

## **Preliminary Performance Review**

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# **State Board of Risk and Insurance Management**

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**BRIM Eliminated It's Unfunded Liability During FY 1998 and FY 1999, but the Unfunded Liability Has Since Grown to Nearly \$46 Million Due to a Combination of Flat Investment Returns, Declining Premium Revenues and Increasing Medical Malpractice and General Liability Claims**

**BRIM's Medical Malpractice Insurance Program for Private Health Care Providers Will Be Transferred to a Physician's Mutual Insurance Company; However, the Program May Be Left With an Unfunded Liability**

**BRIM's Loss Control Department is Understaffed But Has Made Some Progress Towards Compliance With PERD's 1997 Loss Control Recommendations**

**BRIM Has Addressed Some Material Weakness Noted In Independent Audits but Recent Premium Increases May Not Be Based on Accurate Loss Exposure Data**



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John Sylvia  
Director

November 16, 2003

The Honorable Edwin J. Bowman  
State Senate  
129 West Circle Drive  
Weirton, West Virginia 26062

The Honorable J.D. Beane  
House of Delegates  
Building 1, Room E-213  
1900 Kanawha Boulevard, East  
Charleston, West Virginia 25305-0470

Dear Chairs:

Pursuant to the West Virginia Sunset Law, we are transmitting a Preliminary Performance Review of the State Board of Risk and Insurance Management, which will be presented to the Joint Committee on Government Operations on Sunday, November 16, 2003. The issues covered herein are "BRIM Eliminated it's Unfunded Liability During FY 1998 and FY 1999, but the Unfunded Liability has Since Grown to Nearly \$46 Million Due to a Combination of Flat Investment Returns, Declining Premium Revenues and Increasing Medical Malpractice and General Liability Claims;" "BRIM's Medical Malpractice Insurance Program for Private Health Care Providers Will Be Transferred to a Physician's Mutual Insurance Company; However, the Program May be Left with an Unfunded Liability;" "BRIM's Loss Control Department is Understaffed but has Made Some Progress Towards Compliance with PERD's 1997 Loss Control Recommendations;" and "BRIM Has Addressed Some Material Weakness Noted in Independent Audits but Recent Premium Increases may not be Based on Accurate Loss Exposure Data."

We transmitted a draft copy of the report to the State Board of Risk and Insurance Management on October 27, 2003. We held an exit conference with BRIM on October 31, 2003. We received the agency response on November 6, 2003.

Let me know if you have any questions.

Sincerely,

Handwritten signature of John Sylvia in cursive script.  
John Sylvia

JS/wsc

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*Joint Committee on Government and Finance*

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# Executive Summary

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**Issue 1      BRIM Eliminated It's Unfunded Liability During FY 1998 and FY 1999, but the Unfunded Liability Has Since Grown to Nearly \$46 Million Due to a Combination of Flat Investment Returns, Declining Premium Revenues and Increasing Medical Malpractice and General Liability Claims.**

BRIM's unfunded liability has reached a level of nearly \$46 million as of March 31, 2003. A number of factors have contributed to the recurrence of the unfunded liability, including the end of surpluses that once existed in BRIM's Mine Subsidence and Flood Insurance lines of business. Another important factor has been the lack of growth in BRIM's investment and premium revenues during recent years. Substantial growth in BRIM's claims losses, particularly with respect to the State Agencies and SB3 3 lines of business has also been important. BRIM has, however, developed a plan to eliminate the unfunded liability within ten years.

BRIM's recent increase in premium levels for most state agencies should substantially increase premium revenues in the future, with premium rate increases for the State Agencies Program totaling \$9,024,057 for FY 2004. This represents an increase equal to 18.5% of BRIM's total FY 2002 premium revenues.

It is possible that increasing claims losses may be concentrated in certain segments of the SB3 Coverage Program. For this reason, BRIM should also consider maintaining separate financial statements for the local governments, non-profit agencies and boards of education insured by this program.

**Issue 2      BRIM's Medical Malpractice Insurance Program for Private Health Care Providers Will Be Transferred to a Physician's Mutual Insurance Company, However, the Program May Be Left With an Unfunded Liability.**

In March 2003, the Legislature passed House Bill 2122 which transfers assets from BRIM's medical malpractice insurance program to a newly-created physicians' mutual insurance company. Some providers will continue to be covered by BRIM, but most will be transferred to the physicians' mutual program. As of March 18, 2003 BRIM II insured 1,164 physicians, 15 hospitals

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and 18 facilities. BRIM projects that the total number of physicians will increase by 200 before the formation of the physicians' mutual insurance company. When the physicians' mutual begins operations in July 2004, BRIM will transfer all insured physicians to the new program. With the transfer of physicians to a physicians' mutual insurance company, BRIM will have no remaining liability for this part of the program.

Although BRIM will continue to insure hospitals until the end of the BRIM II Program, BRIM's Board voted not to insure any additional hospitals after July 1, 2003. BRIM II will cease to exist June 30, 2004 and no policies will be in effect after that date. Hospitals cannot enter the physicians' mutual program but may purchase *tail insurance coverage* from BRIM. *Tail coverage* is optional malpractice protection that allows an insured to report claims that occurred while its policy was in force but after the policy ended. These facilities will have to obtain coverage elsewhere but the end of this type of BRIM coverage could leave BRIM with an unfunded liability. BRIM's actuary is currently evaluating the fiscal impact, but currently no projections exist. BRIM should carefully monitor residual liabilities from the BRIM II Program and make sufficient claims loss allowances to compensate for the projected fiscal impact.

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### **Issue 3      BRIM's Loss Control Department is Understaffed But Has Made Some Progress Towards Compliance With PERD's 1997 Loss Control Recommendations.**

BRIM's Loss Control Department is currently composed of a Loss Control Manager and an Office Assistant. Until the end of January 2003, BRIM also employed a Loss Control Specialist, who transferred to another state agency. In August 2003, BRIM hired another Loss Control Specialist. Given BRIM's small Loss Control Department, the Board must out-source its loss control services to private vendors. Payments to loss control vendors increased from \$407,500 in FY 1999 to the present figure of nearly \$500,000 annually (see Table 5).

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*Although BRIM has had five years since PERD conducted the last performance evaluation, there are still nearly 10,000 outstanding loss control recommendations from Schirmer Engineering Corporation.*

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Although BRIM has had five years since PERD conducted the last performance evaluation, there are still nearly 10,000 outstanding loss control recommendations from Schirmer Engineering Corporation, 6,350 of which are left over from previous years. This indicates that there are still many areas of potential improvement that require BRIM's attention. Another important consideration is that BRIM now utilizes the services of additional loss control companies, which means that there are great demands put upon BRIM's small Loss Control Department. Effectively monitoring the activities of several

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loss control vendors and following up on their recommendations is a difficult task given the size of BRIM's Loss Control Department.

BRIM and its loss control vendors also need to develop a system for categorizing the level of importance attached to each loss control recommendation. BRIM has asked Schirmer Engineering to develop such a system.

BRIM has not yet designed a detailed system of surcharges and incentives that differentiates between varying loss ratios among insureds, as recommended by PERD in its 1997 report. BRIM should make the design of such a system a priority. BRIM should consider using loss control recommendations as part of this system of surcharges and incentives.

#### **Issue 4 BRIM Has Addressed Some Material Weaknesses Noted in Independent Audits but Recent Premium Increases May Not Be Based on Accurate Loss Exposure Data.**

BRIM has replaced its financial accounting system in an effort to improve the quality of its financial data. BRIM needs to improve the manner in which it collects loss exposure data to ensure that premium rates are based on accurate data. BRIM should make the development of a means to verify the value of state property it insures a priority. Finally, BRIM has increased premium rates for State Agencies and SB3 lines of business in order to improve BRIM's financial condition, but the communication of loss exposure data to the underwriting department would improve the accuracy of premium rate calculations.

