property reinsurance, resulting in a 25 percent decrease from a fourfold hike originally proposed by carriers. This volatility in the reinsurance industry is expected to persist and will remain extremely sensitive to local, national, and world events. But, customers and citizens can be assured that they will continue to receive the best possible value because of the vigilance of the Risk Management Division.

With the total value of all state property exceeding $12 billion, protecting the citizens' investment must remain of paramount importance for the state. Through its work, and despite ongoing challenges, the division will continue to strive for the day when Minnesota achieves the goal of "zero loss" for the benefit of all Minnesotans.

David F. Fisher, Commissioner

DIRECTOR'S MESSAGE

Fiscal year 2002 proved to be as was predicted in my message last year – "a difficult world to live in." Not only did the events of September 11, 2001 have a dramatic impact on the insurance industry and financial markets, but we were also trying to adjust to difficult conditions and events here in Minnesota.

As predicted, the insurance and reinsurance industry, upon whom we rely for catastrophic coverage, quickly reacted by imposing sharp premium increases, more restrictive coverage, demanding insurance conditions, and imposing high risk retention levels through deductibles or self-insured retentions.

Events in Minnesota included two large losses at state facilities, which are detailed in this document. The following direct results to the state and the Risk Management Fund (RMF) were felt immediately and decisively:

- Reinsurance costs for property insurance were increased sharply and the RMF was obliged to retain a much greater part of the risk than in prior years.

- The need for insurance to value was dramatically clear because the values reported to the Risk Management Division (RMD) nowhere near represented the actual replacement values. The high values, together with increased rates, had a significant impact on not only this year's premiums, but will affect future years also.

- The message that the state's internal property loss conservation efforts were lacking was very clear, and this had the impact of increasing the severity of the losses. To meet this issue head on, we have introduced new property loss conservation programs that focus on loss prevention, self-inspections, and education. Recent issues of *Alert*, RMD's quarterly newsletter, have focused on specific programs.

Our hope in these difficult days is to minimize the risks, improve the loss experience, and put the state in a stronger bargaining position for future reinsurance renewals.

A very difficult decision was reached by the Risk Management Advisory Committee to withhold the payment of the dividends declared for fiscal year 2002 for two reasons: 1) adverse loss experience during the year, and 2) we were going to have to absorb significant retention increases in the next fiscal year. With a potential turn around in both our own experiences and the emergence of a more favorable reinsurance market place, we hope that we will be able to resume dividend payment in the near future.

We have long realized that, with the many lines of insurance we are providing through the RMF, the need for a new Risk Management Fund Information System (RMIS) was essential in order to continue providing our services in a cost-effective manner. In FY02, we made a major investment commitment in an information system that will provide an underwriting program and reporting warehouse to move us into the 21st century. This significant investment has resulted in higher expenses in FY02, but it is expected that it will result in lower operating costs and more timely and valuable information in the future. Renewal information, invoicing, and premium calculation will all be completed in a much more effective and efficient manner. The system will be fully operational in FY04.

The past year has been challenging and difficult, but all staff members responded to the call, resulting in the RMD and RMF emerging in a stronger position. We will continue to meet the insurance and risk management needs of state agencies and political subdivisions that have also been challenged to deal with similar demands. As we go forward, we are committed to customer service and responding to your needs in these difficult times.

Frederick R. Johnson, Jr., Director

Fiscal Year 2002 Annual Report

Fiscal year 2002 was a landmark year with significant achievements, tremendous challenges, and continued growth for the RMF. The events of September 11, 2001 greatly impacted the insurance industry, and, consequently, the RMF, as reinsurance became very expensive and, in some cases, non-obtainable. In spite of the challenges, the RMF enjoyed increases in exposures underwritten, dividend payments, and continued building financial stability and integrity for the future.

- The RMF's total assets increased by 89 percent from $15,324,085 in FY01 to $28,962,230 in FY02. Reinsurance recoverable is 62 percent of the increase and cash is 25 percent. These increases are not permanent because they are the result of large claims that generate both cash and recoverables from our reinsurers. As the reinsured claims settle, the recoverables are converted to cash and paid to the insureds.
- Policyholders' surplus (reserved retained earnings) decreased by a modest one percent to $5,670,515, compared to $5,726,279 in FY01.
- FY01 dividends, paid in FY02, were $1,169,226. Dividends paid to date total $6,637,774.
- The total insured property values increased by 8 percent from $5.4 billion in FY01 to $6 billion in FY02, an 11 percent increase.

In addition, the RMD has seen continued growth and achievements in the following noteworthy areas:

- Started a comprehensive statewide Property Loss Conservation program for our property insureds.
- Successfully assisted in creating a new statewide worker's compensation cost allocation fund that will kick off in October 2002.
- Met Council and Metropolitan Radio Board obtained coverage in the RMF as a result of Legislative authority to insure political subdivisions.
- Developed property underwriting guide to support our reinsurance renewal effort.
- On the technology front, RMD's web master moved to another agency. Due to a hiring freeze, the position was not filled and we were unable to update or upgrade the content of our web site. Staff members are now training in order to manage our site internally. Our goal is to make the site a more useful tool for our customers.
- The other primary technology initiative is development of a policy management/data warehouse system, which began mid-year. The expectation is to be fully functional at the beginning of FY04. The initial phases of development have demonstrated great potential for the enhanced system.

"Most successful men have not achieved their distinction by having some new talent or opportunity presented to them. They have developed the opportunity that was at hand."
- Bruce Marton

Property Loss Control Management

The theme for this year's annual report is *Property Loss Control Management*. Loss control can be defined as a risk management technique that seeks to eliminate or minimize loss activity with training, safety, and security measures.

In FY02, we changed property reinsurers from Swiss Re to Chubb. Chubb is a well-respected player in the insurance world and they have a reputation for financial strength and professionalism.

The new carrier introduced an active property loss control requirement to our program. During the first year, the plan was to visit insureds that have the highest values. The RMD, in its role as liaison for the new program, participated in twelve loss control visits in the first year, which included inspections at the State Capitol, Rush City Prison, MnSCU institutions, among others.

The approach was to coordinate the visits with the Chubb loss engineer who conducted the inspections, the insured, and the Marsh, Inc. (the state's broker and loss control vendor) loss engineer, who would oversee the requests and requirements that were being recommended by the Chubb engineer. This is a very amicable relationship. The cooperation of the state agencies has also been an added plus. Recommendations were made and agencies responded in a timely manner. This mission resulted in positive changes to facilities that contribute to the overall safety of the state's insured property. An example of the contribution that these inspections made was the statewide implementation of monthly churn tests for facilities that have fire pumps. These mandatory tests were not always being performed. In addition, other recommendations included housekeeping issues, sprinkler coverage to occupancy, proper storage of flammables and hazardous substances, as well as others.

Then, in January 2002, two serious property fires occurred. One of the fires started in the Faribault prison laundry. The exact cause of this fire was not determined. The claim will eventually be settled for under $4 million. The other January 2002 fire occurred at Southwest State University in Marshall, Minnesota. The cause of this fire was attributed to incorrect welding procedures. This claim, which is still being adjusted, could finalize at more than $20 million.

The Southwest State claim elicited a response from Chubb to immediately institute a statewide "Hot Work" policy or they would not continue as our reinsurer. The RMD, with the help of loss engineers at Marsh, was able to put a Hot Work policy together and introduce it statewide within a very short timeframe. This was done to the satisfaction of Chubb and the benefit to the state will be that any type of hot work, which includes welding, hot riveting, soldering, grinding, and other activities that produce sparks or use flame, must follow the state's new Hot Work policy.

