Report

of the

Examination of

Local Government Property Insurance Fund

Madison, Wisconsin

As of June 30, 2006

TABLE OF CONTENTS

Page

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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April 6, 2007

Honorable Sean Dilweg
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53703

Commissioner:

In accordance with your instructions, a targeted examination has been performed as of June 30, 2006, of the affairs and financial condition of:

Local Government Property Insurance Fund
Madison, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The most recent audit of the Local Government Property Insurance Fund (Fund) was made in 2005, as of June 30, 2004, by the Legislative Audit Bureau (LAB). The Fund is audited by LAB on a routine cycle. This is the third examination of the Fund by this office. The previous examinations of the Fund conducted by OCI were as of December 31, 1974, and as of June 30, 1986. The current targeted examination covered the period from June 30, 2001, through June 30, 2006, and included a review of such subsequent transactions deemed essential to complete this examination.

The "Summary of Examination Results" contains elaboration on all areas of the Fund's operations that were examined. Special attention was given to the action taken by the Fund to satisfy the recommendations and comments made in the previous LAB audit report and areas accorded a high priority by the examiner-in-charge. Corporate records, investments, and underwriting were not reviewed in this examination.

The Fund was organized as the State Property Insurance Fund in 1903, under the provisions of the then existing Wisconsin Statutes. Between 1911 and 1913, coverage was extended to include the property of counties, towns, cities, villages, school districts, and library boards, when it was difficult for these units of government to obtain reasonably priced coverage in the private sector. In 1979, the current name was established to signify the Fund's purpose in insuring nonstate-owned government properties and coverage of state-owned property was transferred to a self-funded program administered by the Wisconsin Department of Administration.

The Fund is currently licensed to insure all property of local governmental units throughout the state for all risks except those resulting from flood, earthquake, wear and tear, extremes in temperature, mold, war, nuclear reactions and embezzlement or theft by an employee.

Contracted Services

This office operates the Fund and hires an Administrator, who performs administrative services and claims administration, through a competitive bidding process. The ASU Group (Administrator), of Okemos, Michigan, is the current Administrator. The examination of the Fund primarily focused on services provided by the Administrator at its Madison office.

A review was made of the policy and application forms currently used by the Fund. The Fund issues approved policies with or without endorsements for terms of one year with premiums payable on an annual basis. The Fund charges no policy fees.

The Fund is not actively promoted and no sales commissions are paid. Business of the Fund is acquired primarily through word of mouth or from information available on the OCI Web site. Claims are adjusted by the Administrator through the contract mentioned above.

Advisory Committee

The Fund has a volunteer Advisory Committee to maintain an open line of communication between policyholders and the Fund and to provide professional expertise and input. The committee consists of up to 21 members; each member shall be a person employed, elected or appointed by a local governmental unit, as defined in s. 605.01, Wis. Stat., and shall be

a policyholder of good standing in the Fund. Members should have a responsibility for, or an interest in, the matters of first-party insurance for the respective local governmental unit appointing them to serve. No more than one representative of a local governmental unit may serve on the committee at any one time nor shall any member receive any type of compensation from business affiliations or relationships with any other local governmental unit. The Chairperson is to use their best effort to assure representation of the members is allocated by type as follows:

School Districts	5
Counties	5
Cities	4
Other	3
At-Large	4

The Advisory Committee currently consists of the following members:

Name	Principal Occupation	Entity	Expiry
Renee Carlson	Town Clerk	Town of Gillett	2007
Carole Charles	Risk Administrator	Outagamie County	2009
Connie Goss	Risk Manager	Chippewa County	2008
Gary Hansen	Superintendent	Rosendale-Brandon S.D.	2007
Julee Helt	Village Clerk	Village of Waunakee	2009
Diane Kropiwka	Administrative Assistant	City of Mauston	2009
Don Lafontaine	Purchasing Agent	City of Oshkosh	2008
Judy Litscher	Acting Risk Manager	Milwaukee County	2008
Glinda Loving	Risk Management Spec.	Milw. Metro Sewer Dist.	2009
Keith Lucius	Director of Bus. Services	Ashwaubenon S.D.	2007
Mary Lee Powell	Clerk	Village of Dickeyville	2009
Ken Rogers	District Administrator	Eleva-Strum S.D.	2007
Jerry Runice	Superintendent	Berlin Area S.D.	2008
Doug Saubert	Finance Director	City of Whitewater	2009
Joanne Sievert	Clerk-Treasurer	Town of Clayton	2007
Laura Stauffer	Risk Manager	Waukesha County	2009
Ken Tronnier	Purchasing Manager	Portage County	2008
Jeff Warnock	Risk Manager	City of Kenosha	2007
Barb Wegner	Risk Manager	Dane County	2008
Tom Wohlleber	Assistant Superintendent	Middleton-Cross Plains Area S.D.	2008
Jim Wyss	City Attorney	City of Manitowoc	2007

Officers

Officers are elected by the Advisory Committee from among its members, hold office for one year, and are eligible for re-election. Officers' service is also voluntary. Those serving at the present time are as follows:

Name	Office
Glinda Loving	Chair
Connie Goss	Vice Chair
Doug Saubert	2nd Vice Chair