*BRIM should examine the manner in which it collects and utilizes general liability loss exposure data to ensure its accuracy.*

In January of 2003, BRIM contracted with ARMTECH to complete a new premium calculation system by the end of calendar year 2003. At the time of this evaluation, the new rate system was not complete. Any redesign of premium rates must, however, be based on accurate loss exposure data. BRIM should examine the manner in which it collects and utilizes general liability loss exposure data to ensure its accuracy. The use of appraisal, or other data for state property value verification, as recommended by PERD in its 1997 report, would also assist in accurate premium rate calculations.

Ernst and Young recommended improved communications between the Risk Management (called Loss Control Department by BRIM) and Underwriting Departments at BRIM. Communication between the two BRIM

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departments is essential in order to set premium rates that are based on the most recent and accurate information available. The Legislative Auditor recommends that BRIM establish regular communications between the two departments to facilitate premium rate-making.

## **Recommendations**

1. *BRIM should evaluate recent premium rate increases following the release of ARMTECH's actuarial study, in order to determine if premium rate structures reflect accurate loss exposure data and adequately address BRIM's unfunded liability.*
2. *BRIM should maintain separate financial statements for each subsection of the SB3 Program to differentiate the various types of entities included in the Program.*
3. *BRIM should carefully evaluate actuarial projections for future claims losses from the BRIM II Program and make sufficient claims loss allowances to compensate for the projected fiscal impact.*
4. *The Legislature should consider expanding the number of positions in BRIM's Loss Control Department in order to provide an adequate number of Loss Control Specialists to monitor the efforts of vendors, the compliance of insureds with loss control recommendations and to reduce the need to employ outside vendors.*
5. *BRIM and its loss control vendors should design a system for categorizing loss control recommendations that ranks them according to their level of importance in order to facilitate the monitoring of action plans.*
6. *BRIM should comply with Recommendation 4 of PERD's 1997 report and implement a system of surcharges and credits, using the relative importance of loss control recommendations as criteria, as soon as possible.*
7. *BRIM should examine its current methods for documenting loss exposure and ensure that the current ARMTECH study adequately addresses the need for accurate data.*
8. *BRIM should make the use of appraisal, or other data for state property value verification, a priority.*

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9. *BRIM's Underwriting Department should establish regular communications with the Loss Control Department for the purpose of obtaining accurate loss exposure data on insureds when determining premium levels.*



# Review Objective, Scope and Methodology

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The Legislature created the Board of Risk and Insurance Management (BRIM) in 1957 to provide property and liability insurance for all units of state government. The objective of the Preliminary Performance Evaluation of BRIM is to determine BRIM's level of compliance with the recommendations of the Performance Evaluation and Research Division's (PERD) October 1997 Report on the Preliminary Performance Evaluation of BRIM, as well as evaluating BRIM's management of the Medical Malpractice Insurance Program (known as the BRIM II Program), the unfunded liability and the methods by which BRIM documents loss exposure. PERD's 1997 report included the following recommendations:

**Recommendation 1:** *The Legislative Auditor recommends that BRIM continue the progress in removing material weaknesses in its internal control structure, as identified in the Ernst and Young audits.*

**Recommendation 2:** *BRIM should consider basing its premium charges on a combination of loss history and loss exposure data.*

**Recommendation 3:** *BRIM should incorporate appraisals of state property in its survey and inspection of state property.*

**Recommendation 4:** *BRIM should consider applying a wider range of incentives and surcharges to account for significant differences in loss ratios.*

**Recommendation 5:** *BRIM should monitor the number of entities without action plans in response to Schirmer reports, and determine the seriousness of outstanding recommendations. Consideration should be given to incorporating within the premium rate such information as actions plans not submitted, outstanding recommendations and the level of seriousness of outstanding recommendations.*

The scope of this review extends from the period from FY 1997 to March 2003. BRIM provided written comments regarding each of the Legislative Auditor's recommendations from the 1997 report and BRIM's subsequent compliance efforts. The source of financial data for this report was BRIM's annual and monthly financial statements. BRIM also provided information on its claims loss ratios and recent premium rate increases. Information regarding the BRIM II Program included House Bill 2122 and

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information on the financial impact of the Program provided by BRIM. BRIM also provided information on its Loss Control Program, including information on the functions of the Loss Control Department, loss control initiatives, loss control vendors and their activities. The Legislative Auditor's Office reviewed reports from independent audits by Ernst and Young in order to determine BRIM's compliance with the firm's recommendations. BRIM provided information on the methods used to document claims loss exposure as well as its methods for analyzing insureds for premium calculation purposes.

# Background

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The West Virginia Board of Risk and Insurance Management (BRIM) has been responsible for providing insurance coverage to all state agencies (152 agencies in FY 2002) since 1957. BRIM has provided insurance coverage to cities, counties, boards of education and non-profit organizations throughout the State under the provisions of a program created by Senate Bill 3, since 1986 (approximately 1,300 entities in FY 2002). BRIM also provides a coal mine subsidence reinsurance program which allows homeowners and businesses to obtain insurance coverage for up to \$75,000 for damage caused by underground coal mines (15,000 policies in FY 2002). In December 2001, the Legislature passed House Bill 601 which authorized BRIM to provide medical malpractice and general liability coverage to private health care providers. In March 2003, the Legislature passed House Bill 2122, which transferred most insureds enrolled in BRIM's medical malpractice program to a newly-created physician's mutual insurance company.

The Board of Directors is composed of five members. One member is the Vice-Chancellor of Health Sciences of the West Virginia Higher Education Policy Commission. The Governor appoints the remaining four members with the advice and consent of the Senate. Each member must be a resident of the State and have experience in at least one of the following areas: law, accounting, business, insurance or actuarial science. The Insurance Commissioner serves as the Board's Secretary and does not vote. The Board selects one of its members as chairman. The Board currently employs a staff of 25.

BRIM's net operating revenues were \$46,656,132 in FY 2002 while its operating expenses totaled \$71,706,342, creating an operating loss of \$25,050,210 and having a unfunded liability of \$37,934,367 at the end of the fiscal year. The unfunded liability grew to \$45,857,397 by March 31, 2003.



## **BRIM Eliminated It's Unfunded Liability During FY 1998 and FY 1999, But the Unfunded Liability Has Since Grown to Nearly \$46 Million Due to a Combination of Flat Investment Returns, Declining Premium Revenues and Increasing Medical Malpractice and General Liability Claims.**

BRIM's unfunded liability has reached a level of nearly \$46 million as of March 31, 2003. A number of factors have contributed to the reassertion of the unfunded liability, including decreases in the surpluses in BRIM's Mine Subsidence and Flood Insurance lines of business. Another important factor has been the lack of growth in BRIM's investment and premium revenues during recent years. Substantial growth in BRIM's claims losses, particularly with respect to the State Agencies and SB3 lines of business has also been important. BRIM has, however, developed a plan to eliminate the unfunded liability within ten years.

### **History of the Unfunded Liability Since 1997**

The Preliminary Performance Evaluation of BRIM released by the Performance Evaluation and Research Division in October 1997 identified an unfunded liability of \$18 million at the end of FY 1997. At that time, BRIM's investment income was steadily increasing. The Board's investment income increased by 198% from FY 1993 to FY 1997, from \$1,781,000 in FY 1993 to \$5,302,000 in FY 1997.