The Property Loss Control effort did not stop there. It was recognized, especially by those impacted by the losses, that the State of Minnesota needed a comprehensive property loss control program. The decision was made to use the expertise that was available to us to set up a program that would lead to a material reduction in property claims by implementing policies to support what is currently considered best practices in loss control.

The objectives of the new Property Loss Control (PLC) effort are to:

- protect personnel from physical harm and loss of life,
- protect state property from physical harm, and
- reduce or eliminate property losses that disrupt state operations and impact the

state's ability to carry on the business of state government.

Seven management programs were identified that we want to introduce statewide:

1. Hot work – a policy that outlines the proper safety procedures to follow when engaged in any activity that produces a spark.
2. Impairment – a policy that outlines the actions to be taken when fire detection/ protection equipment is inoperable.
3. Inspection and testing – policy to outline proper maintenance of fire protection equipment.
4. Emergency response – policy to discuss with local fire officials the lay of the land so that they are well prepared in case there is a catastrophic event.
5. Plan review of modifications and new construction – review blueprints for sprinkler density to occupancy relations, as well as any other loss control particulars regarding the construction project.
6. Audits to confirm implementation of programs – loss control visits to check local conditions and compliance with implemented programs.
7. Loss investigation and analysis – to determine cause of loss so changes can be made statewide for weaknesses found in the system.

The plan is to systematically introduce the programs statewide. We will introduce the concept; produce the written programs and tags, if applicable; and manage the programs. The policies will again be reviewed and assistance offered for implementing the programs. When facilities are visited for loss control inspections, inquiries will be made regarding the managerial programs that have been introduced in order to follow up on compliance. Input and feedback are sought from the local managers regarding any problems they are experiencing in complying with the new policies.

In addition, blueprints for construction projects will be obtained from the building project's architects. The Chubb engineer will review and sign off on the sprinkler plans, as well as noting any other related concerns that they may have, based on the project plans.

We believe that, with this proven approach, we will be successful in introducing solid property loss control management techniques statewide, which will lead to reduction in claims and better protect the state's property and the health and welfare of its people.

"An ounce of [loss] prevention is worth a pound of cure."
- Henry de Bracton

Division Operations

In FY02, the RMD continued to provide three major areas, plus one new area, of service to state departments, boards, bureaus, commissions, and component units of the State of Minnesota, as well as political subdivisions. Those services include:

- Managing the RMF, which operates as the state's internal insurance company. The RMF provides property and casualty insurance coverages tailored to meet agencies' needs.
- Purchasing commercial insurance to meet agencies' needs when the placement of insurance coverage in the RMF may not be appropriate or cost effective.
- Providing risk and insurance management consulting and training services on a wide variety of issues.
- As outlined throughout this report, Property Loss Control or Conservation efforts have added new responsibilities to RMD's mission.

The RMD develops, for the Department of Finance, a business plan for each line of insurance underwritten by the RMF. Each line of insurance is evaluated for the development of losses, adjusting expenses, reinsurance expenses, administrative expenses, and, where appropriate, legal expenses.

An objective of the RMD is to maintain operating expenses well below the industry average for comparable insurance companies (as reported by AM Best in its annual publication *Aggregates and Averages*). The five-year performance of the RMF, compared to industry averages, as demonstrated in Exhibit 1, indicates that we have met our objective in each of the past five years.

For the last three years, the RMF has experienced a very stable expense ratio. In FY02, the expense ratio is adjusted for a one-time charge for the systems development project.

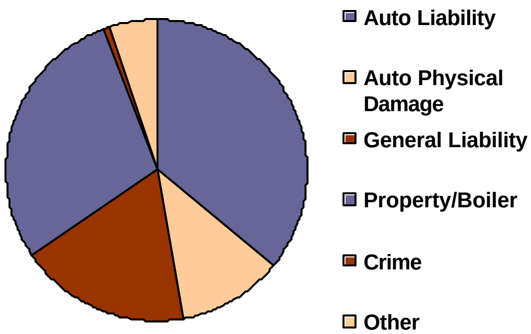
Exhibit 1

	FY98	FY99	FY00	FY01	FY02
Net Premium Written	$4,788,323	$4,590,939	$4,658,498	$5,419,278	$5,585,401
Industry average operation expense ratio	29.95%	30.5%	30.6%	28.6%	27.8%
Projected industry average operation expense based on RMD's actual premium	$1,434,103	$1,400,196	$1,425,500	$1,549,914	$1,552,742
Actual RMD operating expenses	$ 498,560	$ 583,454	$ 780,405	$ 910,691	$ 950,542
RMD operating expense ratio	10.4%	12.7%	16.8%	16.8%	17.0%

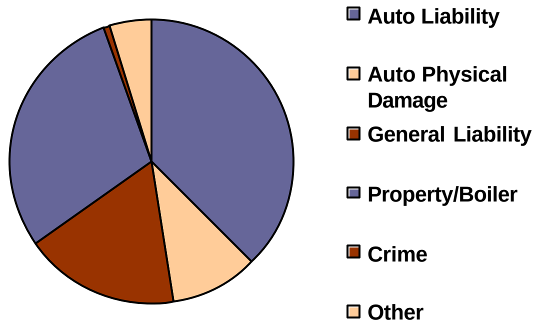
Exhibit 2

Gross Comparative Earned Premium by Line of Business

FY02



FY01



Line of Insurance	Premium
Auto Liability	$2,473,245
Auto Physical Damage	789,014
General Liability	1,259,829
Property/Boiler	1,969,545
Crime	57,393
Other	349,677
Total	$6,898,703

Line of Insurance	Premium
Auto Liability	$2,303,193
Auto Physical Damage	599,021
General Liability	1,096,637
Property/Boiler	1,767,211
Crime	52,352
Other	290,820
Total	$6,109,234

On July 1, 1995, the RMF changed from a primarily mono-line automobile liability insurance fund to a full-line property and casualty insurance fund offering a wide variety of insurance coverages tailored to meet the clients' needs.

Exhibit 2 reflects the change from FY01, and demonstrates stabilization and consistency among the various lines of coverage. The RMF continues to grow as additional customers seek coverage. With the difficult insurance market, including much higher prices and reduced amounts of coverage, the RMD's goal is to continue to provide affordable coverage.

Our clients now include political entities that are not state agencies. A larger client base allows the RMF greater flexibility to assist all our customers.

Dividends

In FY02, the RMF calculated, but retained, dividends totaling $1,508,730. This brings the total of dividends since inception to $8,146,504. FY02 dividends, by line of insurance and total dividends paid from the inception of the program, are as follows:

	FY02	Total Dividends Paid-to-Date
Auto Liability	$ 700,195	$4,097,470
General Liability	570,693	1,194,373
Property Insurance	237,842	1,345,931
	$1,508,730	**$6,637,774**

The RMD made the recommendation to postpone the payment of the FY02 declared dividends. The Risk Management Advisory Committee approved this action based on the following logic: *The decision to postpone FY02 dividend payments was based on the FY03 increase in property retention from $500,000 to $2.5 million, the increase in aggregate loss coverage from $2.5 million to $7.5 million, and the increase in property reinsurance cost of almost $2 million. These three major cost increases, coupled with a surplus of $5.6 million, prompted the decision to postpone the $1.5 million dividend payment for FY03.*

The following outlines the dividend strategy exercised by the RMF.

Dividend declarations vary by the line of insurance and the maturity or conclusion of claims. Property losses have the shortest maturity and payment pay out, so dividends are generated more quickly with a 25 percent dividend declaration 24 months after the close of the policy year, and the remaining amount paid 36 months after the close of the policy year.