Committees of the Advisory Committee

The Fund's Advisory Committee bylaws allow for the formation of certain committees by the officers. The committees at the time of the examination are listed below:

Loss Control Committee
Carole Charles, Chair
Connie Goss
Joanne Sievert
Ken Tronnier
Barbara Wegner
Tom Wohlleber

Claims & Policy Issues Committee
Don LaFontaine, Chair
Julee Helt
Kenneth Rogers
Jerry Runice
Doug Saubert
Jim Wyss

Reinsurance/Flood Committee
Glinda Loving, Chair
Diane Kropiwka
Judy Litscher

Rate Analysis
Doug Saubert, Chair
Carole Charles
Glinda Loving
Keith Lucius
Laura Stauffer

Bylaws Committee
Mary Lee Powell, Chair
Renee Carlson
Doug Saubert
Barbara Wegner

Oversight Committee

The Commissioner acts as the Fund's ultimate manager. An Oversight Committee is maintained to take into consideration Advisory Committee recommendations and provide guidance for the Fund. Current members of the Oversight Committee are the following:

John Montgomery, Insurance Administrator, Chair
Danford Bubolz, Insurance Program Officer (IPO)
Rhonda Peterson, Property & Casualty Section Chief
Glinda Loving, Acting Chair – Advisory Committee
Connie Goss, Acting Vice Chair – Advisory Committee
Peter Medley, Insurance Financial Examiner Supervisor

Growth of the Fund

The growth of the Fund since the previous examination as compiled from its filed annual statements was as follows:

As of June 30,	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2006	$21,177,450	1,156	$ 4,475,789	$53,901,908	$38,995,906
2005	20,958,820	1,160	10,251,790	45,867,340	34,520,117
2004	20,953,893	1,203	9,793,162	36,121,455	24,268,328
2003	12,644,019	1,206	(2,472,109)	28,083,841	14,475,165
2002	10,017,732	1,183	(3,871,950)	28,047,340	16,947,274

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

As of June 30,	Gross Premiums Written	Net Premiums Written	Policyholders' Surplus	Writings Ratios Net	Gross
2006	$23,964,981	$20,141,263	$38,995,906	61%	52%
2005	25,099,214	21,090,978	34,520,117	73	61
2004	26,948,848	20,691,446	24,268,328	111	86
2003	21,994,653	16,280,560	14,475,165	152	112
2002	13,302,448	9,824,208	16,947,274	78	58

For the same period, the company's operating ratios were as follows:

As of June 30,	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Premiums Earned	Loss Ratio	Expense Ratio	Com-posite Ratio
2006	$17,393,352	$1,419,754	$21,177,450	82%	7%	89%
2005	10,022,547	1,740,815	20,958,820	47	8	55
2004	10,523,346	1,447,306	20,953,893	50	7	57
2003	14,852,229	1,183,691	12,644,019	117	9	126
2002	14,159,150	1,078,182	10,017,732	141	11	152

The Fund experienced high loss ratios in 2002 and 2003 due to large losses from fire and catastrophe windstorm claims in those years. The net and gross writings ratio for 2003 and 2004 were higher than usual after the Fund increased rates to build to surplus. As surplus and premiums have remained at adequate levels since 2004, the writings ratio has returned to a more conservative level. The Fund has consistently maintained a low expense ratio; there are no commissions or marketing expenses.

II. REINSURANCE

The Fund purchases reinsurance on an annual basis each year beginning in March. The examiners' review of the Fund's reinsurance portfolio revealed there are currently five ceding treaties as shown below:

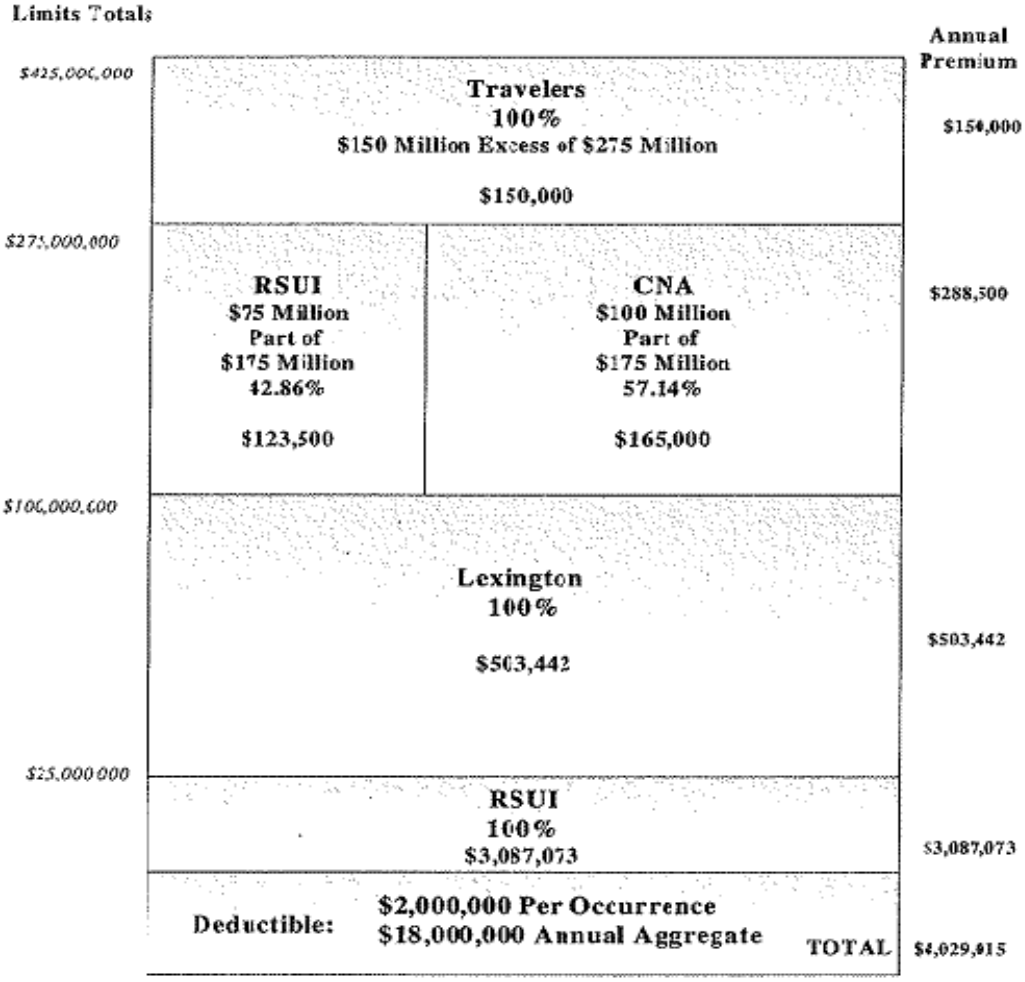
1.	Type of contract:	Property Excess of Loss – Primary Layer
	Reinsurer:	RSUI Indemnity Company
	Effective date:	March 31, 2007
	Lines reinsured:	All risk of direct physical loss or damage including flood and earthquake (at stated sublimits)
	Company's retention:	$2,000,000 per occurrence; $18,000,000 annual aggregate Only losses in excess of $5,000 per occurrence shall apply against the annual aggregate Once the annual aggregate has been reached the deductible becomes $10,000 for all perils
	Coverage:	$25,000,000 per occurrence including $20,000,000 annual aggregate separately on flood and earthquake*
	Reinsurance premium:	$3,087,073 includes terrorism coverage
	Wholesaler commission:	$79,955; paid to surplus lines broker for access to the reinsurer for this layer and part of 2nd Excess Layer
	Termination provisions:	90-day notice of cancellation/10 days for nonpayment
2.	Type of contract:	Property Excess of Loss – 1st Excess Layer
	Reinsurer:	Lexington Insurance Company
	Effective date:	March 31, 2007
	Lines reinsured:	All risk of direct physical loss or damage excluding flood and earthquake
	Coverage:	$75,000,000 excess of $25,000,000 per occurrence
	Reinsurance premium:	$503,442 includes terrorism coverage
	Termination provisions:	90-day notice of cancellation/10 days for nonpayment

* Although the Fund's policy form specifically excludes coverage for flood and earthquake, the excess of loss (reinsurance) coverage provides coverage on a limited basis for these two perils in order to limit the excess insurer's exposure in the event that a court would require the Fund to pay a claim resulting from a flood or an earthquake event.

3.	Type of contract:	Property Excess of Loss – part of 2nd Excess Layer
	Reinsurer:	RSUI Indemnity Company
	Effective date:	March 31, 2007
	Lines reinsured:	All risk of direct physical loss or damage excluding flood and earthquake
	Coverage:	$75,000,000 part of $175,000,000 excess of $100,000,000 per occurrence
	Reinsurance premium:	$123,500 includes terrorism coverage
	Termination provisions:	90-day notice of cancellation/10 days for nonpayment
4.	Type of contract:	Property Excess of Loss – part of 2nd Excess Layer
	Reinsurer:	Continental Casualty Company
	Effective date:	March 31, 2007
	Lines reinsured:	All risk of direct physical loss or damage excluding flood, earthquake, and boiler & machinery
	Coverage:	$100,000,000 part of $175,000,000 excess of $100,000,000 per occurrence
	Reinsurance premium:	$165,000 includes terrorism coverage
	Termination provisions:	90-day notice of cancellation/10 days for nonpayment
5.	Type of contract:	Property Excess of Loss – 3rd Excess Layer
	Reinsurer:	Travelers Indemnity Company
	Effective date:	March 31, 2007
	Lines reinsured:	All risk of direct physical loss or damage excluding flood and earthquake
	Coverage:	$150,000,000 excess of $275,000,000 per occurrence
	Reinsurance premium:	$150,000 includes terrorism coverage
	Termination provisions:	90-day notice of cancellation/10 days for nonpayment

The following page shows the current structure of the Fund's reinsurance program.