Figure 1 illustrates the development of the unfunded liability since the end of FY 1997. After achieving modest positive total retained earnings figures for FY 1998 and FY 1999, the unfunded liability returned during FY 2000. The temporary elimination of the unfunded liability was due to large surpluses in the Mine Subsidence and Flood Insurance lines. Asset deficiencies continued to exist, at the same time, in the State Agencies and Senate Bill 3 lines of coverage.

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*The temporary elimination of the unfunded liability was due to large surpluses in the Mine Subsidence and Flood Insurance lines.*

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### Figure 1

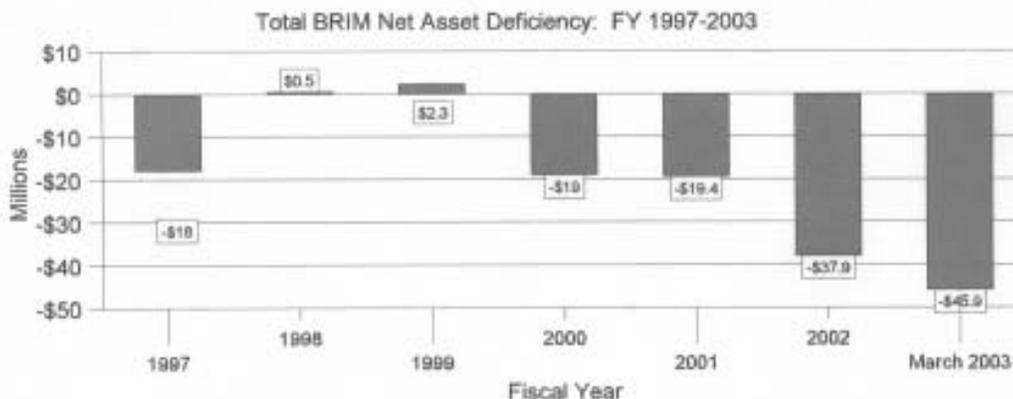


Table 1 provides data on the history of the unfunded liability from FY 1997 to January 2003. The table separates BRIM's retained earnings into separate lines of business to illustrate the programs which are responsible for the unfunded liability. The Mine Subsidence Program consistently had positive retained earnings, particularly prior to FY 2002. On the other hand, the State Agencies and SB3 Programs consistently experienced asset deficiencies. The performance of the Mine Subsidence Program was able to offset the losses suffered in the other programs during FY 1998-1999 but was unable to do so in later years. With the end of BRIM's Flood Insurance Program in FY 2002, which also had positive retained earnings, another offsetting factor disappeared. By the end of March 2003, with the current fiscal year three-fourths completed, the unfunded liability grew to nearly \$46 million.

<b>Table 1</b>							
<b>Components of Retained Earnings or Unfunded Liability: FY 1997-2003</b>							
<b>FY Year</b>	<b>State Agencies</b>	<b>SB3 Entities</b>	<b>Mine Subsidence</b>	<b>Flood</b>	<b>Preferred House Bill 601 Medical Mal.</b>	<b>High Risk House Bill 601 Medical Mal.</b>	<b>Total BRIM Retained Earnings or Unfunded Liability (End of Year)</b>
1997	*N/A	N/A	N/A	N/A	--	--	\$-18,035,000
1998	\$-7,751,000	\$-6,429,000	\$12,507,000	\$2,158,000	--	--	\$485,000
1999	\$-5,928,000	\$-7,423,000	\$13,438,000	\$2,251,000	--	--	\$2,338,000
2000	\$-19,032,000	\$-14,699,000	\$12,634,000	\$2,063,000	--	--	\$-19,034,000
2001	\$-14,849,000	\$-19,005,000	\$12,215,000	\$2,252,000	--	--	\$-19,387,000
2002	\$-27,674,451	\$-23,587,509	\$14,494,921	N/A	\$-989,921	\$-177,407	\$-37,934,367
2003	**N/A	N/A	N/A	N/A	N/A	N/A	\$-45,857,397

*Source: BRIM*  
*\*BRIM's accounting practices did not separate retained earnings/unfunded liability by line of business prior to FY 1998.*  
*\*\*BRIM's current accounting practices do not separate retained earnings/unfunded liability by line of business until the end of the fiscal year. Since FY 2003 data does not represent an entire fiscal year, these data were unavailable. FY 2003 total unfunded liability is as of March 31, 2003.*

### **Detailed Data on Categories of SB3 Insureds Should Be Collected**

BRIM does not maintain separate financial statements for each category of insureds of the SB3 Program, such as boards of education, county governments, cities, other governmental entities and non-profit organizations. Since the SB3 Program contributes significantly to the total unfunded liability, having detailed data for it can be useful. The SB3 Program is broad in terms of the diverse types of entities that it insures. It can be helpful to determine if some categories of insureds in the SB3 Program are particularly costly or are responsible for a disproportionate share of the SB3 unfunded liability. It may also be that some categories of SB3 insureds subsidize others.

BRIM data suggests that the SB3 Program is not responsible for a disproportionate share of the total unfunded liability compared to total premiums paid. Table 1 shows that in FY 2002 approximately 45% of the unfunded liability came from the SB3 Program when excluding the surplus in the Mine Subsidence Program. On the revenue side, premium payments made by SB3 entities in FY 2002 were 44.6% of total premiums collected by BRIM. The

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SB3 share of the total unfunded liability is, therefore, proportional to the SB3 share of total premiums paid.

It is, however, not clear if some types of SB3 insureds add a disproportionate amount to the SB3 unfunded liability in comparison to the revenue collected from such entities. Data provided by BRIM indicate that boards of education accounted for \$4,551,844, or 36.5% of the \$12,479,052 in total SB3 Program claims losses during FY 2003. Non-profit agencies accounted for \$3,004,253 or 24.1% of SB3 claims losses that year. Cities accounted for another \$2,448,999 or 19.6% of SB3 claims losses. Given their claims loss experience, these three types of insureds are probably responsible for most of the unfunded liability related to the SB3 Program. Maintaining separate financial statements for each type of insured would facilitate the tracking of changes in the unfunded liability within the SB3 Program. A BRIM representative provided the following response to the suggestion that separate financial data be maintained for each category of SB3 insured:

*We cannot tell what portion of the unfunded liability relates to the specific customers within SB3 (boards of ed, cities, non-profits, etc.). We do have financial data that is segregated by SB3 in total, state, mine subsidence and HB 601. We can further segregate that data by line of business such as general liability, medical malpractice, auto and property. At year end, we provide financial statements by lines of coverage within SB3 and state.*

*In order to capture financial data by type of customer for SB3 (i.e. boards of ed, cities, county commissions, other governmental, non-profits) we would have to:*

*(1) Rebid our contract with AIG and make sure that in our specifications we asked for payments to be delineated by type of SB3.(our current reporting does not break this information down).*

*(2) Rebid the actuarial contract asking for risk funding and IBNR analysis to be segregated by type of SB3.*

*Currently the above two items are easily segregated by state and SB3 in total as well as by type of coverage (general liability, medical malpractice and property).*

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*Our stance on this issue has been that we believe the cost outweighs the potential benefits to segregate the SB3 data by type of customer. The actuary segregates the premium projections by type of customer for SB3. When these premium projections are performed, the premiums will be increased if the claims came in at higher than anticipated amounts and they will be maintained at the current rate or reduced if the claims were lower than anticipated. All groups within our SB3 rate class have difficulty finding other insurance options in the market. To remove one line of business, such as boards of education or non-profits, would adversely affect the State of West Virginia because they may have to operate without insurance. Insurance is a pool concept and while one class of business may be profitable in one year, they may not be the next year. As long as their premiums are calculated according to the type of customer and the type of line of business, we have deemed that this is all that is necessary.*

It is, therefore, BRIM's position that the costs of collecting financial data on SB3 insureds in this manner outweighs the potential benefits.