Automobile liability losses take longer than property losses to mature and be paid. Dividends are declared 36 months after the close of the policy year, based on the experience of that year, and are paid out over a four-year time period (35 percent, 25 percent, 25 percent, and 15 percent respectively). General liability takes the longest time to mature, resulting in a 48-month period before the first dividend declaration. However, the pay out pattern is the same as automobile liability (35 percent, 25 percent, 25 percent, and 15 percent respectively). See Exhibit 3 for a matrix of dividend pay out percents by line of business.

Dividends represent the return of premium for superior loss and expense experience. From premiums collected, excess funds are invested by the state's Board of Investment. The difference between premium and investment income, less deductions for losses paid, administrative expenses, loss adjustment expenses, reinsurance costs, and legal fees paid to defend claims, equals the amount of funds that are eligible for dividend declaration. This is done as part of the annual business plan. The evaluation process to determine how much, if any, dividends will be paid involves the analysis of each line of insurance. This analysis takes into account the RMF's performance for each line of business for each policy year. If there is a positive balance and sufficient development time has elapsed, a dividend is determined for that year and line of business.

In the event of unsatisfactory experience, it is possible that no dividend will be declared or a favorable year's dividend will be used to offset the poor experience. This approach creates a more level dividend over time, and also minimizes the possibility of dividend recapture, which can be very disruptive to an agency's budget planning. Due to the huge price increases in the reinsurance markets, the RMD obtained approval from the Risk Management Advisory Committee to use dividend proceeds to help finance the reinsurance premium increase, thereby minimizing the premium increase to our customers.

Exhibit 3

Risk Management Division
Dividend Criteria

		Dividend Pay Out Pattern in Years after Policy Year is Closed								
Lines of Business	**Dividends Start Date**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Total**
Property	24 mos. after fiscal year closes	0%	0%	25%	75%	0%	0%	0%	0%	100%
Auto Liability	36 mos. after fiscal year closes	0%	0%	0%	35%	25%	25%	15%	0%	100%
General Liability	48 mos. after fiscal year closes	0%	0%	0%	0%	35%	25%	25%	15%	100%

Exhibit 4

Self-Insurance Property and Casualty Underwriting Results

Premiums Earned by Line

	FY99	FY00	FY01	FY02
Auto Insurance				
Auto Liability	$2,215,176	$1,993,664	$2,303,193	$2,473,245
Auto Physical Damage	473,530	467,228	599,021	789,014
Garagekeeper's Legal Liability	24,320	31,220	33,611	35,147
Standard Commercial Insurance				
Property	$1,403,707	$1,448,908	$1,592,633	$1,753,658
General Liability	890,195	998,853	1,096,637	1,259,829
Boiler & Machinery	134,776	146,691	174,578	215,887
Crime	42,621	42,330	52,352	57,393
Other	145,113	182,339	257,209	314,530
Total Premiums Earned	$5,329,438	$5,311,233	$6,109,234	$6,898,703
Less Reinsurance Ceded	$ 757,816	$ 677,145	$ 714,372	$1,336,742
Total Net Premiums Earned	4,571,622	4,634,088	5,394,862	5,561,961
Plus Unearned Premium	19,317	24,410	24,416	23,440
Total Net Premiums Written	$4,590,939	$4,658,498	$5,419,278	$5,585,401

Combined Loss and Expense Ratio

	FY99	FY00	FY01	FY02
Auto Insurance				
Auto Liability	57%	83%	74%`	65%
Auto Physical Damage	91%	100%	90%	79%
Garagekeeper's Legal Liability	38%	14%	14%	16%
Standard Commercial Insurance				
Property	91%	64%	118%	1298%
General Liability	31%	47%	40%	31%
Boiler & Machinery	79%	37%	32%	36%
Crime	37%	14%	14%	16%
Other	38%	109%	101%	47%
Combined Loss Ratio **Before** Reinsurance	55%	63%	76%	369%
Combined Loss Ratio **After** Reinsurance	64%	73%	78%	82%

Financial Position Discussion

Exhibit 4 illustrates a four-year comparison of the RMF's underwriting results, showing net premiums earned and the combined loss and expense ratios by line of insurance.

- In FY02, the RMF experienced total net premiums earned of $6,898,703. This was an increase of 13 percent over FY01 and represents two consecutive years of increased earned premium volume. The increase was primarily due to growth in the auto liability, auto physical damage, property, and general liability lines. It was not offset by decreases in any line of business underwritten by the RMD.
- The total increase in net premiums written was a minor 3 percent, or $166,123, over last year due to the impact of a substantive increase in the amount of reinsurance ceded.
- Reinsurance ceded increased by 87 percent, or $622,370, from FY01.

In FY01's Financial Position Discussion, reference was made to the fact that the reinsurance costs were at bargain rates. Prior to September 11, 2001, the entire insurance industry was under reserved and had a negative cash flow. Poor yields on investment income and a major decline in the stock market put an end to high investment income. Also, September 11th put an end to inexpensive reinsurance. The RMF, through sound fiscal management, has absorbed these additional expenditures without passing it on to our policyholders. The impact of increased reinsurance expenses has not been reflected by an increase in the premium charged to the policyholder for property coverage.

Higher premium rates and improved loss experience typically would be the factors that enable most insurers to earn an underwriting profit. However, in FY02, absorption of additional reinsurance costs by the RMF in the form of an increase in the reinsurance ceded, i.e. $622,370, has impacted underwriting results and lessened underwriting profit. Additionally, it is the expectation of the RMD that significant losses within the property line will continue to be a cost factor affecting underwriting results in FY03. Two major property claims contributed to a combined loss ratio before reinsurance of 1,298 percent within the property line. The total combined loss ratio before reinsurance was 369 percent, for an underwriting loss of $2.69 per premium dollar. The combined loss ratio after reinsurance was 82 percent, or an underwriting profit of 18 cents for each premium dollar. It is important to note that the RMF utilized reinsurance to manage the impact of the two major property losses and to assure an underwriting profit.

The RMD will continue to closely monitor the increase in reinsurance costs and it will take measures to lessen the impact to policyholders, while continuing to responsibly manage risk.

From FY01 to FY02, the policyholder surplus (total net assets) decreased by only 1 percent, or $55,174. This fiscal performance achieved the desired effect of minimizing the impact of less positive underwriting results and the decrease in investment returns. Investment earnings declined by $233,172, or 34 percent, from FY01 to FY02 as a result of the declining stock market.