LGPIF – 2007/08 Program Structure
TIV: $41,032,247,790



III. FINANCIAL DATA

The following financial statements reflect the financial condition of the Fund as reported to the Commissioner of Insurance in the June 30, 2006, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Local Government Property Insurance Fund
Statement of Assets and Liabilities
As of June 30, 2006

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash deposited in checking account	$ 995	$	$	$ 995
Short-term investments	48,932,000			48,932,000
Bonds	3,997,231			3,997,231
Premiums, agents' balances and installments:				
In course of collection	746,380			746,380
Investment income accrued	225,302			225,302
Totals	$53,901,908	$	$	$53,901,908

Liabilities and Surplus

Net unpaid losses	$ 8,566,942
Unpaid loss adjustment expenses	140,536
Unearned premiums	5,798,195
Other liabilities:	
Expense related:	
Accounts payable	400,329
Total Liabilities	14,906,002
Policyholders' surplus	38,995,906
Total Liabilities and Surplus	$53,901,908

Local Government Property Insurance Fund
Statement of Operations
For the Year 2006

Net premiums and assessments earned		$21,177,450
Deduct:		
Net losses incurred	$16,703,125	
Net loss adjustment expenses incurred	690,227	
Other underwriting expenses incurred	1,419,755	
Total losses and expenses incurred		18,813,107
Net underwriting gain (loss)		2,364,343
Net investment income:		
Net investment income earned		2,111,446
Net income (loss) before federal income taxes		4,475,789
Net Income (Loss)		$ 4,475,789

Local Government Property Insurance Fund
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending June 30, 2006

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2006	2005	2004	2003	2002
Surplus, beginning of year	$34,520,117	$24,268,328	$14,475,165	$16,947,274	$20,819,224
Net income	4,475,789	10,251,790	9,793,162	(2,472,109)	(3,871,950)
Surplus, end of year	$38,995,906	$34,520,117	$24,268,328	$14,475,165	$16,947,274

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the Fund as of June 30, 2006, is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

This report reviewed the Fund's compliance plan and actions regarding the LAB's most recent audit; however, the LAB will make its own determination in regards to the Fund's compliance with the LAB's prior recommendation. Comments and recommendations contained in the LAB audit report and the action taken on them by the Fund are as follows:

1. Records Disposal Authorizations—It is recommended the Fund maintain records in accordance with state record disposal authorization rules.

   Action—Each employee of the Administrator has completed annual records retention training and adheres to these rules.

Current Examination Results

Annual Statement Values

Audit software and procedures were used in the claim and premium testing noted below to verify the accuracy and completeness of numerous premium, loss, expense and reinsurance annual statement values as of June 30, 2006. Examiners verified: direct and net premium written; direct and net premium earned; uncollected premium; unearned premiums; direct and net losses incurred; direct and net loss adjustment expenses; unpaid net losses and loss adjustment expenses; and other expenses. Investment and income balances and their related records were not examined. Exceptional items were noted as follows:

- There are two categories of Loss Adjusting Expense – Defense and Cost Containment (DCC), and Adjusting and Other (A&O). The Fund has not reported any DCC payments over the statement periods reviewed. Estimated DCC expenses for 2006 were $69,390, which is not material. However, these expenses should be separated from A&O and be reported on Schedule P – Part 1 of the annual statement. It is recommended that the Administrator properly report defense and cost containment expenses in accordance with NAIC Annual Statement Instructions-Property and Casualty.
- The Fund's reinsurance contract states that the annual premiums paid are adjustable based upon the average annual value of insurance in force over the year. The total insured value as of December 31, 2005, $38,363,710,301, was used for the reinsurance contracts for the March 31, 2006, to March 31, 2007, contract year. Though they had done so in the four prior annual statements, the Administrator did not recognize a liability for the potential change in total reinsurance premium due over the reinsurance contract period in the annual statement as of June 30, 2006. The total value of property insured by the Fund increased to $41,032,247,790 as of December 31, 2006, which resulted in an increase of 3.5% in the average total value of the property insured by the Fund during 2006. According to the reinsurance contracts, premiums could be increased up to this percentage. It is recommended the Administrator establish a liability to account for the potential change in total reinsurance premium due over the reinsurance contract period.

Claims Testing

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and claims which were denied during the examination period. The examiners chose a sample from the register of claims from June 30, 2001, through December 31, 2006, which included a total of 11,595 claims. A sample of 85 claims was selected using a combination of approaches including probability-proportional-to-size (PPS) sampling, random sampling, and other claims as determined in planning. All 43 claims over $250,000 (paid or reserved) from the claims register were included in the sample, as were every type of member and every transaction type (i.e., paid, unpaid or closed with payment). The sample size was determined using the level of risk identified and the NAIC Financial Condition Examiner's Handbook standards. Many results of the testing of claims were part of the performance standards discussed in the next section.

Performance Standards

As stated in the contract with OCI for administrative and claims services, the Administrator shall be reasonably audited for compliance with the performance goals, standards and measures included in the contract. The Administrator and IPO have established 18 standards to be reviewed on a quarterly basis.

A significant part of the examination of the Fund involved audit steps performed by the examiners to determine whether the Administrator was meeting the agreed-to performance standards – including a review of the underlying data used by the Administrator in generating the performance reports. The majority of these standards involve claims processing which were reviewed during claims testing.

Results of the examination of performance standards were as follows:

1. File closure ratio – The examiners used auditing software to analyze the files opened and those closed within the last year. The Administrator's software consultant performs a similar procedure each quarter using proprietary software. The resulting ratio of opened to closed files was less than the 1:1 standard, which favorably exceeds the current standard.