### **Lack of Growth in Investment and Premium Revenues Has Contributed to the Unfunded Liability**

*In recent years, BRIM's investment income has generally been between \$5-6 million annually, with the exception of FY 2001.*

Figure 2 shows that in recent years, BRIM's investment income has generally been between \$5-6 million annually, with the exception of FY 2001. BRIM invests certain funds in the Enhanced Yield Pool managed by the West Virginia Investment Management Board. During FY 2001, the performance of investments in this pool improved dramatically with year-end returns reaching 9.2%. This represents an increase in investment returns of nearly 4% over the previous year. With the exception of FY 2001, BRIM's investment income appears to have remained at a relatively stable level during recent years. The lack of growth in investment income has failed to offset the growth of BRIM's unfunded liability.

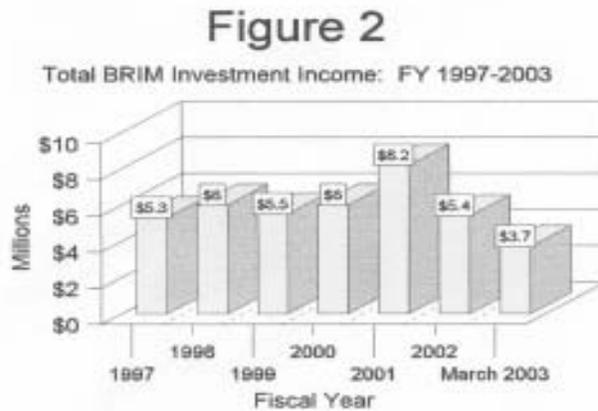
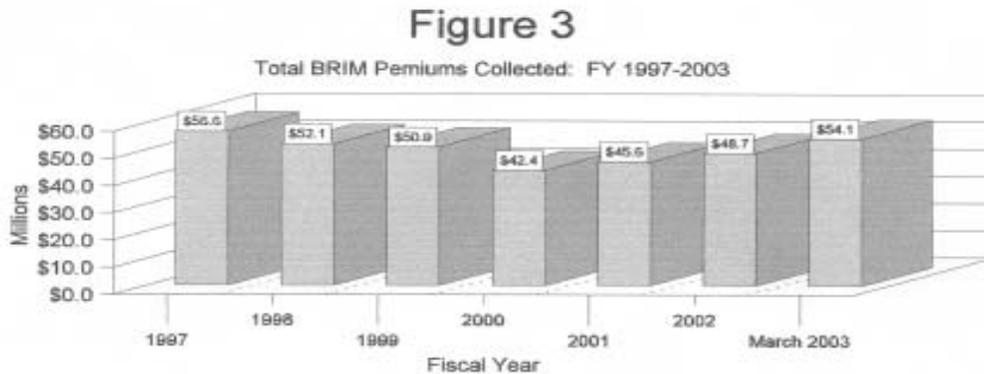


Figure 3 provides data on premium revenues earned by BRIM. Premium revenue actually dropped from a high of \$56,568,000 in FY 1997 to a low of \$42,404,000 in FY 2000, which represented a 25% reduction in premium revenues. One problem with the collection of premium revenues is the fact that West Virginia University (WVU) and Marshall University (Marshall) are the only insureds to have fallen in arrears with their premium payments to BRIM during this time period. By FY 2001, the WVU and Marshall had a total indebtedness of \$2,070,840 and \$738,943, respectively. The two universities have participated in a premium payment plan since that time (see the Special Report of the West Virginia Board of Risk and Insurance Management completed by the Legislative Auditor's Office, Post Audit Division in October 2002). Premium revenues have increased gradually since FY 2000, reaching \$54,062,000 by March 31 of FY 2003, which indicates that BRIM premium revenues for FY 2003 may equal or exceed the \$56,568,000 collected in FY 1997. BRIM's recent increase in premium levels for most state agencies should substantially increase premium revenues in the future, with premium rate increases for the State Agencies Program totaling \$9,024,057 for FY 2004. This represents an increase equal to 18.5% of BRIM's total FY 2002 premium revenues. See Issue 4.

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*BRIM's recent increase in premium levels for most state agencies should substantially increase premium revenues in the future.*

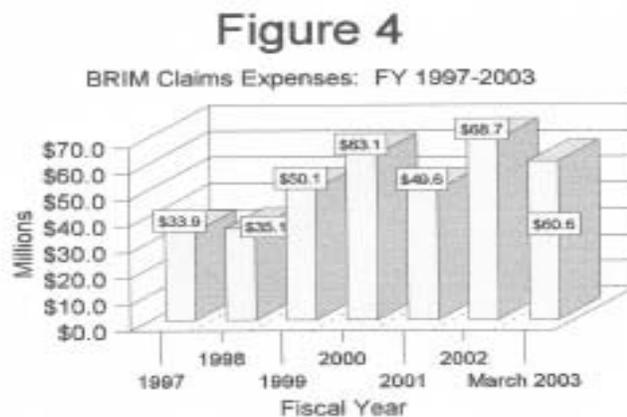
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### Increased Claims Losses as a Contributing Factor to the Unfunded Liability

*BRIM has attributed the growth in claims expenses to increased losses in two types of coverage, general liability for state agencies and other public entities (the SB3 Program) and medical malpractice for state agencies.*

Figure 4 provides data for claims expenses incurred by BRIM from FY 1997 to the present. After a 27.2% decline from FY 2000 to FY 2001, claims expenses rose to \$68,730,000 during FY 2002. This occurred during the period in which the Medical Malpractice Insurance Program began. BRIM has attributed the growth in claims expenses to increased losses in two types of coverage, general liability for state agencies and other public entities (the SB3 Program) and medical malpractice for state agencies.



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## Comparison of BRIM to Insurance Industry Averages

A comparison of BRIM's loss ratios with insurance industry averages in West Virginia and the United States as a whole (see Table 2), indicates that the growth of BRIM's claims losses has greatly exceeded that of the industry as a whole. The loss ratio is computed by dividing BRIM's claims and claims adjustment expense by its premium revenues. Over time, the loss ratio illustrates the relationship between the growth of claims losses and premium revenues.