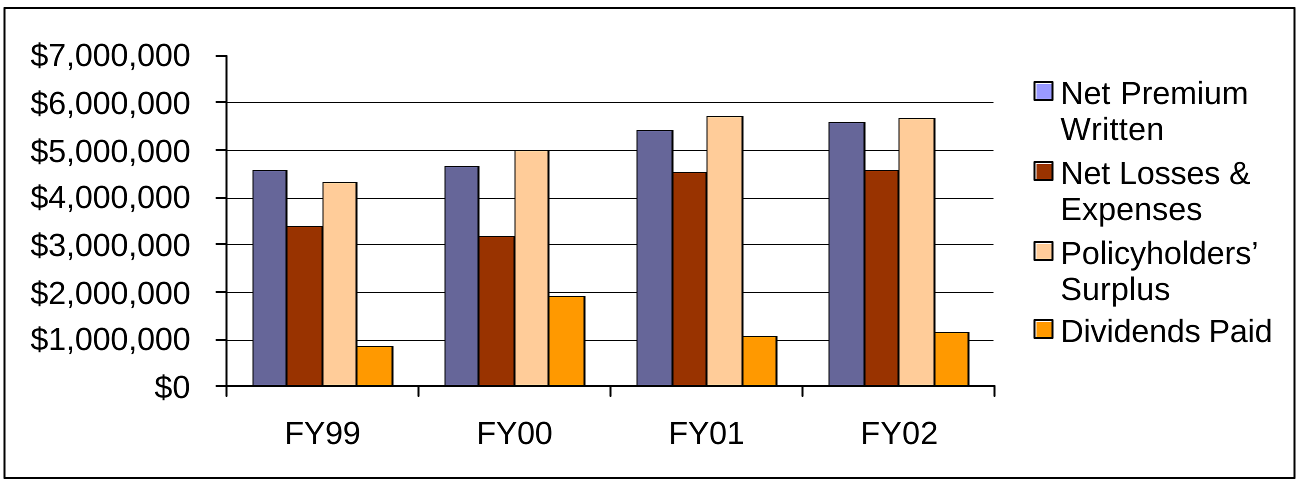
The dividend policy of the RMF is to return all underwriting profit and investment income to its policyholders whenever economically feasible so the results inure to the benefit of the state agencies the RMF insures. The ultimate costs to the state are losses, administrative expenses, adjusting expenses, and reinsurance costs, less investment income. To guarantee a sound fund, a healthy policyholder's surplus, and continuing to manage the increasing costs associated with reinsurance, the Risk Management Advisory Committee determined not to issue a dividend for FY02, payable in FY03.

It is important to maintain a favorable financial position for the following reasons: (1) access to quality reinsurance, (2) adequate funding to assure liquidity in the event of unexpected adverse loss experience, and (3) a reasonable premium written to policyholders' surplus ratio. The current industry average of premium written to policyholders' surplus is 1.12 to 1. The RMF's ratio is .98 to 1. A ratio of 1 to 1 or better would provide the greatest financial security. For example, a ratio in excess of 3 to 1 is considered a high premium to surplus ratio. The RMF's ratio is better than that of the industry. This is a positive development that contributes to a stronger fund. In addition to the RMF's strong net premium to surplus ratio, the RMF utilizes reinsurance to guard against catastrophic losses, as well as the aggregation of losses.

Exhibit 5 identifies the past four years' performance of the RMF, detailed for those four major items representing the financial integrity of the RMF – net premium written, combined losses and expenses, policyholders' surplus, and dividends.

Exhibit 5

RMF Performance by Fiscal Year



	FY99	FY00	FY01	FY02
Net Premium Written	$4,590,939	$4,658,498	$5,419,278	$5,585,401
Net Losses & Expenses	3,399,790	3,179,702	4,514,794	4,566,634
Policyholders' Surplus	4,303,530	5,002,628	5,726,279	5,670,515
Dividends Paid	841,060	1,899,812	1,068,999	1,169,226

Lines of Insurance Discussion

Automobile Liability

Automobile liability insurance continues to be the largest single line of insurance, representing 36 percent of the RMF's premium. The six-year auto liability experience is shown in Exhibit 6 (losses are valued at the end of 12 months for each of the years identified). Exhibit 6 also reflects the cumulative loss and expense ratio at June 30, 2002, for the last six years, before dividends and interest income are calculated.

Exhibit 6

Automobile Liability Exhibit

Year	Number of Accidents	Number of Vehicles	Frequency per 100 Vehicles	Average Cost per Vehicle Accident	Combined Loss & Expense Ratio after One Year	Cumulative Loss & Expense Ratio
2002	777	13,860	5.6%	$2,102	65%	65%
2001	640	12,828	5.0%	$2,138	59%	69%
2000	507	11,263	4.5%	$2,804	68%	73%
1999	695	11,232	6.2%	$2,251	75%	68%
1998	680	10,738	6.3%	$3,068	84%	93%
1997	870	10,686	8.1%	$2,796	91%	98%

The combined loss and expense ratio after one year increased by 6 percent, from 59 percent in FY01 to 65 percent in FY02. Until 2002, first-year results showed an improvement in the loss ratio for five consecutive years. It is noteworthy to emphasize that, as claims mature in any given year, an increase in the loss ratio is always likely.

The number of vehicles increased by 8 percent since FY01. Although there was a modest elevation in the frequency of accidents, the cost per accident decreased slightly, indicating a larger number of minor accidents.

As a cautionary note, the overall combined loss and expense ratio can vary significantly from one year to the next since one or two serious accidents can have a tremendous impact on loss experience. This variance can be expected to widen as changes in the tort cap begin to intensify loss severity. The tort cap increased from $200,000 per person and $600,000 per occurrence to $300,000 per person and $750,000 per occurrence on January 1, 1998. On January 1, 2000, the occurrence tort cap increased from $750,000 to $1 million. Fortunately, there have been no reported accidents of this magnitude in FY02.

Automobile Physical Damage

Auto physical damage represents only 11 percent of the RMF's premium.

FY02 is the fifth consecutive year that the 12 months combined loss ratio has improved. Additional rate increases have contributed to the improvement in the loss ratio, which decreased from 81 percent in FY01 to 78 percent in FY02. Subrogation recoveries are another contributor – 25 percent of claims dollars are recovered through RMF's subrogation efforts.

The average cost per claim increased by 15 percent, from $1,185 in FY01 to $1,361 in FY02. This claim cost increase is a reflection of the rising costs of repairs in the automotive industry.

The 1999 Risk Management Division Annual Report stated, "The experience on this line of business has been disappointing." The RMD is pleased to report in 2002 that a favorable trend has since developed for this line of insurance and it is now performing acceptably.

The five-year auto physical damage experience is shown in Exhibit 7 (losses are valued at the end of 12 months for each of the years identified).

Exhibit 7

Automobile Physical Damage Exhibit

Year	Number of Accidents	Number of Vehicles	Frequency per 100 Vehicles	Average Cost per Claim	Combined Loss and Expense Ratio at 12 months	Subrogation Recovery
2002	457	6857	6.7%	$1,361	78%	$114,923
2001	410	6,244	6.6%	$1,185	81%	$162,973
2000	361	5,472	6.6%	$1,230	115%	$174,658
1999	287	5,478	5.2%	$1,996	121%	$111,075
1998	327	5,320	6.1%	$1,519	168%	$141,352

Property/Boiler & Machinery/Crime

The property lines continue to remain the second largest category of insurance, representing 35 percent of the RMF's written premium.

The 12-month combined loss and expense ratios have risen in recent years – 74 percent in FY00, 112 percent in FY01, and 129 percent in FY02. Upon maturity, loss ratios initially below 100 percent will climb to 100 percent since any unallocated premiums – those not earmarked for loss payments and expenses – are returned to insured state agencies in the form of a dividend, resulting in a combined loss and expense ratio of 100 percent. Conversely, loss ratios exceeding 100 percent indicate a declining trend and an inadequate premium base.

The claims frequency in the property line has decreased significantly, from 161 claims in FY01 to 114 claims in FY02. The dramatic increase in the FY02 loss ratio is attributable to several large property losses.

The five-year property experience is shown in Exhibit 8 (losses are valued at the end of 12 months for each of the years identified).

FY96 was the first year of the expanded property insurance program, which included the Minnesota State Colleges and Universities (MnSCU), the State Fair, the Veterans Homes Board, and those agencies previously covered through commercial insurance programs. During FY96 and FY97, the RMD's program had been a combination of funded self-insurance and excess property coverage with the St. Paul Companies. Under this program, the RMF insured losses below $100,000. Losses that exceeded the $100,000 limit were insured by excess coverage. In addition, had the aggregate losses in the RMF reached $1 million, all subsequent losses would have been insured by excess coverage, subject to a $10,000 deductible.