2. Date received to date added – The examiners reviewed the documentation from claims in the sample and compared the date the claim was reported to the Administrator with the

date the claim file was created in the computer system. The Administrator sends a letter to the insured notifying them of the receipt of the claim, along with any further instructions. The examiners found 8 of the 85 files examined had differences of 4 or more days between the reported date in the system and the documentation in claim files – 3 of these 8 reports of a claim were not date stamped, so no determination of date received could be made. Further investigation found the "reported date" in the claims system is automatically generated as the date the claim is initiated in the computer system. Using the computer-generated date can afford extra time for completion of time-sensitive tasks measured in the performance standards because this date may be later than the actual reported date on the loss reporting form. Though the Administrator appears to be meeting 2.5-day standard, it is recommended that the Administrator manually enter the reported date of loss from the loss reporting form, or other evidence of the reported claim, into the claim system. It is also recommended that the Administrator date stamp all policy and claim materials when received to establish a time of receipt of these items.

3. Policyholder contact – The examiners reviewed the claim files for documentation of contact with the insured within the period of time designated in the performance standard (80% within 24 hours; 100% within 48 hours). The examiners found evidence of policyholder contact within the standard timeframes for all claims in the sample.

4. Prompt investigation of claim/incident is conducted – The examiners reviewed the claim files for documentation of initial investigation of claims within the period of time designated in the performance standard (3 business days). The examiners found evidence of initial investigation of claims within the standard timeframe for all claims in the sample.

5. Prompt initial review of claim is conducted with policyholder – The examiners reviewed the claim files for documentation of initial review of the claim with the policyholder within the standard timeframe (30 days). The examiners found evidence of initial review with the policyholder within the standard timeframe for all claims in the sample.

6. Prompt initial review of litigated claim is conducted with policyholder – The examiners reviewed the litigated claim files for documentation of initial review of the litigated claim with the policyholder within the standard timeframe (60 days). There were only four of these

claims in the sample. Examiners found evidence of initial review with the policyholder within the standard timeframe for all claims in the sample.

7. Claim/incident information is accurately captured in system – The examiners reviewed the claim files to verify accuracy of the data elements in 12 categories (i.e., insured name, policy number, loss date, reporting date, loss paid, etc.) within the standard (less than 1% error rate). The examiners found only one data accuracy error in one category of the claims sample data; a loss before deductible was entered incorrectly. Overall, the error rate was much lower than the performance standard.

8. Initial reserves established, reviewed at 30-day intervals and restated at 6-month intervals – The examiners reviewed claim files for documentation of the initial establishment of reserves and periodic changes throughout the life of the claim. The Administrator uses a diary system for timed-interval review or adjusts reserves based on new information. The examiners found evidence of the initial establishment of reserves and periodic adjustments were in compliance with the performance standards.

9. Reservation of rights/denial letter are issued when appropriate – During claims testing, the examiners reviewed claim files for appropriate use of reservation of rights letters and denial letters. There were 11 claims in the sample for which one of the letters was issued to the policyholder. Examiners reviewed them and found conditions existed which warranted the issuance of one of the letters. For files where no letter was issued, there did not appear to be a condition which would have warranted the issuance of a letter.

10. Recommendations and counsel are provided on proposed settlements – The examiners reviewed the claim files for documentation of requests for counsel when appropriate. Additionally, the examiners reviewed the counsel request log as provided to the IPO during periodic meetings with the Administrator. The examiners found counsel was requested in appropriate circumstances.

11. Hourly charges and allowable expenses are reviewed in accordance with litigation management standards – The examiners reviewed expenses in the claim file sample to determine compliance with the litigation and billing guidelines included in the Administrator's

claims procedures manual. The examiners found one instance in the sampled files where the expert's billed expenses exceeded the threshold whereby the IPO's approval was needed. Another request for approval was found in a claim file which had been approved (determined from other correspondence in the file) but was not signed or dated. Additionally, the examiners noted that not all claim, expert, or legal expenses were listed on the hard copy claim set-up form in 3 of the 85 claim files sampled. It is recommended that the Administrator notify the Insurance Program Officer when actual or estimated expert or legal payments are to exceed the threshold level established in the Administrator's claim procedure manual. It is also recommended that the Administrator make screen prints of all claim and expense payments and include these in the hard copy claim file.

12. Provide accurate claim data and support information to the IPO – Testing of this standard consisted of reviewing the claim files for accuracy and tracing payments into the claim payment system. No exceptions were noted in either of these procedures. Additionally, the examiners reviewed the latest Large Loss Report provided to OCI and found no inaccuracies. Based on the procedures above, it appears the Administrator is in compliance with this performance standard.

13. Reviews and recommends potential recoveries to the IPO – Testing of this standard consisted of reviewing the latest Large Loss Report provided to OCI, which includes potential subrogation recoveries. The examiners also reviewed all claims for salvage and subrogation considerations during claims testing. Based on the above procedures, it appears the Administrator is in compliance with this performance standard.

14. Timely recording and payment of claim payments – During claims testing, the examiners reviewed the hard copy claim files, electronic claims system, and the electronic payment system for documentation of timely recording and payment of claims within the standard timeframe (15 days). The examiners found all claim payments sampled were recorded and paid within the standard timeframe.