The data in Table 2 show that 1999 was a turning point for BRIM. That year, BRIM's loss ratios began to substantially exceed industry standards. According to Standard and Poor's, the loss ratio for private insurance companies should fall within 60-80%. A loss ratio in excess of 80% would generally indicate significant adverse losses. The Legislative Auditor's Office does recognize that there are important differences in the manner in which BRIM operates as opposed to the operations of a private insurance company. One difference is that BRIM is statutorily required to insure certain entities whereas a private insurance company has the option of deciding not to insure an entity with an unusually high level of loss exposure or loss experience. **Since 1999, however, BRIM's overall loss ratio has consistently exceeded 100% of net premium revenues.**

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*Since 1999 BRIM's overall loss ratio has consistently exceeded 100% of net premium revenues.*

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**Table 2**  
**BRIM Loss Ratios: FY 1997-2003**

	1997*	1998	1999	2000	2001	2002	As of March 31, 2003**
State Agencies	N/A	73.6	100.1	163.9	95.0	180.3	N/A
SB3	N/A	68.8	105.7	141.9	128.5	123.6	N/A
Mine Subsidence	N/A	13.0	65.4	177.1	176.9	15.2	N/A
Preferred House Bill 601 Medical Malpractice	--	--	--	--	--	137.9	103.2
High Risk House Bill 601 Medical Malpractice	--	--	--	--	--	119.0	102.3
<b>Total: All BRIM Lines of Business</b>	<b>61.8</b>	<b>69.6</b>	<b>101.6</b>	<b>154.5</b>	<b>112.9</b>	<b>147.3</b>	<b>117.1</b>
WV Average: All Lines of Business	62.0	75.6	72.4	70.2	76.5	74.3	N/A
National Average: All Lines of Business***	60.6	65.6	67.2	70.2	79.0	92.0	N/A

*Sources: BRIM financial data were used to calculate BRIM loss ratios. Data from the National Association of Insurance Commissioners (NAIC) provided loss ratio averages for West Virginia and the U.S., except for 2002, which was unavailable. Data from Standard and Poor's Industry Surveys, Insurance: Property/Casualty, July 18, 2002 provided national average: all lines of business loss ratio data for 2002. Loss ratios provided by the NAIC were calculated using claims expenses net of claims adjustment expenses, expressed as a percentage of premium revenues. These ratios would be slightly higher if calculated in the same manner as BRIM's ratios, the formula for which adds claims expenses to claims adjustment expenses, and the sum is expressed as a percentage of premium revenues.*

*\*BRIM's accounting practices did not separate revenue and expense data by line of business prior to FY 1998, therefore loss ratios for individual lines of business could not be calculated for FY 1997.*

*\*\*BRIM's current accounting practices do not separate revenue and expense data by line of business until the end of the current fiscal year, therefore, loss ratios for individual lines of business could not be calculated for FY 2003.*

*\*\*\*For insurance companies writing policies in West Virginia, except for 2002 data.*

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## **BRIM's Plan to Eliminate the Unfunded Liability**

BRIM has developed a financial plan to eliminate the unfunded liability. For the last three years BRIM has made an assessment to SB3 insureds, in addition to standard premium charges, totaling \$1 million. This assessment is divided among the 1,400 entities in this program. Beginning in FY 2004, state agencies will also be assessed an additional \$1 million. BRIM will continue to request \$2 million annually from the Legislature to be applied towards the unfunded liability. In describing the program, a BRIM representative stated:

*If all agencies pay their respective amounts, practice good loss control, and losses don't continue to deteriorate, we expect that we can eliminate the unfunded liability within 10 years.*

### **Conclusion**

Since the 1997 Report on the Preliminary Performance Evaluation of BRIM, BRIM's unfunded liability briefly disappeared during Fiscal Years 1998 and 1999 but developed once again thereafter. The unfunded liability nearly doubled from FY 2001 to FY 2002, growing from \$19,034,000 to \$37,934,367. Growing general liability claims losses in the State Agencies and Senate Bill 3 Programs, coupled with increasing medical malpractice claims losses, left the Mine Subsidence Program as the only line of coverage with positive retained earnings in FY 2002. A lack of growth in BRIM's investment income and premium revenues that remained below FY 1997 levels meant that revenue sources failed to compensate for increasing claims losses. Recent BRIM premium rate increases will help to reverse this trend. BRIM should evaluate recent premium rate increases following the release of ARMTECH's actuarial study (see Issue 4), in order to determine if premium rate structures reflect accurate loss exposure data and adequately address BRIM's unfunded liability. BRIM should make loss control a top priority (see Issue 3) in order to keep its plan to eliminate the unfunded liability on schedule.

### **Recommendations**

1. *BRIM should evaluate recent premium rate increases following the release of ARMTECH's actuarial study, in order to determine if premium rate structures reflect accurate loss exposure data and adequately address BRIM's unfunded liability.*

- 
2. *BRIM should maintain separate financial statements for each subsection of the SB3 Program to differentiate the various types of entities included in the Program.*



### **BRIM's Medical Malpractice Insurance Program for Private Health Care Providers Will Be Transferred to a Physician's Mutual Insurance Company, However, the Program May Be Left With an Unfunded Liability.**

In December 2001, the Legislature passed House Bill 601 which designated BRIM as the insurance carrier of last resort for physicians who cannot obtain malpractice insurance in the State (known as the BRIM II Program). The program insured 288 physicians and 4 hospitals at the end of FY 2002. By January 2003, the program insured 962 physicians, 12 hospitals and 16 facilities/clinics. During FY 2002, the program generated 5.2% of BRIM's premium revenues. At the end of FY 2002, approximately 3% of BRIM's unfunded liability was related to the medical malpractice program.

In March 2003, the Legislature passed House Bill 2122 which transfers assets from BRIM's medical malpractice insurance program to a newly-created physicians' mutual insurance company. Some providers will continue to be covered by BRIM, but most will be transferred to the physicians' mutual program. As of March 18, 2003 BRIM II insured 1,164 physicians, 15 hospitals and 18 facilities. BRIM projects that the total number of physicians will increase by 200 before the formation of the physicians' mutual insurance company. When the physicians' mutual begins operations in July 2004, BRIM will transfer all insured physicians to the new program. With the transfer of physicians to a physicians' mutual insurance company, BRIM will have no remaining liability for this part of the program.

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***BRIM II will cease to exist June 30, 2004 and no policies will be in effect after that date.***

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Although BRIM will continue to insure hospitals until the end of the BRIM II Program, BRIM's Board voted not to insure any additional hospitals after July 1, 2003. BRIM II will cease to exist June 30, 2004 and no policies will be in effect after that date. Hospitals cannot enter the physicians' mutual program but may purchase *tail insurance coverage* from BRIM. *Tail coverage* is optional malpractice protection that allows an insured to report claims that occurred while its policy was in force but after the policy has ended. These facilities will have to obtain coverage elsewhere but the end of this type of BRIM coverage could leave BRIM with an unfunded liability. BRIM's actuary is currently evaluating the fiscal impact, but currently, no projections exist. BRIM should carefully monitor residual liabilities from the BRIM II Program and make sufficient claims loss allowances to compensate for the projected fiscal impact.

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## Conclusion

The transfer of individual physicians to the physicians' mutual insurance company will eliminate BRIM's liability for their coverage, however, hospitals that purchase tail coverage from BRIM may create claims losses for years to come. BRIM should plan for future claims losses from the BRIM II Program and project the possible unfunded liability.

## Recommendation

3. *BRIM should carefully evaluate actuarial projections for future claims losses from the BRIM II Program and make sufficient claims loss allowances to compensate for the projected fiscal impact.*

## **BRIM's Loss Control Department is Understaffed But Has Made Some Progress Towards Compliance With PERD's 1997 Loss Control Recommendations.**

BRIM's Loss Control Department is currently composed of a Loss Control Manager, a Loss Control Specialist and an Office Assistant. From the end of January 2003, until August 2003, there was no Loss Control Specialist in the Department. BRIM hired another Loss Control Specialist at that time. Given BRIM's small Loss Control Department, the Board must out-source its loss control services to private vendors. Payments to loss control vendors increased from \$407,500 in FY 1999 to the present figure of nearly \$500,000 annually (see Table 5).

### **BRIM's Use of Loss Control Vendors**

One vendor is the Schirmer Engineering Corporation, which inspects various properties and operations of insureds. A representative of BRIM described the inspection process as follows.

