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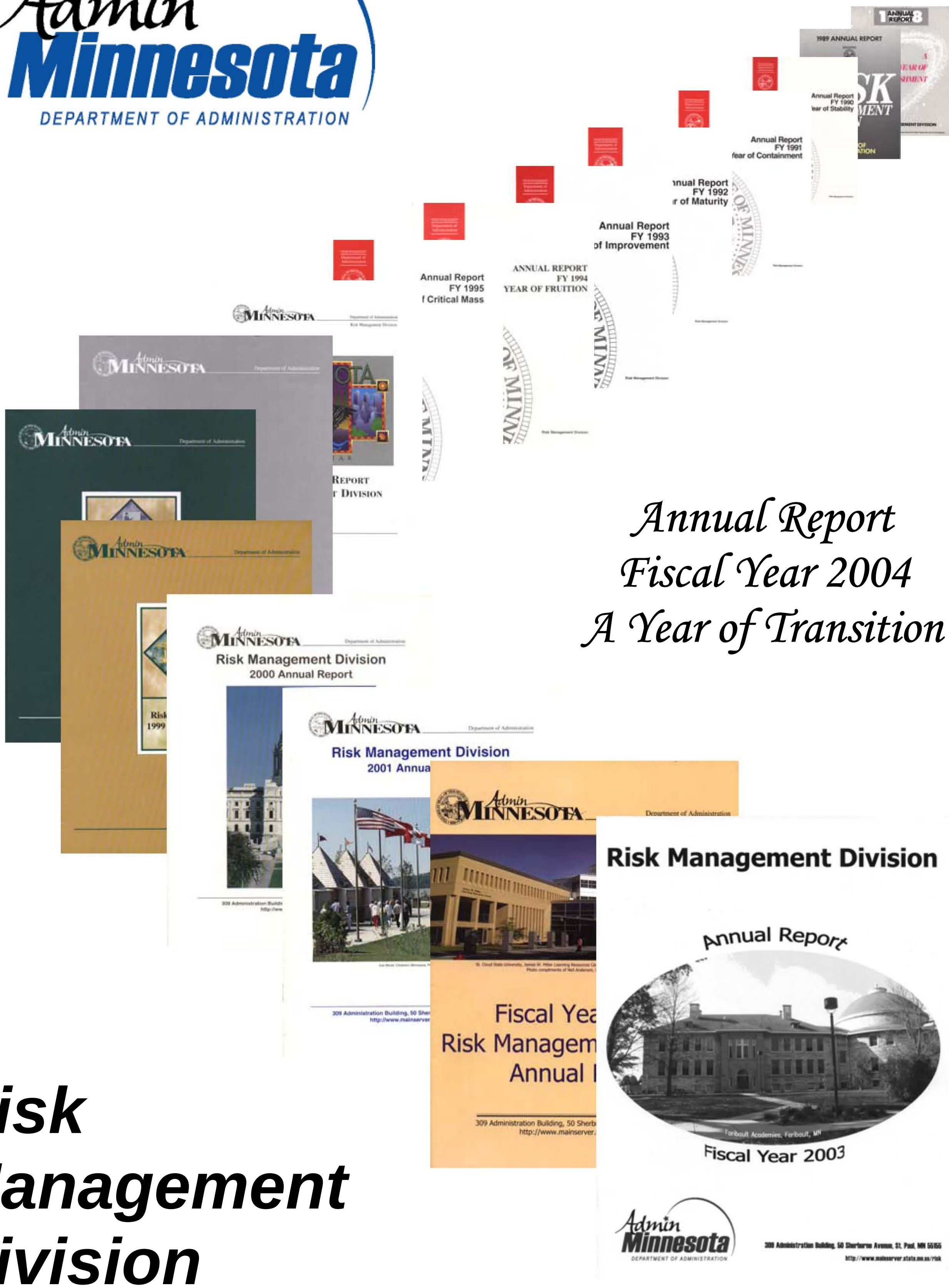
http://www.mainserver.state.mn.us/risk

Admin Minnesota
DEPARTMENT OF ADMINISTRATION



Annual Report
Fiscal Year 2004
A Year of Transition

Risk Management Division

Retrospective

March 2, 2004 marked the end of an era for the Risk Management Division. Fred Johnson retired 17½ years after starting the Risk Management program from scratch.

In 1986, the state could not obtain auto insurance from the commercial marketplace. Insurance was simply not available and several carriers that had previously written insurance for the state had gone bankrupt. Since auto liability insurance is required by Minnesota law, the legislature authorized creation of the Risk Management Division to serve as the state's internal insurance company.

The first policy was effective January 1, 1987. Since that time, many other insurance needs have been identified. From the first additional coverage offered to the Department of Natural Resources for their safety programs in August 1987, numerous other insurance requirements have been addressed through the addition of new coverage lines. These coverages include Auto Physical Damage, Property, Boiler & Machinery, Crime, Garagekeeper's Legal Liability, Inland Marine, Builder's Risk, Public Official's Errors & Omissions, Police Officer's Professional Liability, Broadcaster's Liability, and Homeowner's Warranty.

Consulting services have also become a large part of the division's business, ranging from the insurance program for the new Light Rail system, insurance programs for large state building projects, and going forward with the proposed Northstar Commuter rail line.

Many things have changed since 1986. The old X286 personal computers have been replaced several times. We now use networked Pentium IV series computers and run a modern risk management information system that gives us the ability to spot trends and more proactively manage risk.

The staff has grown from just Fred to the current level of ten full-time employees. We have enjoyed the tradition of having a "pizza party" as we manually prepared bulk mailings of the quarterly newsletter *Alert* and our annual report. As technology progresses, we foresee the day we will simply e-mail the *Alert* to our customers. However, we will continue to occasionally gather for a pizza luncheon, dedicated to Fred, as we discuss new developments for the division and look forward to meeting ongoing challenges with our new director, Phil Blue.

Picture: View from the director's office window

State of Minnesota
Department of Administration
Risk Management Division

Mission Statement

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.

Fundamental Truth . . .

Risk Management may be the only departmental function of government capable of materially reducing cost without eliminating people or programs . . .

Marsh USA

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Commissioner's Statement

It goes without saying that protecting Minnesota citizens' exceptional investment in government is paramount for the Risk Management Division. What is less well known is the day-in, day-out hard work of this ten-member organization in continually seeking new, better, and more cost-effective solutions for protecting people and property. Their successes over the past year are a testament to their dedication to customers and commitment to mission.

For starters, Risk Management obtained property reinsurance on a more favorable basis, reducing reinsurance rates by 10 percent and adding better terms and conditions, including an increase in total limits from $300 million to $750 million. Favorable underwriting results and moderate claims experience over the 2004 fiscal year also resulted in a 20 percent reduction in the state's deductible, from $2.5 million to $2 million.

While pinpointing a direct cause/effect relationship can be tricky in a business as complicated as insurance, it's obvious that Risk Management's three-year old loss control program is having a positive impact. By emphasizing the little things – from testing fire suppression pumps to the proper storage of combustibles and keeping an eye on "hot work" projects such as welding – the loss control program is increasing awareness of the constant need to be careful and vigilant.