15. Timely recording and processing of expense payments – During claims testing, the examiners reviewed the hard copy claim files, electronic claims system, and the electronic

payment system for documentation of timely recording and payment of expenses within the standard timeframe (15 days). The examiners found all expense payments sampled were recorded and paid within the standard timeframe.

16. Accuracy of check issuance – During claims testing, the examiners reviewed the claim file documentation, entries in the payment system, and the general ledger for duplicate or voided checks. The examiners found 6 duplicate or voided checks during fiscal year 2006. Considering over 1,500 checks were issued during the year, the error rate is much lower than the performance standard.

17. Timely mailing of surveys – The examiners interviewed the Administrator's District Manager regarding claims surveys. These are mailed by the Administrator via U.S. mail on a monthly basis for all closed claims from the prior month and open claims over $100,000. The insured sends the completed survey to OCI where the results are tallied. Beginning February 2007, all claim and policy surveys are sent out and replied to using e-mail.

The examiners traced 19 surveys received at OCI (the response rate is approximately 10%) to the closed claims report for the 4th quarter 2006 to determine if claim surveys were sent in a timely manner. It appears the Administrator is mailing claim surveys in a timely manner in accordance with the performance standard (by the end of the following month).

18. All new and existing staff are trained in state record retention requirements and the need for state approval before any records may be destroyed – The examiners reviewed the latest state record disposal authorizations (RDAs) at the Administrator's office and reviewed signed and dated forms for each employee to verify annual training and understanding of RDAs. The Administrator is in compliance with this performance standard.

Premium Testing

A total of 90 policy files were tested. Examiners randomly selected 73 files from the policy transactions register from the period June 30, 2004, through December 31, 2006. An additional 17 policy records were haphazardly selected by the examiners in order to include all policy types (i.e., valuation, standard, or coinsurance), transaction types, and types of members in the sample. The 90 sampled policies were reviewed for the presence of a certified resolution in

the file and for the accuracy of payment information, coverage, and premium credits (i.e., alarm, deductibles, dispersion).

Premium payments received were compared with policy summary forms and traced to lockbox deposit slips and canceled checks. Exceptional items were noted as follows:

Examiners found that 11 of the 90 policies sampled (12.2%) were not in compliance with s. 605.21 (1), Wis. Stat. This statute requires a certified copy of the local governmental unit's resolution authorizing insurance from the Fund to be maintained in the policy file. The policy files not in compliance either had no resolution in the file or the file copy was not certified or notarized. The examiners noted that several resolutions in the files were greater than 50 years old, so it is possible that some of the missing resolutions to join the Fund may have been lost over the years or were not certified at the time the municipality joined the Fund. It is recommended that the Administrator and Insurance Program Officer establish specific procedures to ensure compliance with s. 605.21 (1), Wis. Stat., regarding certified resolutions.

Review of cash receipts data entry revealed that 6 out of 90 receipts (6.7%) had data entry errors (i.e., vendor number, check number, date of bank deposit). Claim processing is subject to performance standards regarding data entry and check accuracy; however, there is no performance standard regarding cash receipts accuracy. A recommendation to include cash testing as a standard in quarterly performance reviews is noted in a subsequent paragraph.

Policy coverage review revealed that 3 out of 90 (3.3%) policies had discrepancies between the coverage that was requested by the policyholder and the coverage that was entered into the premium system (i.e., the deductible requested was $1,000, amount entered was $500). However, there is no performance standard regarding policy coverage accuracy. A recommendation to include policy coverage as a standard in quarterly performance reviews is noted in a subsequent paragraph.

Some policies are allowed alarm credits based on installed devices to improve fire protection. A review of alarm credits revealed 4 out of the 90 (4.4%) of the policies had errors between the alarm credit forms and the alarm credit calculations (i.e., some building valuations were excluded from the total calculation or the wrong credit percentage was applied). The

Administrator corrected each of these errors by the end of fieldwork. It was also noted during this review that only the cover page of the policy application packet is date stamped. The policy application packet includes the completed new or renewal policy form and several additional forms from the policyholder. Some of the pages in the policy application packet are removed for placement into the permanent file, and there is no audit trail to determine the receipt dates of the forms. A recommendation to include premium credits as a standard in quarterly performance reviews is noted in the subsequent paragraph. A recommendation for date stamping of all policy material was previously included in the performance standards section.

The prior three paragraphs resulted in similar recommendations to include areas of premium processing as standards in quarterly reviews of the Administrator. For efficiency, these are combined here into one recommendation. Therefore, it is recommended that the quarterly performance reviews be modified to include standards for cash receipts, policy coverage, and premium credit calculations.

The examiners noted that in some instances the policyholder failed to complete fields on the application form (i.e., the amount of the deductible on a building, use of the replacement cost or actual cost of the motor vehicle), and the Administrator processed the request using prior year information. Conversation with Administrator personnel and review of the Administrator's policy procedures manual showed that certain circumstances allowed for the use of the prior year information while other circumstances required contact with the policyholder. The IPO believed that the Administrator would contact the policyholder in every circumstance and then annotate the summary form with the Administrator's employee's initials and date. Examiners were unable to find documentation on the establishment of either procedure. It appears a periodic review by the IPO of the Administrator's procedure manuals would likely identify any disagreement on procedures. It is recommended that the Insurance Program Officer implement a process by which the Administrator's procedure manuals are reviewed on an annual basis.