*The Schirmer representative, along with a representative of the insured, inspects the location for property and liability exposures. Schirmer issues a detailed report to BRIM, which then forwards a copy of the Schirmer report to the insured. A portion of the report contains recommendations for needed action. BRIM has an internal system for tracking these recommendations and the compliance therewith. As necessary, a member of the BRIM Loss Control staff will personally follow up with the insured if the seriousness of a reported condition so warrants.*

Recommendation 5 of PERD's October 1997 report states the following:

*BRIM should monitor the number of entities without action plans in response to Schirmer reports, and determine the seriousness of outstanding recommendations. Consideration should be given to incorporating within the premium rate such information as action plans not submitted, outstanding recommendations and the level of seriousness of outstanding recommendations.*

BRIM has taken steps to comply with this recommendation. Since PERD's 1997 report, the number of new and outstanding recommendations from Schirmer Engineering have fallen. Table 3 compares information provided in the 1997 report with updated figures for calendar year 2002. Although the number of old outstanding recommendations has fallen by 54% and the total number of outstanding recommendations has fallen by 45%, the number of new recommendations has only fallen by 14%. In addition, although BRIM has had five years since PERD conducted the last performance evaluation, there are still nearly 10,000 outstanding recommendations, 6,350 of which are left over from previous years. These facts indicate that there are still many areas of potential improvement that require BRIM's attention. Another important consideration is that BRIM utilizes the services of additional loss control companies, which means that there are great demands put upon BRIM's small Loss Control Department. Effectively monitoring the activities of several loss control vendors and following up on their recommendations is a difficult task given the size of BRIM's Loss Control Department.

*Effectively monitoring the activities of several loss control vendors and following up on their recommendations is a difficult task given the size of BRIM's Loss Control Department.*

Status	September 1997	Calendar Year 2002	Change
Recommendations from Previous Years	17,866	8,446	-53%
Recommendations Completed During Current Year	3,659	1,916	-48%
Remaining Recommendations from Previous Years	14,207	6,530	-54%
New Recommendations from Current Year	4,009	3,456	-14%
Total Outstanding Recommendations	18,216	9,986	-45%

*\*Source: BRIM*

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*BRIM has not developed a formal system for categorizing and ranking loss control recommendations according to their relative importance.*

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BRIM and its loss control vendors have not addressed one important aspect of Recommendation 5. BRIM has not developed a formal system for categorizing and ranking loss control recommendations according to their relative importance. The Legislative Auditor's Office obtained a database of 17,904 recommendations from Schirmer Engineering, BRIM's most important loss control vendor. Two of the recommendations were categorized as "Urgent Recommendations" while the categories used to describe the rest of the recommendations in the database had no relation to their level of importance. The lack of categorical rankings according to the relative importance of loss control recommendations does not allow BRIM or its loss control vendors to prioritize the need for agency action plans. The monitoring of agency action plans is, therefore, not based on the importance of recommendations, unless they are categorized as "Urgent Recommendations". Each non-urgent recommendation is, therefore, treated equally. A BRIM representative provided the following description of Schirmer Engineering's category system.

*Code (99) identifies URGENT recommendations for which immediate attention should be given. The other categories of recommendations do not convey a level of importance of the recommendation. At this time there is no provision to assign an importance of one recommendation over another in the data base. Schirmer has been requested to investigate the possibility of developing such, but as of this date has not devised a method.*

Another vendor, Acordia National has provided loss control services to BRIM since July 1, 2002. Acordia will provide a total of 500 loss control hours during FY 2003. Acordia is assisting BRIM by collecting data for the purposes of enabling insureds to develop loss control measures such as fleet safety programs or model safety plans.

Marsh USA, Inc. has been administering the Medical Malpractice Program for private physicians (BRIM II). House Bill 601 required participation in loss control programs by healthcare providers. Marsh conducts two loss control seminars in different areas of the State, four times annually. Marsh has also conducted site assessments at physician offices and hospitals, offering recommendations to reduce the frequency and severity of losses.

Hartford Steam Boiler inspects all pressure boilers used by entities insured by BRIM. In a manner similar to that followed for Schirmer Engineering reports, each insured receives a copy of its Hartford Steam Boiler Inspection report and BRIM monitors compliance with the report's recommendations. Sometimes, a BRIM loss control representative meets with the insured to discuss problems noted in the reports. Hartford Steam Boiler also provides

four safety and maintenance workshops annually. BRIM maintains data for Hartford Steam Boiler inspections in a different format than data for Schirmer Engineering recommendations. Table 4 provides data on letters mailed to insureds and their responses to recommendations.

Table 4 Recommendations Made By Hartford Steam Boiler During FY 2003*		
Boiler Inspections	Advisory/Recommendation Letters Mailed	Responses to Recommendations
1,665	179	25
<i>Source: BRIM</i> <i>*Data represents the first eight months of FY 2003. BRIM has employed the services of Hartford Steam Boiler since July, 1, 2002.</i>		

### **The Cost of Loss Control Vendors Versus the Cost of Expanding BRIM's Loss Control Staff**

BRIM provided data to the Legislative Auditor's Office regarding BRIM's payments to loss control vendors for Fiscal Years 1999 through 2003 (see Table 5). In addition to data for payments to Hartford Steam Boiler and Machinery Insurance and Schirmer Engineering Corporation, current loss control vendors, Table 5 also contains data for CNA Insurance, which no longer provides loss control services. Total salaries for BRIM's three-person Loss Control Department currently total \$117,996. The Department's total annual salaries indicate that substantial savings on loss control vendor costs could be realized if BRIM increases the size of its loss control staff. BRIM should evaluate the potential savings that could be realized through the expansion of its loss control staff. While factors such as technical expertise may be a consideration in the utilization of loss control vendors, BRIM's current Loss Control Department is so small that the Department is limited in its ability to complete tasks beyond monitoring the activities of vendors.

*The Department's total annual salaries indicate that substantial savings on loss control vendor costs could be realized if BRIM increases the size of its loss control staff.*

Table 5 BRIM Payments to Loss Control Vendors: FY 1999-2003			
Year	Hartford Steam Boiler	Schirmer Engineering Corporation	CNA Insurance
1999	--	\$248,000	\$159,500
2000	--	\$248,000	\$159,500
2001	--	\$243,000	\$155,500
2002	--	\$243,000	\$155,500
2003	\$247,175	\$243,000	--
2004*	\$247,175	\$250,000	--
Source: BRIM *Amount contracted			

### Other Loss Control Measures

Other loss control measures taken by BRIM include two annual seminars on public liability, offered in different parts of the State, in conjunction with the law firm of Steptoe and Johnson. BRIM staff also appear before selected groups such as school administrators or Division of Highways supervisors to discuss relevant loss control issues. BRIM also responds to requests for loss control assistance from individual entities, sometimes sending a representative. BRIM provides loss control information on its web site as well. BRIM provides printouts of five-year loss histories to each insured and BRIM staff meet with representatives of entities that lead in terms of claim frequency or severity. BRIM also maintains a video library of loss control information for the use of insureds and has created a public school safety manual.