Vigilance in day-to-day operations within Risk Management is also resulting in dramatic improvements in customer service. As an example, all policy transactions between the division and its clients are now performed electronically, eliminating labor-intensive manual processes and assuring greater accuracy. On the consulting side, the division is involved in the initial stages of creating an insurance plan for the Northstar Commuter Rail project following an evaluation of an owner-controlled insurance program (OCIP) approach. Consultants are also winding down work for the Hiawatha Light Rail Line, which began full operation in late 2004.

In a little over a year, Risk Management will mark two decades of service to Minnesota government. Initially created in 1986 as the state's self-insurer for automobile liability insurance, Risk Management today writes nearly $7.5 billion in state property coverage as well as general liability exposures. Over the last 10 years, Risk Management has declared more than $10 million in dividends to its customers. As of June 30, 2004, the Risk Management Fund has paid out over $50 million in claims since its inception.

Through their dedication, the staff of the Risk Management Division is assuring that the many and varied operations of state government face the least risk at the lowest cost, that loss prevention is key in making smart decisions, and that citizens are receiving the best value for their dollar. It is to their credit that Minnesota has earned and maintains a national reputation for effective risk management.

Dana B. Badgerow, Commissioner

Director's Message

This is the first director's message, since the Risk Management Fund (RMF) was founded in 1986, that has not been authored by Fred Johnson. After 17½ successful years as the State of Minnesota's director of the Risk Management Division (RMD), Fred decided to retire in March 2004.

The transition has started. We have continued the many programs initiated under Fred's leadership, as well as added a few of our own. This annual report has continued some of the old and has initiated a little bit of the new.

One of the most important topics to discuss is property reinsurance. The property reinsurance market after September 11, 2001, coupled with RMD's adverse property loss experience in fiscal year 2002, had resulted in high reinsurance rates and high retentions. The reinsurance renewal was particularly challenging since RMD's carrier continued to charge high rates. Because of this situation, a great deal of time and effort were required to search the market for competitive alternatives in order to keep reinsurance costs as low as possible so we did not have to increase our clients' property rates. The final outcome was to move the property reinsurance program to a new reinsurer. The property account for the RMF was awarded to PEPIP (Public Entity Property Insurance Pool). The decision to make this move was driven by the fact that this is the largest property reinsurance pool in the world, with over $100 billion of insured values. In addition, the premium savings were significant, resulting in a $1.7 million drop in costs, compared to the incumbent's original premium renewal indications. Higher per occurrence limits ($750 million compared to $300 million) and improved terms and conditions were also factors in deciding to move the property reinsurance to PEPIP.

In fiscal year 2004, we resumed paying dividends (returned monies), after a one-year hiatus, with a total pay out of over $1.6 million. In fiscal year 2005, dividends of over $1.7 million will be paid to the policy-holders insured by the RMF, bringing the total dividends paid for all years to a milestone of over $10 million.

The property loss control program continued for the third straight year. This program has been well received by our clients and, so far, has contributed to much improved property loss experience. In addition to the property loss control visits, we added an appraisal service this year for both real and personal property. These services are included in our property premium rate. In this first year of the appraisal program, Maximus, the service provider, appraised over $1 billion of the State's insured properties.

In fiscal year 2004, the first year our new *RiskSmart* policy management system was used, over 90 percent of our business was electronically renewed. This was a service that many of our clients were clamoring for, so we are pleased that this initiative was so successful.

The Hiawatha Light Rail project (initiated four years ago) activated part 1A as a regular light rail service between downtown Minneapolis and Fort Snelling in June 2004. The RMD is involved, along with many other governmental segments, in managing the owner-controlled insurance program (OCIP) during the construction and initial operational phases.

Fiscal year 2004 also saw continuation of the Northstar Commuter Rail discussions. This is another Minnesota project where insurance is a major factor and the Risk Management Division is a player in the endeavor.

All in all, it has been a very productive and exciting year. RMD staff continue to do an excellent job and I am pleased at what has been accomplished in fiscal year 2004. RMD looks forward to continuing to provide the State of Minnesota with the very best insurance programs, customer service, and pricing that is available in the marketplace.

Phillip E. Blue, Director

To formalize the transition, Fred Johnson, retiring Director of Risk Management, hands over the gavel to Phil Blue

tran·si·tion – Pronunciation: tran(t)-‘si-sh&n,’ tran-‘zi-, *chiefly British* tran(t)-‘si-zh&n
Function: *noun*; Etymology: Latin *transition-, transitio,* from *transpire*
1 a : passage from one state, stage, subject, or place to another –change – **b :** a movement, development, or evolution from one form, stage, or style to another
2 a : a musical modulation **b :** a musical passage leading from one section of a piece to another
3 : an abrupt change in energy state or level (as of an atomic nucleus or a molecule) usually accompanied by loss or gain of a single quantum of energy.
Merriam Webster Dictionary

Fiscal Year 2004 Annual Report Highlights

FY04 brought a number of changes, but the RMD's financial position remained stable despite many pressures. Premium rates remained at the same level as the prior year, in spite of increased operating costs; however, since claims frequency and severity were lower than in the previous three years, this helped even out the overall results.

Highlights

- Fred Johnson, founder of the RMD, retired. Phil Blue, RMD's Underwriting and Marketing Manager, filled the director position. Marlys Williamson, Senior Underwriter, was promoted to fill the marketing and underwriting manager position.
- Completed the third year of a comprehensive statewide property loss control program. For the first time, real and personal property appraisals were included in the program at no extra cost to our clients.
- Paid $1.7 million in dividends to RMF's policyholders.
- Total claims paid since the beginning of the RMD in 1987 have surpassed $50 million.
- The policy management system, *RiskSmart*, has been configured and tested. More than 90 percent of all FY04 policy renewals were done electronically.
- Completion of the Continuity of Operations Plan prototype. This template document can be used by all state agencies to enable them to quickly and efficiently put a disaster recovery plan in place. The project, funded by a FEMA grant, was done in partnership with the Department of Public Safety and the Department of Administration's Business Continuation Management team of the InterTechnologies Group.
- Our quarterly newsletter, *Alert*, is published internally, rather than being outsourced, saving both time and money.
- Oversight of the Hiawatha Light Rail project's OCIP (owner-controlled insurance program) continued through their insurance advisory committee as light rail service from downtown Minneapolis extended to Fort Snelling.
- Negotiated Builder's Risk coverage for the $238 million Capitol Complex building project that includes construction of three buildings for the Departments of Agriculture, Health, and Human Services.
- A new reinsurance program was implemented that has better terms and conditions over the prior year, and a state retention level that is reduced from $2.5 to $2 million.
- Tom Chukel, Claims Manager, went to Washington D.C. as a representative of the Minnesota chapter of the Risk and Insurance Management Society's legislative committee on tort reform.
- Produced a casualty insurance underwriting guide in our ongoing effort to document policies and procedures.
- Cyber insurance research was started during this period to explore the state's need for this coverage.

Loss Control Program

In cooperation with our property reinsurance program, we have continued the physical site loss control surveys. The emphasis of the surveys continues to be on the higher valued properties insured within the RMF. To date, we have participated in more than thirty site visits. An important part of this process involves the identification of areas for improvement from property protection and life safety standpoints. These recommendations for improvement are communicated to the appropriate facility personnel. Loss control visits will continue in FY05.