Other Procedures

Another part of the examination of the Fund involved review of other procedures performed by the Administrator not specifically part of the quarterly performance report noted earlier. The standards tested and the results are as follows:

Processing of Non-Sufficient Fund (NSF) Checks – There are only a few NSF checks received per year; however, there is no established procedure for collecting NSF subrogation checks received from payees and the associated fees pertaining to them. From review of the general ledger, non-sufficient subrogation checks are debited to the Subrogation Received account; however, there is no procedure in place to collect this money or clear these items from the bad check receivable account. It is recommended that the Administrator work with the OCI Agency Accountant and Insurance Program Officer to establish a procedure for non-sufficient fund check processing and accounting.

Maintain Subrogation Files – The Administrator is required to maintain all original claims files relating to ongoing subrogation being collected through the previous administrator. Files for these claims are kept at the current Administrator's office, while duplicate files are retained at the previous Administrator's office for documentation purposes. The examiners traced the latest subrogation recovery worksheet of open subrogation files to the 33 files kept at the current Administrator's office. The examiners determined 16 of 33 files appear to be claim files, and the remaining 17 are open subrogation files. Due to the destruction of claim files, as discussed in the LAB audit as of June 30, 2004, original files were only available on open subrogation claims that escaped destruction. Files that appear to be subrogation only are primarily from claim years 1991 through 1999, and the likelihood that original claim files were not destroyed is remote. It appears that the current Administrator is retaining all original claim files available, and a subrogation file is maintained on subrogation claims where the original is unavailable.

Subrogation Payments – The examiners reviewed the 4th quarter 2006 subrogation fees on the Administrator's invoice to OCI and traced the deductible refund and one payment for each subrogation claim on the report into the payment system to verify the accuracy and

existence of subrogation recoveries and deductible refunds. Additionally, the examiners used the current contract rates and recalculated the fees to verify that the subrogation fees charged were properly calculated. The examiners found no exceptions in tracing each subrogation recovery selected on the contractor invoice to the payment system or in recalculation of the fees due to the Administrator. However, the examiners noted there was no consistently applied policy to refund deductibles to policyholders (i.e., refund deductible to policyholder upon first subrogation receipt, or wait until receipts are equal to deductible before issuing a refund).

The current policy is to refund the full deductible upon the first receipt of subrogation. A more appropriate policy would be for the Fund to return to the policyholder all subrogation recoveries for the applicable deductible within 30 days from the day the subrogation recoveries have accumulated to $100, or amounts accumulated within six months if less than $100. The examiners found that 10 of 45 (22.2%) deductible refunds shown on the Administrator's 4th quarter 2006 invoice could not be traced to the payment system and thus had been posted to the Administrator's accounting system as paid but were not in fact paid to the policyholder through OCI's WISMART accounting system. It is recommended that the Administrator and Insurance Program Officer develop, document, and consistently apply an appropriate procedure for refunding deductibles to the policyholder upon receipt of subrogation payments.

Fee-Based Adjusting – In accordance with the Administrator's contract, loss adjusting services for claims over $500,000 are paid on an hourly basis. Log sheets which document staff time for loss adjusting on these claims are maintained both in the hard copy claim file and in an electronic note file in the claim system; only the electronic file contains details of the activity. The examiners traced the hard copy log sheets to the electronic documentation and recalculated the fees for each claim on the December 2006 invoice sent to OCI. The examiners found one error in which a fee for 0.4 hours, out of a total of 90.2 hours, was entered twice. This resulted in an error rate less than 0.5% of the total bill. The fee-based expenses appear reasonable and no recommendation is noted for this area.

Large Loss Reports/Proof of Loss Forms – Of the 43 losses greater than $250,000 reviewed in claims testing, 17 had a copy of an individual Large Loss Report in the file and 7 had

a signed Proof of Loss report in the file. Most of the signed Proof of Loss reports were obtained by the contracted third-party adjusters based on that adjusting firm's procedures. Neither of these forms is specifically required or discussed in the Administrator's claims procedure manual, except that the Large Loss Report is required when requesting outside counsel.

In preparation for monthly meetings with the IPO, the Administrator prepares an aggregate Open Large Loss Report and Counsel Request Log for review. It appears the Administrator is notifying the OCI of large losses (over $250,000) on a timely basis. However, the requirement or use of the individual Large Loss Report and obtaining a signed Proof of Loss is not consistent. It is recommended that the Insurance Program Officer and Administrator develop procedures for issuing of the individual Large Loss Report and signed Proof of Loss forms and including them in the corresponding claims file.

Notifications to Reinsurer – The examiners performed procedures to determine if the Administrator was providing proper notice to the reinsurer on large losses and aggregate summaries. The examiners reviewed the last two aggregate summaries (as of June 30, 2006, and December 31, 2006), and the latest 72-hour catastrophe claim notification and associated update. It appears the contract Administrator is providing updates to the reinsurer of claims in a timely fashion as required by the reinsurance contracts.

Organizational Review – The organizational chart and staff qualifications of the current Administrator was compared with the organization chart and staff qualifications when the contract was initiated in 2002. The examiners noted that six high-level personnel (two from the Madison office) have left the Administrator since mid-2005. These persons were replaced with four management personnel – primarily internal staff – which provides some continuity to the organizational structure. Services provided by the Administrator appear to be completed in an efficient manner, though turnover of office personnel should be monitored for further departures.