Exhibit 8

Property/Boiler & Machinery/Crime

Year	Number of Claims	Insurable Values	Frequency per $1 Million of Insurable Values	Average Cost per Claim	Combined Loss & Expense Ratio at 12 Months
2002	114	$6,225,662,878	1.9%	$27,330	129%
2001	161	$5,397,569,866	3.0%	$14,863	112%
2000	158	$5,009,281,119	3.2%	$ 8,878	74%
1999	63	$4,648,483,354	1.4%	$19,031	68%
1998	39	$3,855,913,116	1.0%	$27,341	109%
1997	26	$3,736,138,327	0.7%	$31,703	100%

In FY98, the RMD reorganized the property program, modifying it from a self-insurance/excess program to a self-insurance/reinsurance agreement. The property insurance limits were increased from $300 million to $400 million to reflect the concentration of values in the capitol complex, which the RMF began insuring the prior year. In addition, the retention level within the RMF was increased from $100,000 to $500,000. The aggregate stop loss remained at $1 million, the boiler and machinery insurance deductible continued at $25,000, and the crime cover remained at a $25,000 limit with a $1,000 deductible.

In FY99, the RMF leveraged a combined property and casualty aggregate stop loss limit of $3.5 million.

In FY01, the property limits were increased from $400 million to $500 million to allow for inflationary increases in insurable values, and to prepare for acceptance of political subdivisions as clients. (The RMD received approval to insure political subdivisions from the 2001 legislature.) All other aspects of the property program remained the same.

In FY02, the business income and extra expense sublimit was reduced from $100 million (blanket) to $2.5 million (per location). The aggregate stop loss increased from $1 million to $2.5 million.

Property lines of insurance represented 23 percent of premiums in FY96 and grew to 35 percent in FY02. Insured property values increased by 94 percent, or $3.0 billion, from FY96 to FY02.

General Liability

Approximately 18 percent of the total premium for FY02 was generated from the general liability line.

The combined loss ratio for FY02 was 40 percent, compared to 33 percent for FY01. The five-year general liability experience is shown in Exhibit 9 (losses are valued at the end of 12 months for each of the years identified). Due to the use of multiple general liability rating bases, claim frequency data would not be germane.

EXHIBIT 9

General Liability Exhibit

Year	Number of Claims	Average Cost per Claim	Combined Loss & Expense Ratio at 12 Months
2002	141	$3,615	40%
2001	170	$2,134	33%
2000	124	$3,781	45%
1999	116	$3,333	40%
1998	109	$4,307	41%

General liability covers tort claims arising from premises and operations. Like automobile liability, effective January 1, 1998, the tort cap increased from $200,000 per person and $600,000 per occurrence for bodily injury and property damage, to $300,000 and $750,000 respectively. The final step in the progression of the tort cap took place January 1, 2000, when legislative mandate further increased the occurrence tort cap from $750,000 to $1 million. This increase, so far, has had no impact on the FY02 policy term since there were no catastrophic claims reported during this period. Although proactive early claim investigations have favorably influenced the average cost per claim for this line, rising medical costs are having a greater impact, causing an upward trend in the average cost per claim.

Although the loss ratio climbed upward in FY02, the general liability experience over the past five years has been favorable. It is important to note, however, that this line of insurance is subject to the six-year statute of limitations that allows for further development in the loss experience over an extended period of time. Historical evidence supports the fact that general liability claims develop more slowly than automobile liability, automobile physical damage, and property insurance claims.

Optional general liability coverages include public officials' liability, broadcasters' liability, and police officers' professional liability.

Other Lines

Other lines of commercial insurance offered by the RMD include inland marine, garagekeepers' legal liability, and homeowners' warranty. Inland marine policies are designed to provide specialized coverage, or lower deductible options, on computers, fine arts, musical instruments, signs, TV and radio towers, as well as many other items. Garagekeepers' legal liability provides coverage for an agency that has automobiles in their "care, custody, or control." Examples include valet parking and garage operations. Homeowners' warranty coverage is designed to provide coverage for defects caused by faulty workmanship or defective materials. MnSCU institutions offering construction career programs have an interest in homeowners' warranty coverage.

Inland marine, garagekeepers' legal liability, and homeowners' warranty are included in the property line for premium and loss reporting purposes.

Reinsurance

Definition of *Reinsurance*: A reinsurer indemnifies another insurance company against all or part of a loss that the latter may sustain under policies it has issued. By reinsuring its policies, an insurance company is able to reduce its risk from loss, while meeting clients' demands for coverages and limits of liability.

Reinsurance has been obtained to protect the RMF from catastrophic events and aggregation of losses in any given year.

Due to the RMF's growing financial strength and favorable loss experience, as well as increased risk retention, reinsurance premiums decreased by 37 percent, or $414,296, from FY96 to FY01. In addition to reduced reinsurance costs, added value was derived from coverage enhancements.

Reinsurance costs have since escalated, despite favorable RMF loss experience, due to adverse changes in the reinsurance marketplace. We experienced an 87 percent increase in reinsurance costs in FY02 and a three-fold increase is slated for FY03.

Reinsurance costs will continue to be a major concern for the RMF going forward, particularly in light of the impending crisis in the commercial property/casualty reinsurance market as a result of the events of September 11, 2001.

Managing future reinsurance costs, while at the same time maintaining the appropriate coverages and limits of liability, will continue to be very challenging tasks.

"Early and provident fear is the mother of safety."
- Edmund Burke (1729 – 1797)
Speech on the Petition of the Unitarians. Vol. VII, P. 50

"Everything is sweetened by risk."
- Alexander Smith (1830 – 1867)
City Poem: The Fear of Dying

Risk Management Fund Advisory Committee

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Fiscal & Administrative Services

Sieglinde Bier
MnSCU

Kirsten Cecil, Asst Commissioner
Department of Administration

Mary Lou Houde
Department of Commerce
Registration & Insurance

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3M Insurance Department (Retired)

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Risk Management Division

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Department of Corrections

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Terry Lahti
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Department of Administration
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State Agricultural Society (State Fair)

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Client Agencies

Administrative Hearings, Office of
Agriculture, Department of
Amateur Sports Commission
Attorney General
Building Codes & Standards
Building Construction
Center for Criminal Justice & Law
  Enforcement
Central Stores
Chicano Latino Affairs Council
Children, Families & Learning
Chiropractic Examiners Board
Communications Media
  CashComm
  DocuComm
  MailComm
  PrintComm
  ReComm
Corrections, Department of
Deaf/Blind Learning Academies
Dentistry Board
Developmental Disabilities Council
Economic Security, Department of
Electricity Board
Emergency Medical Services Regulatory Board
Environmental Assistance, Office of
Financial Management & Reporting
Gambling Control Board
Governor's Office
Governor's Residence
Health, Department of
Higher Education Facilities Authority
Higher Education Services Office
Housing Finance Agency
Human Rights, Department of
Human Services, Department of
Indian Affairs Council
InterTechnologies Group
Investment Board
IRRRB
Judicial Standards Board
Labor & Industry, Department of
Lawyers Professional Responsibility Board
Management Analysis
Medical Practice, State Board of
Metropolitan Airports Commission
Metropolitan Council
Metropolitan Radio Board
Military Affairs, Department of
MN State Lottery
MN Technology
MnSCU – all facilities
MOCVS (MN Office of Citizenship &
  Volunteer Services)
Municipal Board
Natural Resources, Department of
Nursing, Board of
Nursing Home Examiners BENHA, Board of
Nursing Home Examiners HPSP, Board of
Ombudsman for Corrections
Ombudsman for Mental Health & Mental Retardation
Perpich Center for Arts Education
Pharmacy (ASU), Board of
Plant Management
Podiatric Medicine, Board of
Pollution Control Agency
Public Defense Board
Public Employees Retirement Association
Public Safety, Department of
Public Service, Weights & Measures
Revenue, Department of
Risk Management
Secretary of State
STAR Program
State Agricultural Society (State Fair)
State Armory Building Commission
State Arts Board
State Auditor
State Treasurer, Office of
Supreme Court – Board of Law Examiners
Surplus Services
Teachers Retirement Association
Technology, Office of
Trade & Economic Development, Department of
Transportation, Department of
Travel Management
Veterans Affairs
Veterans Homes Board – all locations
Veterinary Medicine, Board of
World Trade Conference Center
Zoological Board