A new program we are reviewing is the use of infrared testing as a means of identifying potential dangers that could result in personal injury or property damage. Infrared testing involves the nondestructive testing of electrical distribution components, heating/cooling systems, and similar equipment for evidence of overloading and/or faulty connections. The testing is conducted by taking photographs with infrared cameras. The images produced are then examined for areas that are outside of the acceptable color spectrum. This type of testing has been proven effective for reducing down time and repair costs, as well as increasing safety and reducing fire hazards.

We have also participated with several state agencies to obtain and record the Global Positioning System (GPS) coordinates for state-owned buildings throughout the state of Minnesota.

The RMD website – http://www.mainserver.state.mn.us/risk/ – has links to several safety management programs including: *Hot Work (Cutting and Welding); Impairment of Fire Protection Systems; Inspection, Testing, and Maintenance of Fire Protection Systems; Churn Testing Requirements and Procedures; and Emergency Preparedness.*

Fire Extinguisher training for MN Department of Administration Plant Management Staff

Testimonial –

Steve Hendrickson, Department of Administration's Safety and Health Officer, was pleased with the loss control training recently provided to Plant Management's grounds and trades crew by the RMF's loss control service provider. Steve says, "The attention to these topics was a good reminder to our crew to follow safe procedures and use proper safety equipment." The training included a fire extinguisher demonstration, reinforcement of hot work procedures, and instruction for inspection and testing of fire protection equipment, to name a few. Steve goes on to say, "The more we can reinforce safe behaviors by providing classes such as these, the less likely that we will incur injuries and losses. Thank you for providing this opportunity for our staff."

Division Summary of Operations

In FY04, the RMD continued to provide four major areas 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 clients' 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.
- Ongoing loss control efforts.

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, and administrative expenses.

An objective of the RMD is to maintain operating expenses well below the industry average for comparable insurance companies (as reported by A.M. 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, with all five years better than 40 percent lower than the industry. In FY04, the RMF's expense ratio was better than half of the industry's expense ratio.

Exhibit 1

	FY00	FY01	FY02	FY03	FY04
Net Premium Written	$4,658,498	$5,419,278	$5,585,401	$5,911,569	$6,309,145
Industry average operation expense ratio	30.6%	28.6%	30.5%	30.0%	29.9%
Projected industry average operation expense based on RMD's actual premium	$1,425,500	$1,549,914	$1,703,547	$1,773,471	$1,886,434
Actual RMD operating expenses	$ 780,405	$ 910,691	$ 950,542	$1,029,334	$ 941,969
RMD operating expense ratio	16.8%	16.8%	17.0%	17.4%	14.9%

Dividends

The FY04 dividend of $1,729,215 was calculated as of June 30, 2004, and declared and paid in FY05. This brings the total dividends paid to $10,035,204. FY04 dividends and total dividends paid from inception of the program, by line of insurance, are as follows:

	Calculated in FY04	Total Dividends Declared
Auto Liability	$ 745,190	$5,586,351
General Liability	650,328	2,423,912
Property Insurance	333,697	2,024,941
	$1,729,215	**$10,035,204**

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. The remaining amount is paid 36 months after the close of the policy year.
- Auto 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 auto liability (35 percent, 25 percent, 25 percent, and 15 percent respectively). Exhibit 2 illustrates dividend pay out percents by line of business.

Exhibit 2

Dividend Pay Out Pattern in Years after Policy Year is Closed

Line 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%

Dividends represent the return of premium for superior loss and expense experience. Premium funds collected are invested by the state's Board of Investment. The difference between premium and investment income, less deductions for incurred losses and loss adjustment expenses, administrative expenses, and reinsurance costs, equals the amount of funds that are eligible for dividend declaration. 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 a premium assessment, which can be very disruptive to an agency's budget planning.

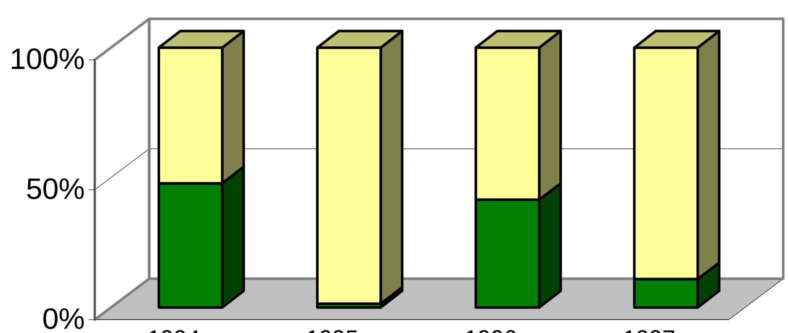
Due to the significant price increases in the reinsurance markets following September 11, 2001, the RMD obtained approval from the Risk Management Advisory Committee to use dividend proceeds to help finance the higher reinsurance costs, thereby minimizing the premium increase to our customers. Also, due to slower than expected development of property claims, a decision was made in FY02 to add one year to the dividend pay out schedule before the first payment is made. This decision continued into FY04.

Exhibits 3A, 3B, and 3C document the dividend pay out amounts and percents versus expenses (claim, reinsurance, and administrative) by underwriting year for the auto liability, general liability, and property lines of business. The underwriting years displayed include the most recent dividend closed years where the dividend pay out has reached 100 percent.

Exhibit 3A

Auto Liability Dividend Pay Out - Closed Years

FY 1994-1997

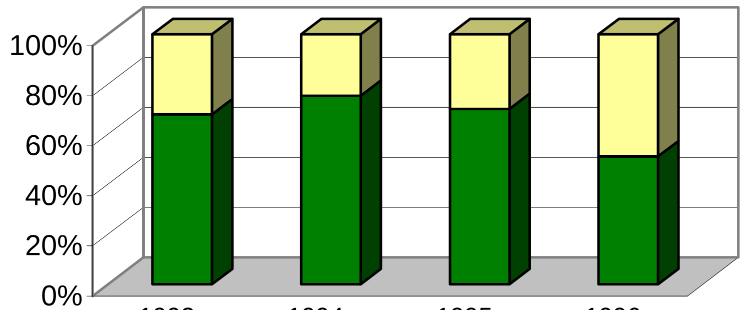


	1994	1995	1996	1997
Paid Loss & Expense	$1,200,508	$2,194,387	$1,373,718	$2,152,419
Dividend	$1,098,028	$31,177	$972,863	$263,421

Exhibit 3B

General Liability Dividend Pay Out - Closed Years

FY 1993 - 1996

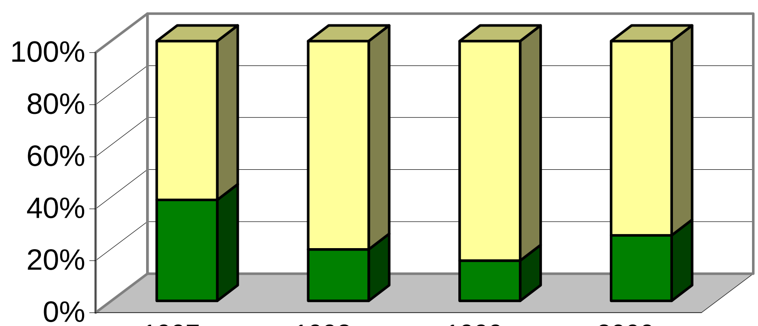


	1993	1994	1995	1996
Paid Loss & Expense	$59,447	$54,882	$67,899	$511,997
Dividend	$125,922	$167,870	$159,259	$536,876