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to

conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The Fund's Administrator has not adopted such a procedure for disclosing potential conflicts of interest. During the bidding process, it was required that the bidder disclose and explain any conflicts of interest. However, this does not meet the annual requirement established for other companies. It is recommended the Fund's Administrator complete annual conflict of interest questionnaires.

Fidelity Bond and Other Insurance

The Fund's Administrator is afforded coverage under the terms of bonds or contracts of its main office as follows:

Type of Coverage	Coverage Limits
Fidelity bond	$ 5,000,000
General liability	2,000,000
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	500,000
Each employee	500,000
Policy limit	500,000
Auto	1,000,000
Professional errors & omissions	5,000,000
Umbrella	10,000,000

Underwriting

In accordance with s. 605.03 (1), Wis. Stat., the Fund cannot refuse or reject any local governmental unit that properly requests fire and extended peril coverage; other coverage may be provided as based on the Fund's underwriting guide. The Fund's underwriting guide was not reviewed as part of the targeted examination procedures. The Fund's reinsurer has a formal procedure whereby it annually inspects selected insured local government property.

EDP Environment

The Administrator's manager was interviewed with respect to controls regarding their electronic data processing environment. Additionally, access to the computers is limited to people authorized to use the computers. It appears the Administrator's established procedures to limit access to its computers is adequate.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The examination of the Administrator's business continuity plan determined that it did not adequately cover all of the above areas; it primarily addressed continuity in the headquarters office in Okemos, Michigan, but there was little mention of ASU's Madison office that serves the Fund. It is recommended that the Administrator formulate an adequate business continuity plan for the local office which provides services to the Fund.

V. CONCLUSION

Admitted assets increased 92.1% from $28,047,340 in 2002 to $53,901,908 in 2006. Liabilities increased 34.2% from $11,100,066 in 2002 to $14,906,002 in 2006. Surplus increased 130.1% from $16,947,274 in 2002 to $38,995,906 in 2006 and has remained above the designated maintenance level since 2004. The Fund had net income for the last three years of the five years under examination. The net income in 2006 was $4,475,789.

This report reviewed the Fund's compliance plan and actions regarding recommendations made in the LAB report as of June 30, 2004, and areas accorded a high priority by the examiner-in-charge. A significant part of the examination of the Fund involved audit steps performed by the examiners to determine whether the Administrator was meeting the agreed-to performance standards; the majority of these standards involve claims processing. Additionally, audit software and procedures were used in claim and premium testing to verify the accuracy and completeness of premium, loss, expense and reinsurance annual statement values as of June 30, 2006.

The examination resulted in 14 recommendations, which are listed in the next section of this report.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Losses—It is recommended that the Administrator properly report defense and cost containment expenses in accordance with NAIC Annual Statement Instructions-Property and Casualty.

2. Page 14 - Reinsurance Premium Liability—It is recommended the Administrator establish a liability to account for the potential change in total reinsurance premium due over the reinsurance contract period.

3. Page 16 - Loss Dates—It is recommended that the Administrator manually enter the reported date of loss from the loss reporting form, or other evidence of the reported claim, into the claim system.

4. Page 16 - Date Stamping—It is recommended that the Administrator date stamp all policy and claim materials when received to establish a time of receipt of these items.

5. Page 18 - Expense Notification—It is recommended that the Administrator notify the Insurance Program Officer when actual or estimated expert or legal payments are to exceed the threshold level established in the Administrator's claim procedure manual.

6. Page 18 - Claim Set-Up—It is recommended that the Administrator make screen prints of all claim and expense payments and include these in the hard copy claim file.

7. Page 20 - Premium Records—It is recommended that the Administrator and Insurance Program Officer establish specific procedures to ensure compliance with s. 605.21 (1), Wis. Stat., regarding certified resolutions.

8. Page 21 - Premium Reviews—It is recommended that the quarterly performance reviews be modified to include standards for cash receipts, policy coverage, and premium credit calculations.

9. Page 21 - Procedure Review—It is recommended that the Insurance Program Officer implement a process by which the Administrator's procedure manuals are reviewed on an annual basis.

10. Page 22 - NSF Check Processing—It is recommended that the Administrator work with the OCI Agency Accountant and Insurance Program Officer to establish a procedure for non-sufficient fund check processing and accounting.

11. Page 23 - Deductible Refunds—It is recommended that the Administrator and Insurance Program Officer develop, document, and consistently apply an appropriate procedure for refunding deductibles to the policyholder upon receipt of subrogation payments.

12. Page 24 - Large Loss Reports—It is recommended that the Insurance Program Officer and Administrator develop procedures for issuing of the individual Large Loss Report and signed Proof of Loss forms and including them in the corresponding claims file.

13. Page 25 - Conflict of Interest Statements—It is recommended the Fund's Administrator complete annual conflict of interest questionnaires.

14. Page 26 - Business Continuity Plan—It is recommended that the Administrator formulate an adequate business continuity plan for the local office which provides services to the Fund.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Lynne Geroux of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Karl K. Albert
Examiner-in-Charge