Policies Offered by the Risk Management Fund

➢ **Auto Liability**
Provides liability coverage for injuries to others and/or damage to their property ("bodily injury and property damage liability") arising out of an agency's ownership or use of motor vehicles, as specified in Minnesota Statute § 65B.

➢ **Auto Physical Damage**
Provides coverage for damage to owned vehicles. Two basic types of physical damage coverage are generally provided for owned vehicles: collision and comprehensive. Collision coverage insures against damage from collision with another vehicle or object, as well as from overturning. Comprehensive coverage provides protection against damage from other perils such as hail, fire, vandalism, and flood.

➢ **Garagekeeper's Legal Liability**
Automobile dealers and garage operators can be held legally liable for loss or damage to customers' vehicles should they fail to exercise the degree of care required of them. The care, custody, and control exclusion in the general liability policy creates the need for garagekeeper's insurance.

➢ **Property**
Property insurance is first-party coverage, as opposed to liability insurance, which is described as third-party coverage. The RMF provides coverage for damage to the insured's (first-party) property caused by an insured peril. The RMF provides coverage for "all risk" of direct physical loss – coverage for all perils not specifically excluded by the policy. Examples of covered perils include, but are not limited to, damage caused by fire, windstorm, hail, collapse, theft, vandalism, flood, earthquake, business interruption, and other unforeseen causes of loss. The RMF property program also provides builders' risk coverage.

➢ **Boiler and Machinery**
Provides coverage against loss arising from the operation of boilers and machinery. Coverage includes loss sustained by the boilers or the machinery itself, damage to other property, and business interruption (use and occupancy) losses.

➢ **General Liability**
General liability protects the insured against a claim alleging bodily injury or property damage, as specified in Minnesota Statutes §§ 3.732 and 3.736. The coverage includes defense costs, awards, or settlements associated with lawsuits brought by third parties who are injured by the insured's operations or while on the insured's premises.

➢ **Inland Marine**
Provides coverage for any goods in transit, except trans-ocean, as well as insurance for certain types of personal property that are transportable. For example, floater policies covering equipment, laptop computers, tools, musical instruments, cameras, etc., are considered inland marine policies.

➢ **Crime**
Governmental entities face substantial crime exposures, particularly with respect to employee dishonesty. The RMF provides coverage for both employee dishonesty and money and securities. Employee dishonesty coverage insures against loss to the agency as a result of employee dishonesty or fraud. Money and securities coverage provides protection for losses occurring inside the insured's premises, or while outside the insured's premises, if the money and securities are in the care and custody of an employee or partner. In addition, coverage applies over and above the limits purchased by an armored car service for loss in transporting the insured's money or securities. Coverage does not extend to any property other than money and securities.

➢ **Others**
In addition to the policies mentioned above, the RMF offers other coverages such as public officials' errors and omissions, police officers' professional liability, broadcasters' liability, and homeowners' warranty.

Also, the RMF offers specialized insurance programs with unique coverages that are designed to meet the diverse needs of its customers.

➢ **Purchased Insurance**
In some instances, it is more expedient to utilize the conventional insurance market, rather than the RMF. In such cases, the RMD works with agencies to determine the appropriate insurance coverages and to obtain the necessary policies.

Frequently Asked Questions

When did the Risk Management Fund (RMF) begin, and why was it formed?

The RMF was formed in 1986 for the purpose of writing automobile liability coverage. Prior to this time, automobile liability coverage was obtained through the conventional insurance market. The state made the decision to self-insure its fleet of approximately 8,000 vehicles in the mid-1980s when conventional insurance market rates escalated. The state's fleet has grown to nearly 14,000 vehicles since 1986, and is still insured through the RMF.

Since its inception, the RMF has offered many additional property and casualty lines of insurance, including automobile physical damage.

Why are some agencies insured through the RMF and others are not?

Actually, all agencies are insured through the RMF for automobile liability. All other lines of insurance are obtained on a voluntary basis. There are several reasons why some agencies have not purchased the voluntary insurance coverages, and we will focus on the most common reasons.

- Some agencies are not aware that insurance coverage is available. As staff changes occur, and information fails to get disseminated to new associates, awareness is impacted. We attempt to overcome this obstacle through marketing efforts.
- Many agencies have the false assumption that they are self-insured through the state, when, in reality, they are uninsured for all lines except automobile liability. Self-insurance requires that there be a funding mechanism in place for loss settlements. Since agencies do not project future losses using generally accepted insurance principles and earmark funds for those losses, they are not self-insured. To the contrary, they are uninsured. The state's only insurance funding mechanism is through the RMD.
- Budgetary issues are a factor. Agencies report that they have no surplus funds for insurance. What is frequently overlooked is the fact that a known insurance premium is much easier to fund than a future loss of unknown magnitude.

How is the RMF impacted by events in the conventional insurance market?

The RMF is heavily impacted by conventional insurance market events since it depends upon the reinsurance market to operate effectively. Although the RMF is fiscally sound, it does not have unlimited capital in the event of catastrophic losses. Thus, reinsurance is the backbone of our insurance operation, protecting the RMF from catastrophic events and aggregation of losses in any given year.

As our reinsurers are affected by catastrophic loss events (i.e., hurricanes, floods, terrorism) in the United States and abroad, the impact trickles down to the RMF in the form of reduced limits and coverages and higher premiums. Additional reinsurance costs must be factored into the premiums that we charge our clients.

What prompted your clients to obtain voluntary insurance coverages from the RMF?

Since it is human nature to realize the value of insurance *after* a loss, it is not surprising that many clients have come to us after they incurred loss or damage to their property, or when a third party sustained an injury on their premises.

The state's Business Continuation Management unit has also boosted state agencies' awareness of the RMF. Those responsible for this initiative realize that insurance is a necessary part of disaster preparedness in minimizing their exposure to financial loss, and in providing the most economical funding alternatives.

What does the RMF do with any surplus funds, and how does it handle unsatisfactory loss experience?

The RMF returns surplus funds to its clients in the form of dividends. Dividends have been declared annually for five consecutive years, from 1996 - 2001. The dividend declared in 2002, payable in FY03, was retained due to escalating expenses driven by changes in the RMF's reinsurance program. Dividend declarations vary by the line of insurance and the maturity or conclusion of claims. In the event of unsatisfactory experience, it is possible that no dividend will be declared, or a favorable year's dividend will be used to offset the poor experience.

Each year, the RMF promulgates rates that are based, in part, on the loss experience of prior years. Unfavorable loss experience can result in increased rates in those instances where the loss experience indicates a declining trend and an inadequate premium base.