Exhibit 3C

Property Dividend Pay Out - Closed Years

FY 1997-2000



	1997	1998	1999	2000
Paid Loss & Expense	$743,618	$1,061,744	$1,521,185	$1,425,661
Dividend	$473,096	$262,895	$279,195	$481,231

Testimonial

"Safety pays!" says MN Department of Natural Resources (DNR) Manager, Dave Schiller, after recently receiving a six-figure auto liability dividend from the Risk Management Fund. Dave goes on to say that DNR's emphasis on accident reporting, investment (and insistence) in defensive driver's training, driver's use agreements, generally improved safety expectations, accountability, and accident reduction, is paying real dollar dividends. DNR is just one of many policyholders that received a FY04 dividend from the RMD. Dividends are the direct, tangible, hard-dollar evidence that reducing accidents pays off!

Exhibit 4
Self-Insurance Property and Casualty Underwriting Results

Premiums Earned by Line

	FY01	FY02	FY03	FY04
Auto Insurance				
Auto Liability	$2,303,193	$2,473,245	$2,075,124	$2,040,527
Auto Physical Damage	599,021	789,014	842,814	806,788
Garagekeeper's Legal Liability	33,611	35,147	34,456	33,743
Standard Commercial Insurance				
Property	$1,592,633	$1,753,658	$4,187,342	$4,437,164
Boiler & Machinery	174,578	215,887	152,662	154,573
General Liability	1,096,637	1,259,829	1,412,839	1,307,708
Crime	52,352	57,393	68,359	70,387
Other	257,209	314,530	309,263	320,632
Total Premiums Earned	$6,109,234	$6,898,703	$9,082,859	$9,171,522
Less Reinsurance Ceded	$ 714,372	$1,336,742	$3,206,085	$2,903,662
Total Net Premiums Earned	5,394,862	5,561,961	5,876,774	6,267,860
Plus Unearned Premium	24,416	23,440	34,795	41,285
Total Net Premiums Written	$5,419,278	$5,585,401	$5,911,569	$6,309,145

Combined Loss and Expense Ratio
(Before Dividends and IBNR)

	FY01	FY02	FY03	FY04
Auto Insurance				
Auto Liability	83%	70%	75%	72%
Auto Physical Damage	90%	77%	70%	68%
Garagekeeper's Legal Liability	13%	18%	42%	10%
Standard Commercial Insurance				
Property	109%	1,360%	11%	25%
General Liability	79%	78%	52%	22%
Boiler & Machinery	13%	16%	7%	130%
Crime	13%	16%	88%	22%
Other	102%	45%	53%	61%
Combined Loss Ratio **Before** Reinsurance	88%	396%	40%	42%
Combined Loss Ratio **After** Reinsurance	91%	89%	61%	59%

Financial Position Discussion

Exhibit 4 illustrates a four-year comparison of the RMF's gross premiums earned and combined loss and expense results, by line of business, before IBNR (incurred but not reported) and dividends. The loss experience of the RMF has been very steady and the results have been excellent. The combined ratio after reinsurance is the most significant result and, as the exhibit reflects, the "bottom line" results have been positive over the four-year period covered by Exhibit 4.

In FY04, the RMF maintained a level earned premium volume, increasing approximately $89,000 over the previous year.

The program, for the second year in a row, was able to avoid any severe property losses after incurring two very large property losses in FY02. The superb response to the property loss control program from the state agencies that are in the RMF, and the emphasis Risk Management puts on property loss conservation, were major contributing factors to the FY04 property loss results.

Reinsurance costs decreased over 10 percent, or approximately $302,000. In addition to the drop in reinsurance costs, the self-insured retention decreased from $2.5 million to $2 million. The reinsurance market pricing is softer than it was two years ago. This is a welcome change and, if results continue to be favorable and reinsurance premiums continue to decrease, then the potential for a positive property rate adjustment is very good.

Exhibit 5 indicates that comparing FY03 to FY04, policyholder surplus (total net assets) increased nearly 14 percent, or $767,507. This positive performance was due to favorable underwriting results and lower reinsurance costs.

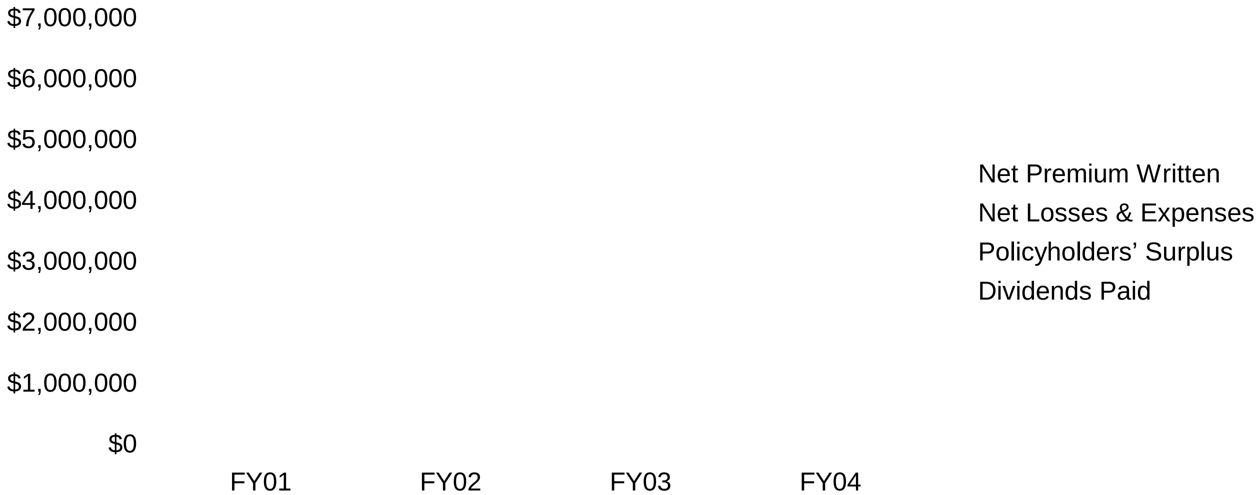
The dividend policy of the RMF is to return all underwriting profit and investment income to its policyholders, whenever economically feasible, so the results inure to the benefit of the customers the RMF insures. The ultimate costs to the state are losses, administrative expenses, adjusting expenses, and reinsurance costs, less investment income. In FY04, the RMF was pleased to be able to resume paying dividends, after not paying a dividend in FY03, when, due to increasing property costs and higher self-insured retentions, the Risk Management Fund Advisory Committee agreed that it was wise to put the dividend pay out on hold.