### Voluntary Versus Mandatory Compliance With Loss Control Recommendations

By its own admission, the small size of BRIM's Loss Control Department limits BRIM's ability to communicate directly with insureds:

*We are also trying to develop better communications with*

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*our insured. Granted, with only two technical loss control personnel (when fully staffed) in the department, personal communication from BRIM itself will be somewhat limited. We will have to rely on our various vendors, i.e., Schirmer, Marsh and Acordia, to meet with and address concerns with our insured. We believe that the Loss Control Department at BRIM needs to be larger. Additional technical personnel will facilitate more face-to-face interaction with our insured. This seems to be the best method for bringing about change.*

A premium structure that charges insureds for risk, based on the number and severity of problems identified, may be a more effective approach for effecting change. ABRIM representative provided the following response to the suggested use of loss control recommendations in premium calculations:

*We don't presently adjust premiums based on compliance, or lack thereof, with Schirmer recommendations. Failure to comply has been reflected in a premium based on loss history. If a loss isn't prevented, then its occurrence affects premiums negatively. The problem with basing a credit or surcharge on the Schirmer recommendations is that we don't have Schirmer inspect all of our insured. It isn't fair to penalize or reward one insured on the basis of something not available to another insured. We presently aren't set up to have every insured inspected by Schirmer.*

The BRIM representative also explained the method by which BRIM selects insureds for loss control inspections:

*No, every insured is not inspected. We have to make a judgement call as to which insureds need this attention based on loss history and potential exposure. We do inspect a great many institutions of learning, both at the public school level and the college level. We are attempting to see the schools we haven't seen to date. We would like to look at every insured, but have not had the resources to do so.*

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***Insureds' Compliance with loss control recommendations is a logical consideration when establishing premium rates.***

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The Legislative Auditor does not view compliance with loss control recommendations as an unfair consideration when calculating premium rates. Although BRIM does not currently have the resources to inspect all insureds, BRIM does not arbitrarily select the insureds it inspects. The use of loss history and potential exposure as considerations when selecting insureds for inspections is a logical criteria. Compliance with recommendations is,

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therefore, a logical consideration when establishing premium rates.

## **Surcharges and Credits**

BRIM is now considering the implementation of a system of surcharges and credits that will provide financial incentives for insureds to control losses. PERD originally recommended such a system in Recommendation 4 of the 1997 report.

*BRIM should incorporate a wider range of incentives and surcharges to account for significant differences in loss ratios.*

In 1997, PERD commented on BRIM's lack of a detailed system of incentive and surcharges to account for varying loss ratios among insureds. In response to PERD's request for information on BRIM's subsequent efforts to implement a system of surcharges and credits, a BRIM representative stated:

*Unfortunately, BRIM has learned that for many insured, issues of the "pocketbook" are the only ones that seem to draw attention to the area of loss control. Interest in loss control grows in proportion to the amount of the increase in premium. We believe that a system of surcharges and credits will focus more of our insureds' attention to the area of loss control. If an insured understands that certain loss control efforts can lead to loss control premium credits, which are spelled out specifically on the bill, that insured will most likely work harder at implementing procedures to try to reduce its losses. The same can be said for finding a surcharge for failing to implement loss control efforts.*

*Given the nature of our pool, this issue has been difficult to address. We are presently working on criteria for applying surcharges and credits and are looking at the internal funding mechanism for such a program.*

BRIM, therefore, admits that it has made little progress towards addressing this recommendation. BRIM's premium structure remains the primary tool used to reflect an insured entity's loss experience and exposure. See Issue 4 for a discussion of recent changes to BRIM's premium structure.

Considering that BRIM has had since 1997 to implement a system of surcharges and credits and has not yet done so, the agency has clearly failed to make this a priority. This is the case in spite of the fact that BRIM

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acknowledged the need for incentives and surcharges at the time of the original report and anticipated implementation of such a system by July 1, 1998. **The last quote from BRIM illustrates that BRIM still recognizes the need for this system. The Legislative Auditor, therefore, recommends that BRIM comply with Recommendation 4 of PERD's 1997 report and implement a system of surcharges and credits, using the number and severity of loss control recommendations as criteria, as soon as possible.**

## **Conclusion**

While BRIM has made progress in reducing the number of outstanding recommendations from Schirmer Engineering, nearly 10,000 recommendations are still outstanding and the number of new recommendations received by insureds has fallen by only 14% since FY 1997. Since BRIM has several loss control vendors to monitor along with thousands of their recommendations, the size of BRIM's Loss Control Department is inadequate for the task, even if BRIM fills the current vacancy for a Loss Control Specialist.

BRIM and its loss control vendors also need to develop a system for categorizing the level of importance attached to each loss control recommendation. BRIM has asked Schirmer Engineering to develop such a system.

BRIM has not yet designed a detailed system of surcharges and incentives that differentiates between varying loss ratios among insureds. BRIM should make the design of such a system a priority.

## **Recommendations**

4. *The Legislature should consider expanding the number of positions in BRIM's Loss Control Department in order to provide an adequate number of Loss Control Specialists to monitor the efforts of vendors, the compliance of insureds with loss control recommendations and to reduce the need to employ outside vendors.*
5. *BRIM and its loss control vendors should design a system for categorizing loss control recommendations that ranks them according to their level of importance in order to facilitate the monitoring of action plans.*

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6. *BRIM should comply with Recommendation 4 of PERD's 1997 report and implement a system of surcharges and credits, using the number and severity of loss control recommendations as criteria, as soon as possible.*



# Issue 4

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## **BRIM Has Addressed Some Material Weaknesses Noted in Independent Audits but Recent Premium Increases May Not Be Based on Accurate Loss Exposure Data.**

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*BRIM has replaced its financial accounting system in an effort to improve the quality of its financial data. BRIM needs to improve the manner in which it collects loss exposure data to ensure that premium rates are based on accurate data.*

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BRIM has replaced its financial accounting system in an effort to improve the quality of its financial data. BRIM needs to improve the manner in which it collects loss exposure data to ensure that premium rates are based on accurate data. BRIM should make the development of a means to verify the value of state property it insures, a priority. Finally, BRIM has increased premium rates for the State Agencies and SB3 lines of business in order to improve BRIM's financial condition, but the communication of loss exposure data to the underwriting department would improve the accuracy of premium rate calculations.

## **BRIM Accounting System is Now in Compliance**

Issue 1 of PERD's 1997 report states the following:

*The Legislative Auditor recommends that BRIM continue the progress in removing material weaknesses in its internal control structure, as identified in the Ernst and Young audits.*

PERD's 1997 report noted that commented on BRIM's lack of a financial accounting system designed to produce financial information in conformity with Generally Accepted Accounting Procedures (GAAP). A condition originally identified in a 1993 Ernst and Young report. BRIM provided the following response regarding actions taken to correct internal control weaknesses identified by Ernst and Young:

*BRIM has gone from an over 50 page management letter, full of internal control deficiencies in 1995, to a 1½ page letter noting minor areas of improvement.*

*BRIM's response to this recommendation indicted plans to convert its mainframe applications to a modern internal network-based system. In 1997, BRIM implemented Peachtree Accounting Software which is a network-based system. This system allows BRIM to produce general ledger financial statements and maintain a highly reliable and verifiable accounting system.*

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BRIM is, therefore, now in compliance with this recommendation.