"I am only one; but still I am one. I cannot do everything, but still I can do something; I will not refuse to do something I can do."
- Helen Keller

State of Minnesota
Risk Management Fund
Final Statement of Financial Position
June 30, 2002

ASSETS	FY02	FY01
CURRENT ASSETS		
Cash	$16,105,384	$12,330,075
Accounts Receivable	73,949	92,357
Prepaid Expenses	0	0
Prepaid Reinsurance	0	0
Prepaid Billback Insurance	289,618	170,856
Reinsurance Recoverable	9,558,803	0
Securities Lending Collateral (Note 5)	2,934,476	2,730,797
Total Current Assets	**28,962,230**	**15,324,085**
NON-CURRENT ASSETS		
Capital Assets	0	0
Less: Accumulated Depreciation	0	0
Total Non-Current Assets	0	0
TOTAL ASSETS	**28,962,230**	**15,324,085**
LIABILITIES & FUND EQUITY		
CURRENT LIABILITIES		
Accounts Payable	246,950	125,229
Salaries Payable	18,128	15,976
Claims Payable	12,161,320	3,381,054
Claims Payable – IBNR (Note 3)	3,185,352	3,001,691
Reinsurance Due to Insureds (Note 6)	4,364,434	0
Dividend Payable	0	0
Unearned Premium – Self Insurance	23,440	24,416
Unearned Premium – Worker's Comp.	0	0
Unearned Premium – Billback	296,498	268,882
Compensated Absences Payable (Note 4)	28,302	24,878
Securities Lending Collateral (Note 5)	2,934,476	2,730,797
Total Current Liabilities	**23,258,900**	**9,572,923**
LONG-TERM LIABILITIES		
Compensated Absences Payable (Note 4)	32,814	24,884
Total Long-Term Liabilities	**32,814**	**24,884**
TOTAL LIABILITIES	**23,291,715**	**9,597,807**
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	0	0
Unrestricted Net Assets (Note 3)	5,670,515	5,726,279
TOTAL NET ASSETS	**5,670,515**	**5,726,279**

State of Minnesota
Risk Management Fund
Final Statement of Revenues, Expenses, & Changes in Retained Earnings
For Period Ended June 30, 2002

	FY02 YTD	FY01 YTD
OPERATING REVENUE		
Insurance Premiums – Self Insurance	6,898,703	6,109,234
Insurance Premiums – Worker's Compensation	581,240	618,681
Insurance Premiums – Billback	961,909	1,000,754
Consulting Services	20,785	16,285
Total Operating Revenue	**8,462,637**	**7,744,954**
OPERATING EXPENSES (Note 1)		
Claims – Self Insurance	3,390,913	3,233,716
Claims – Worker's Compensation	610,280	413,290
Claims – Billback	0	0
Claims – IBNR	183,661	123,921
Salaries & Benefits	597,219	554,634
Rent	43,443	42,101
Advertising	0	0
Repairs	2,106	30
Insurance	418	166
Insurance Premium – Billback	961,909	1,000,429
Insurance Premium – Self Insurance	1,336,742	714,372
Printing	21,102	13,582
Professional Services – Adjuster	203,173	246,466
Professional Services – Broker	87,000	99,280
Professional Services – Legal and Other	189,894	50,023
Computer Services	1,753	391
Communications	11,592	9,201
Travel	5,870	6,908
Other Operating Costs	37,846	40,089
Memberships & Employee Development	1,942	2,842
Supplies	38,031	38,044
Depreciation	0	0
Indirect Costs	79,986	53,400
Total Operating Expenses	**7,804,880**	**6,642,885**
OPERATING INCOME (LOSS)	**657,757**	**1,102,069**
NON-OPERATING REVENUE (EXPENSES)		
Interest Earnings	453,451	686,623
Policyholder Dividend Expense	(1,169,226)	(1,068,999)
Securities Lending – Gross	61,236	133,671
Securities Lending – Fees	(58,981)	(131,715)
Total Non-Operating Revenue (Expenses)	**(713,520)**	**(380,419)**
NET INCOME (LOSS)	(55,763)	721,650
Net Assets – Beginning of Period	5,726,278	5,002,629
Adjustment to Net Assets (Note 3)	0	2,000
Net Assets – End of Period	**5,670,515**	**5,726,279**

State of Minnesota
Risk Management Fund
Final Statement of Cash Flow
For Period Ended JUNE 30, 2002

	FY02
CASH FLOW FROM OPERATING ACTIVITIES	
Receipts from customers and users – Insurance	$8,486,901
Receipts from customers and users – Consulting Services	20,785
Payments to employees	(583,711)
Payments to suppliers for goods and services	(12,578,651)
Payments for insurance claims	9,143,505
Net cash provided by (used for) operating activities	4,488,829
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES	
Policyholder dividend payments	(1,169,226)
Net cash provided by (used for) non-capital and related financing activities	(1,169,226)
CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Purchase of fixed assets	0
Proceeds from sale of fixed assets	0
Payments of interest	0
Capital Contributions	0
Net cash provided by (used for) capital and related financing activities	0
CASH FLOW FROM INVESTING ACTIVITIES	
Investment Earnings	453,451
Securities Lending Collateral	2,255
Net cash provided by (used for) investing activities	455,706
Net Increase (Decrease) in Cash and Cash Equivalents	3,775,309
Cash and cash equivalents – July 1	12,330,075
Cash and cash equivalents – June 30	16,105,384
Reconciliation of operating income to net cash provided (used) by operating activities	
Operating Income	657,757
Adjustments to reconcile operating income to net cash provided (used) by operating activities:	
Depreciation expense	0
Amortization expense	0
(Increase) decrease in accounts receivable	18,409
(Increase) decrease in inventories	0
(Increase) decrease in prepaid expenses	(118,762)
(Increase) decrease in other current assets	(9,558,803)
Increase (decrease) in accounts payable	121,720
Increase (decrease) in salaries payable	2,153
Increase (decrease) in due to other fund	0
Increase (decrease) in sales tax payable	0
Increase (decrease) in compensated absences	11,354
Increase (decrease) in deferred revenue	26,640
Increase (decrease) in claims payable	3,328,361
Total Adjustments	3,831,072
Net cash provided by (used for) operating activities	4,488,829

Non-cash Investing, Capital, and Financing Activities

None

State of Minnesota
Risk Management Fund
Notes to Financial Statements as of June 30, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Risk Management Internal Service Fund utilizes full accrual accounting, pursuant to M.S. § 16A.055.

The RMF provides automobile liability, general liability, automobile physical damage, property, boiler and machinery insurance on real and personal property, business interruption, and other insurance coverage to state agencies. Insurance coverage generally coincides with the fiscal year, and revenue is recognized over the period of coverage. Coverage was first issued beginning January 1, 1987. The RMF also purchases reinsurance from reinsurance companies to protect itself from catastrophic losses and the aggregation of losses. The RMF also purchases commercial insurance at the request of state agencies and bills those agencies at cost. These revenues and expenses are referred to as “Billback” and are pro-rated over the lives of the various policies. Billback revenues and expenses are identified separately.

Effective July 1, 1996, Department of Administration (ADMIN) Policy and Procedure 96.2 increased the fixed asset minimum dollar-reporting requirement for all state agencies from $500 to $2,000. Complementing this mandate, Admin issued internal policy FMR-1G-01 to expense personal computers (excluding those used for LAN servers) and all their component parts at the time of purchase.

Expenses are based on data received from the MAPS accounting system, and from subsidiary records.