The RMF enjoys 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 net premium written to policyholders' surplus is 1.17 to 1. The RMF's ratio is 1.01 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 surplus to premium ratio is better than that of the industry. This is a positive factor that contributes to a stronger RMF. In addition to the RMF's strong ratio, it utilizes reinsurance to guard against catastrophic losses, as well as the aggregation of losses.

Exhibit 5 highlights the RMF's performance over the past four years, detailed for those four major items representing the financial integrity of the RMF – net premium written, net losses and expenses before IBNR losses, policyholders' surplus, and dividends paid.

Exhibit 5

RMF Performance by Fiscal Year



	FY01	**FY02**	**FY03**	**FY04**
Net Premium Written	$5,419,278	$5,585,401	$5,911,569	$6,309,145
Net Losses & Expenses	4,898,296	4,970,164	3,599,563	3,694,938
Policyholders' Surplus	5,726,279	5,670,515	5,491,210	6,258,717
Dividends Paid	1,068,999	1,169,226	0	1,668,215

Lines of Insurance Discussion

Auto Liability

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 insured's ownership or use of motor vehicles, as specified in Minnesota Statute § 65B.

MnDOT plow by salt shed

For the second consecutive year, auto liability insurance was *not* the largest line of insurance for the RMF. The volatile changes in the property line continued to have an impact on the RMF's premium distribution, making the auto liability line the second largest, at 22 percent.

Although the number of vehicles decreased by three percent since FY03, the number of accidents dwindled by an astonishing 24 percent compared to FY03. Not since the year 2000 has the number of accidents been this low.

The decrease in the combined loss and expense ratio, from 79 percent in FY03 to 72 percent in FY04, is further evidence that the number of accidents has declined. Traditionally, a decrease in accidents has been attributed to inclement weather, particularly snowfall. However, RMF statistical records show that the frequency of accidents has no correlation with annual snowfall. The increase in the average cost per vehicle accident, in light of significantly fewer events, is an indicator that accident severity is on the rise.

The six-year auto liability experience and six-year cumulative experience are shown in Exhibit 6 (losses are valued at the end of 12 months for each of the years identified, as well as the loss and expense ratio position for each year, as of June 30, 2004).

Exhibit 6

Auto 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	Loss & Expense Ratio as of 6/30/2004
2004	545	13,551	4.0%	$2,707	72%	72%
2003	713	14,086	5.1%	$1,868	79%	74%
2002	777	13,860	5.6%	$2,102	78%	67%
2001	640	12,828	5.0%	$2,138	78%	76%
2000	507	11,263	4.5%	$2,804	83%	78%
1999	695	11,232	6.2%	$2,251	85%	61%
Avg.	646	12,803	5.0%	$2,311	79%	71%

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. Since January 1, 2000, the tort cap has been $300,000 per person and $1 million per occurrence.

Auto Physical Damage

Auto physical damage provides coverage for damage to vehicles. Two basic types of physical damage coverage are generally provided for 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.

Auto physical damage represents only 9 percent of the RMF's premium, the same as in FY03.

There is a downward trend in the combined loss and expense ratio, from 74 percent in FY03 to 67 percent in FY04, marking the fourth successive year of decrease. Although the number of vehicles is up by 4 percent, from 8,200 in FY03 to 8,563 in FY04, the number of accidents has decreased by 12 percent, from 390 in FY03 to 341 in FY04. As with the auto liability line, there appears to be no direct correlation between frequency and severity of accidents and annual snowfall. However, we do recognize that our insureds are focusing more on safety and that their efforts are paying off!

Subrogation recoveries are another contributor to improved loss ratios – 24 percent of claims paid are recovered through RMF's subrogation efforts.

The average cost per claim has risen for the last four years. We attribute this trend, in part, to rising automotive repair costs. All indications are that this development is not subsiding.

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

Exhibit 7

Auto 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
2004	341	8,563	4.0%	$1,600	67%	$106,723
2003	390	8,200	4.8%	$1,594	74%	$134,912
2002	457	6,857	6.7%	$1,361	78%	$117,466
2001	410	6,244	6.6%	$1,185	81%	$163,185
2000	361	5,472	6.6%	$1,230	115%	$175,138
Avg.	392	7,067	5.7%	$1,394	83%	$111,075

Property/Boiler & Machinery/Crime

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 coverage is written on an "all risk" of direct physical loss basis – 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 builder's risk coverage.*

Boiler and Machinery – *Although it is called Boiler and Machinery Insurance, businesses with no boilers on premises have a significant exposure. What is referred to as "boiler insurance" provides important coverage for machinery as well; i.e., building maintenance equipment, like air conditioners, furnaces, and production machinery. Equipment breakdowns and electrical damage losses are relatively commonplace occurrences. They are not covered under property insurance policies; rather, they are covered under boiler and machinery. Coverage includes loss sustained by the boilers or the machinery itself, damage to other property, and business interruption (use and occupancy) losses.*

Crime – *The RMF provides coverage for both employee dishonesty and money and securities losses. 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.*

Again this year, the property line surpassed the auto liability line as the largest category of insurance written by the RMF, representing 55 percent of the total RMF written premium for all lines of business.

The total insurable values continue to rise as more emphasis is placed on insurance-to-value.

While the claims count hovered around 125 this year and last, the average cost per claim climbed 14 percent. Furthermore, the RMF has had two consecutive catastrophe-free years; although, FY04 saw a five point increase in the combined loss and expense ratio, from 80 percent in FY03 to 85 percent in FY04. An increase in loss severity and the escalating cost of building materials typically contribute to rising claim costs for the property line. (The dramatic increase in the FY02 loss ratio is attributable to several large property losses.)

Upon maturity, loss ratios initially below 100 percent will climb to that level since any unallocated premiums – those not earmarked for loss payments and expenses – are returned to policyholders in the form of a dividend, resulting in a combined loss and expense ratio of 100 percent.

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

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
2004	125	$7,727,906,314	2.0%	$35,370	85%
2003	124	$7,360,890,716	1.7%	$30,917	80%
2002	114	$6,225,662,878	1.9%	$17,330	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%

The RMD reorganized the property program in FY98, 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 a $100 million blanket to $2.5 million per location. The aggregate stop loss increased from $1 million to $2.5 million.

FY03 saw another year of significant restrictions in reinsurance terms and conditions. The business income and extra expense sublimit was reduced from $2.5 million per location to $50,000 per location. Property limits were reduced from $500 million to $300 million, and the aggregate stop loss escalated from $2 million to $7.5 million, with a $25,000 maintenance deducible. In addition, the RMF retention level increased from $500,000 to $2.5 million, and the boiler and machinery insurance deductible increased from $25,000 to $100,000.

A much-improved program was obtained in FY04 when the RMF became a part of PEPIP, the largest property program in the world. The business income and extra expense sublimit was increased from $50,000 per location to $100,000 per insured/$2,500,000 per occurrence. Property limits were increased from $300 million to $750 million. The aggregate stop loss remained at $25,000. The RMF retention decreased from $2.5 million to $2 million. The boiler and machinery deductible remained at $100,000.

Property lines of insurance represented 28 percent of premiums in FY98, grew to 35 percent in FY02, 52 percent in FY03, and 55 percent in FY04. Insured property values increased by $3.9 billion from FY98 to FY04.

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 or sustain property damage as a result of the insured's operations or while on the insured's premises.

Fourteen percent of the total FY04 RMF premium was applicable to the general liability line.

The combined loss ratio decreased significantly from 46 percent in FY03 to 21 percent in FY04, as did the average cost per claim, from $4,750 in FY03 to $2,100 in FY04. This line has historically had favorable loss experience.

EXHIBIT 9

General Liability Exhibit

Year	Number of Claims	Average Cost per Claim	Combined Loss & Expense Ratio at 12 Months	Cumulative Loss & Expense Ratio as of 6/30/2004
2004	134	$2,100	21%	21%
2003	140	$4,740	46%	51%
2002	141	$3,615	40%	75%
2001	170	$2,134	33%	72%
2000	124	$3,781	45%	32%
1999	116	$3,333	40%	38%

The six-year general liability experience and six-year cumulative experience are shown in Exhibit 9 (losses are valued at the end of 12 months for each of the years identified, as well as the loss and expense ratio position for each year, as of June 30, 2004). Due to the use of multiple general liability rating bases, claim frequency data would not be germane.

The current tort cap became law effective January 1, 2000, when legislative mandate put into effect a $300,000 per person and $1 million per occurrence cap.

Risk Management's claim handling philosophy of proactive early claim investigations has favorably influenced the average cost per claim for this line, offsetting any adverse impact that rising medical costs have had.

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 of loss experience. Historical evidence supports the fact that general liability claims develop more slowly than auto liability, auto physical damage, and property insurance claims.

Optional general liability coverages include public official's liability, broadcaster's liability, and police officer's professional liability.

Other Lines

Other lines of commercial insurance offered by the RMD include inland marine, garagekeeper's legal liability, and homeowner's warranty.

Inland Marine – *Inland marine policies are designed to provide specialized coverage or lower deductible options. They cover goods in transit, except trans-ocean, as well as certain types of personal property that are transportable, i.e., floater policies covering equipment, laptop computers, tools, fine arts, musical instruments, and cameras.*

Century College auto repair program

Garagekeeper's Legal Liability – *Auto 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. Garagekeeper's legal liability provides coverage for an agency that has vehicles in their "care, custody, or control." Examples include valet parking and garage operations.*

Homeowner's Warranty – *Homeowner's warranty coverage is designed to provide coverage for defects caused by faulty workmanship or defective materials. MN State Colleges and Universities institutions offering construction career programs have an interest in homeowner's warranty coverage.*

Hennepin Technical College Carpentry Program "Habitat for Humanity" home

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

Purchased Insurance

In some instances, it is more expedient to utilize the conventional insurance marketplace, rather than the RMF. In such cases, the RMD works with clients to determine the appropriate insurance coverages and then obtains the necessary policies through its worldwide broker and insurance contacts.

Purchased insurance is another example of gratis insurance services the RMD provides to its clients. Over the last 18 years, Risk Management has been successful in becoming the "one-stop shop" as far as property and casualty insurance requirements for the state of Minnesota is concerned. This spectrum of services ranges from administering the RMF, obtaining purchased insurance, setting contractual insurance requirements, reviewing insurance issues, receiving and issuing certificates of insurance, to training and consulting on property and casualty insurance matters. The RMD has made great strides in becoming the focal point for the state's property and casualty insurance needs.

Property 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.

From FY96 to FY01, reinsurance premiums decreased by 37 percent, or $414,296, due to the RMF's growing financial strength and favorable loss experience, as well as increased risk retention. In addition to reduced reinsurance costs, added value was derived from coverage enhancements. Coupled with adverse changes in the reinsurance marketplace and unfavorable RMF loss experience, reinsurance costs then escalated. We experienced an 87 percent increase in reinsurance costs in FY02 and a staggering 238 percent increase in FY03.

By FY04, the RMF property loss experience had begun to show signs of improvement and the tremendous hardening of the reinsurance market began to subside. The timing of both of these events led to the RMF being able to obtain reinsurance from a public entity-specific property reinsurer at a 10 percent cost savings. As an added benefit, the reinsurer included loss control services in the reinsurance cost.

Managing future reinsurance costs, while at the same time maintaining appropriate coverages, limits of liability, and terms and conditions, will be ongoing challenges.

Risk Management Fund Advisory Committee

Frank Ahrens
Department of Public Safety
Fiscal & Administrative Services

Sieglinde Bier
MN State Colleges and Universities

Asst Commissioner
Department of Administration

Mary Lou Houde
Department of Commerce
Registration & Insurance

Bill Hoyt
Metropolitan Airports Commission

Tom Hugdahl
3M Insurance Department (Retired)

Phillip Blue
Department of Administration
Risk Management Division

John King
Department of Corrections

Merrill King
Department of Finance

Terry Lahti
Department of Natural Resources

Linda Lunzer
Attorney General's Office

Tim Morse
Department of Administration
Travel Management Division

Mary Pittelko
State Agricultural Society (State Fair)

Richard Swanson
Department of Transportation

Amy Trumper
Department of Administration

Gary Westman
Department of Employee Relations

Peter Young
University of St. Thomas

Risk Management Fund Advisory Committee Members and RMD staff: (back row, left to right) – Gary Westman, Mary Pittelko, Mary Lou Houde, Fred Johnson (last Advisory Committee Meeting), Amy Trumper, Terry Lahti, Tim Morse, Linda Lunzer, Bill Hoyt; (front row) Sieglinde Bier, Marlys Williamson, Caroline Wisniewski
Absent: Frank Ahrens, Tom Hugdahl, John King, Merrill King, Richard Swanson, and Peter Young

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Back row (left to right): Tom Chukel, Gay Scharpen, Phil Blue, Caroline Wisniewski, Lea Shedlock
Front row: Marlys Williamson, Dave Agren, Denise McGovern, Erica Richards, Carol Morgan

Client Agencies and Political Subdivisions

Administrative Hearings, Office of
Agriculture, Department of
Amateur Sports Commission
Attorney General
Building Codes & Standards
Center for Criminal Justice & Law Enforcement
Chicano Latino Affairs Council
Chiropractic Examiners, Board of
Communications Media
DocuComm
MailComm
ReComm
Corrections, Department of
Dakota County
Deaf/Blind Learning Academies
Dentistry, Board of
Developmental Disabilities Council
Education, Department of
Electricity, Board of
Emergency Medical Services Regulatory Board
Employment and Economic Development, Department of
Environmental Assistance, Office of
Financial Management & Reporting
Gambling Control Board
Governor's Office
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
Iron Range Resources
Judicial Standards, Board of
Labor & Industry, Department of
Lawyers Professional Responsibility Board
Management Analysis
Medical Practice, Board of
Metropolitan Airports Commission
Metropolitan Council
Metropolitan Radio Board
Military Affairs, Department of
MN State Lottery
MN State Colleges and Universities – all facilities
MN Technology
National Sports Center
Natural Resources, Department of
Nursing, Board of
Nursing Home Examiners BENHA, Board of
Office Supply Connection
Ombudsman for Mental Health & Mental Retardation
Perpich Center for Arts Education
Pharmacy (ASU), Board of
Physical Therapy, Board of
Plant Management
Podiatric Medicine, Board of
Pollution Control Agency
Public Defense, Board of
Public Employees Retirement Association
Public Safety, Department of
Public Service, Weights & Measures
Revenue, Department of
Risk Management
Secretary of State
Social Work, Board of
STAR Program
State Agricultural Society (State Fair)
State Architect's Office
State Armory Building Commission
State Arts Board
State Auditor
State Energy Office
State Services for the Blind
State Treasurer, Office of
Supreme Court – Board of Law Examiners
Surplus Services
Teachers Retirement Association
Technology, Office of
Transportation, Department of
Travel Management
Veterans Affairs
Veterans Homes Board – all locations
Veterinary Medicine, Board of
Zoological Board