2. LEGISLATION AFFECTING THE RISK MANAGEMENT FUND

The Risk Management Internal Services Fund was created by Minnesota Laws 1986, Chapter 455, Section 3.

3. NET ASSETS

An estimated liability has been included for claims incurred but not reported (IBNR). No estimated liability has been established for claims incurred but not enough (IBNE).

The financial statement includes claims information known as of June 30, 2002 for claims incurred prior to July 1, 2002.

First quarter net income (loss) was ($637,452.52), second quarter net income (loss) was $81,950.14, third quarter net income (loss) was $217,418.55, and fourth quarter net income (loss) was $282,320.37.

Unrestricted Net Assets at the end of the fourth quarter were $5,670,515.17.

In FY01, an adjustment was made to Net Assets to account for an overstatement of FY00 Worker’s Comp Unearned Premiums. The adjustment decreased Unearned Premiums, and increased Unrestricted Net Assets in the amount of $2,000.

4. COMPENSATED ABSENCES

State employees accrue vacation leave, sick leave, and compensatory leave at various rates within limits specified in the collective bargaining agreements. Such leave is liquidated in cash only at the time of separation from state employment. The accumulated leave is shown as a liability.

5. SECURITIES LENDING COLLATERAL

In March 2000, the state began lending securities of the state’s cash investment pool (invested Treasurer’s Cash or ITC) to derive extra income. Securities lending is an investment procedure used by managers of large investment pools that places large volumes of securities in someone else’s custody for a fee. The securities lender receives a large amount of collateral (cash or securities) from the borrower that is invested for short-term gain. The securities are returned to the lender and the collateral returned to the borrower at the end of the loan term. The valuation of the asset and offsetting liability are provided by the Department of Finance. The income and expense figures are also provided by the Department of Finance.

6. REINSURANCE DUE TO INSUREDS

At the end of the fiscal year (June 26 and June 28), the RMF received two payments totaling $4,364,434 from the reinsurance companies. Those funds were to be passed on to the insureds. As of June 30, the money was still in the RMF, so it is therefore shown as a liability.

Statement of Actuarial Opinion
Regarding the State of Minnesota
Assumed Automobile, and Liability Other than Auto, Retained Liabilities
As of March 31, 2002

My name is Todd A. Gruenhagen and I am the Consultant and Managing Director of RTAG Consulting and Software, Inc., a Minnesota Corporation. RTAG Consulting and Software, Inc. is a worldwide actuarial and risk management consulting firm specializing in software solutions to actuarial analyses. I am an Associate of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. I meet the qualification standards of the American Academy of Actuaries for rendering an actuarial opinion on property and casualty loss and loss adjustment expense reserves.

RTAG Consulting and Software, Inc. has been retained by the State of Minnesota as their consulting actuary. One of the services we provide to the State of Minnesota is the evaluation of liabilities assumed under Minnesota Statutes Chapter 3, Section 376, Subdivision 4 for automobile liability and liability other than auto exposures.

All loss data utilized in this analysis was provided to me via the State of Minnesota, Risk Management Division. I relied on the accuracy and completeness of the loss data without audit or independent verification. Exposure information was provided via the State of Minnesota, Risk Management Division. If the data is inaccurate or incomplete, these estimates may need to be revised.

The State of Minnesota's retained automobile liability for accident periods July 1, 1995 through March 31, 2002, listed by accident period as of March 31, 2002, are as follows:

		(1)	(2)	(3)	(4) =(3)-(2)	(5) =(1)-(3)	(6) =(4)+(5)
Accident Period		Ultimates	Paid Losses	Incurred Losses	Case O/S Reserves	IBNR Reserves	Total Reserves
Beginning:	Ending:	@3/31/2002	@3/31/2002	@3/31/2002	@3/31/2002	@3/31/2002	@3/31/2002
7/1/1995	6/30/1996	967,400	874,458	965,014	90,556	2,386	92,942
7/1/1996	6/30/1997	1,700,400	1,576,121	1,692,728	116,608	7,672	124,279
7/1/1997	6/30/1998	1,808,000	1,479,035	1,782,838	303,803	25,162	328,965
7/1/1998	6/30/1999	1,009,700	864,426	911,895	47,469	97,805	145,274
7/1/1999	6/30/2000	1,445,800	993,242	1,156,728	163,486	289,072	452,558
7/1/2000	6/30/2001	1,916,100	744,831	1,183,664	438,833	732,436	1,171,269
7/1/2001	3/31/2002	1,587,000	308,387	724,357	415,970	862,643	1,278,613
Totals		10,434,400	6,840,499	8,417,224	1,576,724	2,017,176	3,593,901

The State of Minnesota's retained liability, other than auto liability, for accident periods July 1, 1995 through March 31, 2002, listed by accident period as of March 31, 2002, are as follows:

		(1)	(2)	(3)	(4) =(3)-(2)	(5) =(1)-(3)	(6) =(4)+(5)
Accident Period		Ultimates	Paid Losses	Incurred Losses	Case O/S Reserves	IBNR Reserves	Total Reserves
Beginning:	Ending:	@3/31/2002	@3/31/2002	@3/31/2002	@3/31/2002	@3/31/2002	@3/31/2002
7/1/1995	6/30/1996	154,900	139,150	154,150	15,000	750	15,750
7/1/1996	6/30/1997	257,800	241,023	255,406	14,383	2,394	16,777
7/1/1997	6/30/1998	218,700	210,722	210,769	48	7,931	7,978
7/1/1998	6/30/1999	157,900	121,388	153,020	31,633	4,880	36,512
7/1/1999	6/30/2000	286,700	56,465	277,123	220,658	9,577	230,235
7/1/2000	6/30/2001	387,400	86,302	197,452	111,151	189,948	301,098
7/1/2001	3/31/2002	257,550	11,709	66,226	54,517	191,324	245,841
Totals		1,720,950	866,759	1,314,148	447,389	406,802	854,191

It is my opinion that the above estimated liabilities:

1. Are computed in accordance with commonly accepted actuarial loss reserving standards and methods, and are fairly stated in accordance with sound actuarial principles.

2. Make a reasonable provision for all unpaid loss and allocated loss adjustment expense liabilities that the State of Minnesota assumes under Minnesota Statute 3.736, Subdivision 4 for automobile and liability other than auto exposures.

3. Are based on factors and data relevant to the State of Minnesota.

I believe that these reserves make a good and sufficient provision, in the aggregate, for all unpaid loss and allocated loss adjustment expense obligations of the State of Minnesota with respect to its retained liability exposures for the accident period July 1, 1995 through March 31, 2002. This opinion is based upon my best estimate of the ultimate loss and allocated loss adjustment expenses to be paid by the State of Minnesota, and is based upon data available as of March 31, 2002.

Note that this estimate is based upon actuarial assumptions as to future contingencies deemed to be reasonable and appropriate under the circumstanc es. The reader of this Statement must realize that these projections involve estimates of future events and, as such, are subject to economic and statistical variations from the expected values. For these reasons, no absolute assurance can be given that the emergence of actual losses will correspond to the projections reflected in this report. However, I have not anticipated any extraordinary changes to the legal, social, or economic environment that might affect the reserve values.

This opinion is provided to the State of Minnesota solely for the purpose of meeting its internal reporting obligations. Any other use is prohibited.

15 April, 2002
Date

/s/ Todd A. Gruenhagen
Todd A. Gruenhagen, ACAS MAAA

Department of Public Safety's Bureau of Criminal Apprehension building (St. Paul, MN) in the final stages of construction.

The Risk Management Fund insures the builder's risk.