A LOOK AT SOME OF OUR CLIENTS

State of Minnesota
Risk Management Fund
Statement of Net Assets
June 30, 2004

ASSETS	FY04	FY03
CURRENT ASSETS		
Cash	$14,460,048.40	$13,493,240.01
Accounts Receivable	34,624.02	24,275.62
Prepaid Expenses	0.00	0.00
Prepaid Reinsurance	0.00	0.00
Prepaid Billback Insurance	234,193.41	263,132.74
Reinsurance Recoverable	135,000.00	4,134,252.00
Securities Lending Collateral (Note 6)	0.00	0.00
Total Current Assets	14,863,865.83	17,914,900.37
NON-CURRENT ASSETS		
Capital Assets (Note 3)	14,180.72	0.00
Less: Accumulated Depreciation	(3,546.00)	0.00
Total Non-Current Assets	10,634.72	0.00
TOTAL ASSETS	**14,874,500.55**	**17,914,900.37**
LIABILITIES		
CURRENT LIABILITIES		
Accounts Payable	45,362.82	46,066.20
Salaries Payable	26,338.04	25,439.38
Claims Payable	3,744,758.00	7,114,517.00
Claims Payable – IBNR (Note 1)	4,396,719.00	4,599,322.00
Claims Payable – Reinsurance Due to Insureds	0.00	0.00
Due to Other Funds (Note 5)	62,682.17	256,795.00
Dividend Payable	0.00	0.00
Unearned Premium – Self Insurance	41,285.00	34,795.00
Unearned Premium – Worker's Comp.	0.00	0.00
Unearned Premium – Billback	253,563.00	276,073.00
Compensated Absences Payable (Note 4)	2,688.05	3,358.01
Securities Lending Collateral (Note 6)	0.00	0.00
Total Current Liabilities	**8,573,396.08**	**12,356,365.59**
NONCURRENT LIABILITIES		
Compensated Absences Payable (Note 4)	42,387.95	67,324.69
Total Noncurrent Liabilities	**42,387.95**	**67,324.69**
TOTAL LIABILITIES	**8,615,784.03**	**12,423,690.28**
NET ASSETS (Note 7)		
Invested in Capital Assets, Net of Related Debt	10,634.72	0.00
Unrestricted Net Assets (Note 6)	6,248,081.80	5,491,210.09
TOTAL NET ASSETS	**6,258,716.52**	**5,491,210.09**

State of Minnesota
Risk Management Fund
Statement of Revenues, Expenses & Changes in Net Assets
June 30, 2004

	FY04 YTD	FY03 YTD
OPERATING REVENUES		
Insurance Premiums – Self Insurance	9,171,522.00	9,082,859.00
Insurance Premiums – Worker's Compensation	0.00	119,559.00
Insurance Premiums – Billback	816,378.00	1,154,740.00
Consulting Services	3,238.00	2,012.00
Total Operating Revenue	**9,991,138.00**	**10,359,170.00**
OPERATING EXPENSES (Note 1)		
Claims – Self Insurance	3,063,085.66	3,139,226.27
Claims – Worker's Compensation	0.00	195,336.17
Claims – Billback	0.00	0.00
Claims – IBNR	(202,603.00)	1,413,970.00
Salaries & Benefits	718,943.09	707,292.48
Rent	33,424.40	43,952.11
Advertising	1,878.07	600.05
Repairs	0.00	436.33
Insurance	(943.00)	417.00
Insurance Premium – Billback	816,378.00	1,154,740.00
Insurance Premium – Self Insurance	2,903,662.00	3,206,085.00
Printing	12,317.81	15,767.72
Professional Services – Adjuster	187,569.68	196,979.50
Professional Services – Broker	19,500.00	63,250.00
Professional Services – Legal and Other	27,802.66	51,068.15
Computer Services	20,194.42	13,005.72
Communications	8,253.55	10,742.70
Travel	3,407.75	6,711.39
Other Operating Costs	13,179.37	4,392.31
Memberships & Employee Development	1,063.00	1,268.00
Supplies	24,249.83	37,241.44
Depreciation	3,546.00	0.00
Indirect Costs	55,152.00	73,190.00
Total Operating Expenses	**7,710,061.29**	**10,335,672.34**
OPERATING INCOME (LOSS)	**2,281,076.71**	**23,497.66**
NON-OPERATING REVENUE (EXPENSES)		
Interest Earnings	154,644.72	277,409.14
Policyholder Dividend Expense	(1,668,215.00)	0.00
Crisis Management Grant	0.00	0.00
Total Non-Operating Revenue (Expenses)	**(1,513,570.28)**	**277,409.14**
CHANGE IN NET ASSETS	**767,506.43**	**300,906.80**
NET ASSETS, BEGINNING	5,491,210.09	5,670,515.17
Adjustment to Net Assets (Note 8)	0.00	(480,211.88)
NET ASSETS, ENDING	**6,258,716.52**	**5,491,210.09**

State of Minnesota
Risk Management Fund
Footnotes to Financial Statements
Year Ended June 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The Fund provides auto liability, general liability, auto 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 Fund also purchases reinsurance from reinsurance companies to protect itself from catastrophic losses and the aggregation of losses. The Fund 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.

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

An estimated liability has been included for claims incurred but not reported (IBNR).

This financial statement includes claims information known as of June 30, 2004 for claims incurred prior to July 1, 2004.

2. LEGISLATION AND AUTHORITY

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

3. CAPITAL ASSETS

	Acquisition Cost	Accrued Depreciation
Balances as of 07/01/03	-0-	-0-
Additions – Server Equipment	14,180.72	
Deletions		
Write-offs		
Current Depreciation		(3,546.00)
Balances as of 06/30/04	14,180.72	(3,546.00)

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. In FY03, the Department of Finance made a change in calculating the short-term liability portion of compensated absences. The short-term liability is based on the assumption that what is earned in the next year will be used first, and only a small portion of the balances will be used in the next year.

5. DUE TO OTHER FUNDS

In January 2004, Risk Management used health and safety funds to purchase a defibrillator from Philips Medical Systems. The total cost was $2,431.83.

In FY03, the Department of Administration became a participant in a new Worker's Compensation plan. The previous Worker's Compensation plan for the Department of Administration, administered by Risk Management, had a surplus balance. Funds are returned to the appropriate division based on the status of outstanding claims.

6. 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. In FY03, the Department of Finance made the decision to not allocate an amount for securities lending collateral to the Risk Management Fund due to the immaterial amount.

7. NET ASSETS

During FY02, the State of Minnesota implemented new accounting standards, as prescribed by the Governmental Accounting Standards Board (GASB). The standards include revised statement formats that resulted in the change from retained earnings to net asset reporting. For historical cost comparison, the total net assets and the retained earnings have been reconciled as shown below.

Invested in Capital Assets, Net of Related Debt	10,634.72
Unrestricted Net Assets	6,248,081.80
Total Net Assets	6,258,716.52

Schedule of Retained Earnings

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
Beginning Retained Earnings	5,491,210.09	4,037,408.78	4,650,187.29	5,362,406.09
Prior Period Adjustment	0.00	0.00	0.00	0.00
Quarterly Net Income (Loss)	(1,453,801.31)	612,778.51	712,218.80	896,310.43
Ending Retained Earnings	4,037,408.78	4,650,187.29	5,362,406.09	6,258,716.52
Add: Capital Contributions	0.00	0.00	0.00	0.00
Reconciliation to Total Net Assets	4,037,408.78	4,650,187.29	5,362,406.09	6,258,716.52

8. ADJUSTMENTS TO NET ASSETS

In FY03, the adjustments to net assets are the summation of the following:

** Risk Management Fund disbursed surplus funds related to the agency's Worker's Compensation plan. The total funds that will be returned equal $572,160, of which $315,365 have already been released.

** Paid $511.88 for a returned Billback premium from FY2002.

** Adjusted Accounts Payable for a FY02 overstatement of $19,600.

** Adjusted Accounts Receivable for a FY02 understatement of $72,860

STATEMENT OF ACTUARIAL OPINION
REGARDING THE STATE OF MINNESOTA
ASSUMED AUTO AND LIABILITY OTHER THAN AUTO RETAINED LIABILITIES
AS OF MARCH 31, 2004

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, 1994 through March 31, 2004, listed by accident period as of March 31, 2004 are as follows:

		(1)	(2)	(3)	(4) =(3)-(2)	(5) =(1)-(3)	(6) =(4)+(5)
Accident Period Beginning:	Ending:	Ultimates @3/31/2004	Paid Losses @3/31/2004	Incurred Losses @3/31/2004	Case O/S Reserves @3/31/2004	IBNR Reserves @3/31/2004	Total Reserves @3/31/2004
7/1/1994	6/30/1995	1,888,553	1,863,553	1,888,556		-	
7/1/1995	6/30/1996	915,700	914,374	914,374	-	1,326	1,326
7/1/1996	6/30/1997	1,695,200	1,670,316	1,690,316	20,000	4,884	24,884
7/1/1997	6/30/1998	1,757,100	1,706,136	1,753,492	47,357	3,608	50,964
7/1/1998	6/30/1999	952,600	890,372	890,372	-	62,228	62,228
7/1/1999	6/30/2000	1,320,500	1,167,409	1,273,079	105,670	47,421	153,091
7/1/2000	6/30/2001	1,379,700	1,172,369	1,325,938	153,570	53,762	207,331
7/1/2001	6/30/2002	1,175,900	711,744	1,046,037	334,293	129,863	464,156
7/1/2002	6/30/2003	1,544,400	463,306	998,182	534,876	546,218	1,081,094
7/1/2003	3/31/2004	1,733,850	306,583	860,186	553,603	873,664	1,427,267
Totals:		14,363,503	10,891,162	12,640,529	1,749,367	1,722,974	3,472,341

The State of Minnesota's retained liability, other than auto liability for accident periods July 1, 1994 through March 31, 2004, listed by accident period as of March 31, 2004, 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:	@3/31/2004	@3/31/2004	@3/31/2004	@3/31/2004	@3/31/2004	@3/31/2004
7/1/1994	6/30/1995	56,902	56,902	56,902	-	-	-
7/1/1995	6/30/1996	151,000	150,753	150,753	-	247	247
7/1/1996	6/30/1997	243,800	242,445	242,445	-	1,355	1,355
7/1/1997	6/30/1998	212,300	210,722	210,722	-	1,578	1,578
7/1/1998	6/30/1999	182,400	155,757	182,173	26,416	227	26,643
7/1/1999	6/30/2000	129,700	85,236	129,600	44,364	100	44,464
7/1/2000	6/30/2001	592,900	444,042	585,143	141,101	7,757	148,858
7/1/2001	6/30/2002	732,900	266,474	632,200	365,726	100,700	466,426
7/1/2002	6/30/2003	727,500	83,498	563,202	479,704	164,298	644,002
7/1/2003	3/31/2004	458,400	40,884	126,747	85,863	331,653	417,516
Totals:		3,487,802	1,736,713	2,879,886	1,143,174	607,916	1,751,089

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, 1994 through March 31, 2004. 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, 2004.

Note that this estimate is based upon actuarial assumptions as to future contingencies deemed to be reasonable and appropriate under the circumstances. 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. In today's environment, all entities are subject to the terrorist attack exposure. RMD's terrorist attack exposure cannot be reasonably estimated. Thus, only reserves excluding terrorist attacks are determined.

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

14 April, 2004
Date

/s/ Todd A. Gruenhagen
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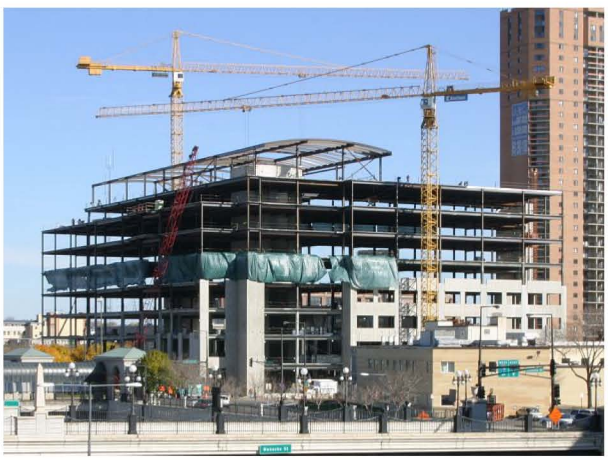
RTAG Consulting & Software, Inc. **F4**

Looking Ahead

April 30, 2004 – Orville Freeman Office Building future home of Agriculture/Health offices

June 30, 2004 – Departments of Agriculture and Health laboratories



October 25, 2004 – Elmer L. Andersen Human Services Office Building

October 25, 2004 – Construction progresses on Ag/Health, lab, and Human Services buildings

Many opportunities are coming. Upon completion of the three new Capitol Complex office and lab buildings, Risk Management will add them to the property insurance program. While we maintain our property loss control program, greater emphasis will be placed on loss prevention for other lines of business. We will continue to expand our client base to ensure responsible management of the state's assets. Contingent upon good loss experience, the larger our base, the more favorable our reinsurance rates become, and the more affordable the program is for all our customers. That is what we are here for – to ensure the long-term financial security of our customers.

Watch how construction (completion fall 2005) progresses by going to the State Architect's Office web site – http://www.sao.admin.state.mn.us/projects/capcompphoto.asp

Fall 2004 – Skyline view of Capitol Complex construction projects

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DEPARTMENT OF ADMINISTRATION

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