## **BRIM Does Not Maintain Accurate Loss Exposure Data**

In October 2002, Ernst and Young sent a management letter to BRIM which identified a particularly important concern. The letter was critical of the accuracy of the loss exposure data maintained by the Board, particularly with respect to general liability:

*As noted in prior years, risk management efforts historically have focused primarily on property exposure with some emphasis on general liability. In executing the annual risk management plan, management should identify the higher risk areas (i.e., medical malpractice, State Police liability) that need attention based on potential exposure and actual loss experience. In addition, loss control personnel should arrange on-site meetings with the insureds for periodic inspections or audits of the reported exposure data and to obtain a better understanding of the insureds operations and risk management practices to form an overall evaluation of the risk associated with the respective insured. Correlation analysis should be prepared, on a periodic basis, between areas of focus and the related claim experience (i.e., number and dollar amount of claims) to determine if the efforts are effective.*

When asked to comment on the management letter, a representative of BRIM stated:

*In a recent E & Y management letter, it was noted that there were exposure data problems that could affect premium rates. This is a problem that BRIM is currently still addressing. BRIM has contracted with ARMTECH (AON) to address BRIM's improvements to the exposure collection process as an integral part of its new premium calculation. That study is currently in its infancy stages.*

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*Any redesign of premium rates must, however, be based on accurate loss exposure data.*

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Since ARMTECH, an actuarial consultant, is currently at an early stage of the study, the Legislative Auditor's Office cannot comment on its outcome. In January of 2003, BRIM contracted with ARMTECH to complete a new premium calculation system by the end of calendar year 2003. At the time of this evaluation, the new rate system was not complete. Any redesign of premium rates must, however, be based on accurate loss exposure data. BRIM

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should examine the manner in which it collects and utilizes general liability loss exposure data to ensure its accuracy. When designing the new rate system, BRIM should consider Recommendation 2 of PERD's 1997 report which states.

*BRIM should consider basing its premium charges on a combination of loss history and loss exposure data.*

A BRIM representative described BRIM's efforts since 1997 to comply with this recommendation in the following manner:

*The response given in the 1997 report was that BRIM was working with its insurance carrier for a [data] system. This change was not implemented exactly as planned, as the system did not fit BRIM's unique needs. Management did, however, contract with Ernst and Young's actuarial group to develop a comprehensive premium calculation program in 1999. This program, called ASSESS, was developed by E & Y actuaries specifically for BRIM's line of business and unique needs. The system does take into consideration a combination of loss history and exposure. The system has worked well, however, BRIM is continually striving to refine its premium calculation process. BRIM's continued refinement of its premium calculation process led to the contract with ARMTECH/AON to develop a new improved system.*

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***BRIM has made progress towards compliance with this recommendation, but needs to ensure the quality of exposure data.***

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BRIM has made progress towards compliance with this recommendation, but needs to ensure the quality of exposure data.

### **BRIM's Documentation of Insured Property**

BRIM needs to examine the means by which it documents insured property in addition to general liability loss exposure. Recommendation 3 of PERD's 1997 stated:

*BRIM should incorporate appraisals of state property in its survey and inspection of state property.*

The 1997 report commented on BRIM's reliance on insureds to report the value of state property. The report highlighted the need to verify the accuracy of this information by utilizing appraisals. In its agency response to the report, BRIM indicated that it was considering an approach to property value verification that was possibly less costly than an appraisal system. This was a comparison of the cost per square foot of insured properties, taken from

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information already in BRIM's database, to established square foot standards. This study was planned for FY 1999. A BRIM representative provided the following response when asked to comment on BRIM's progress towards compliance with this recommendation.

*BRIM did not complete the square footage study as indicated in the 1997 response. The focus of BRIM's loss control measures is currently on the high risk areas such as general liability and medical malpractice. Property losses represent approximately 7% of BRIM's total losses. A number of current loss control initiatives are being implemented including liability site surveys, medical record and office reviews, and seminars.*

PERD's 1997 report emphasized the need for BRIM to incorporate loss exposure data in determining premiums for insureds. Although the focus of the 1997 report was on property insurance, the growth of losses in the categories of general liability for state agencies and SB3 entities and medical malpractice for state agencies, coupled with the fact that these two types of coverage account for an overwhelming percentage of total claim liability, show that there is a need to carefully restructure premiums for general liability coverage. Although BRIM is not in compliance with this recommendation, the Legislative Auditor's Office recognizes that BRIM must prioritize its loss control efforts to focus first on the types of coverage experiencing the greatest claims losses. At the same time, BRIM should not abandon its efforts to properly verify the reported values of state property.

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*The Legislative Auditor's Office recognizes that BRIM must prioritize its loss control efforts to focus first on the types of coverage experiencing the greatest claims losses. At the same time, BRIM should not abandon its efforts to properly verify the reported values of state property.*

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### **BRIM Has Recently Increased Its Premium Rates for the State Agencies and SB3 Programs in Response to an Ernst and Young Recommendation**

For FY 2004, most state agencies will experience substantial increases in the total amount paid to BRIM in premiums for various types of insurance coverage, including, automobile liability, general liability, medical malpractice, liability and property. Premium increases will average 33.2% for all agencies. Increases will range from 0% to as much as 85.7%. Premium increases for all state agencies will total \$9,024,057. Other factors besides loss experience appear to have influenced the recent rate increases. The West Virginia Division of Public Safety, for example, will experience a premium increase of 60.4% in spite of the fact that BRIM losses for the State Police have fallen dramatically in recent years. An agency of this type, however, has a high level of potential exposure to losses because of its law enforcement duties.

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*For FY 2004, most state agencies will experience substantial increases in the total amount paid to BRIM in premiums for various types of insurance coverage, including, automobile liability, general liability, medical malpractice, liability and property.*

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The SB3 line of business will also experience premium rate increases for FY 2004. Premium increases for all SB3 entities will total \$5,021,258. Total premiums will increase from \$26,524,789 in FY 2003 to \$31,546,047 in FY 2004. This will be an 18.9% increase over total premiums for FY 2003.

BRIM described methods used to analyze each insured:

*To date, a great deal of the analysis for each insured has been directed only toward the insured's loss history. We are now performing a more detailed analysis that goes well beyond just loss history.*

*For example, we are looking at the insured's loss ratio, that is, the amount paid out in claims versus the amount collected as premium. We are in the process of developing benchmarks, in several areas, for a comparison of the insured with others in the same rate class who are similarly situated to that insured. An example would be comparing one board of education with other boards of education. We are analyzing the increase or decrease in the frequency and severity of claims as well as reviewing claim-reporting delays, which inevitably lead to higher claim costs. We are reviewing the underwriting files to see if there are increased or unusual exposures that need loss control attention. We are looking for the existence of safety committees and/or loss control plans currently in use by our insured. Finally, we are looking more closely at the Schirmer and Hartford Steam Boiler reports to make certain that their findings are included in the total analysis of the insured.*

BRIM's recent premium rate increases followed a recommendation from Ernst and Young in its October 2002 management letter:

*BRIM's operations reflect a trend of decreasing net assets for the last couple of fiscal years and a net asset deficiency [unfunded liability] approximating \$37,934,000 at June 30, 2002. We recommend that management continue its operations improvement efforts by developing a formal financial stability corrective action plan, encompassing opportunities for revenue enhancement and claims expense reduction, including increasing premiums as deemed necessary, to improve BRIM's financial position. Once formalized, the financial stability plan should be monitored and updated as necessary, to ensure realization of the desired improvement in operations in a timely manner.*

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Ernst and Young also recommended improved communications between the Risk Management (called Loss Control Department by BRIM) and Underwriting Departments at BRIM. The 2002 management letter stated:

*Coordination and communication between risk management and underwriting is crucial to ensure that premium rates are set by underwriting at an adequate amount for each respective insured based on their loss experience, risk management initiatives and exposure data.*

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*The Legislative Auditor recommends that BRIM establish regular communications between the two departments to facilitate premium rate-making.*

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Communication between the two BRIM departments is essential in order to set premium rates that are based on the most recent and accurate information available. The Legislative Auditor recommends that BRIM establish regular communications between the two departments to facilitate premium rate-making.

## **Conclusion**

BRIM has addressed the need for a financial accounting system that conforms to GAAP and has generally improved its data systems. Recent increases in BRIM premiums highlight the importance of another issue identified by Ernst and Young. Premium increases, coupled with more effective loss control measures are important factors in achieving improved financial stability for BRIM. At the same time, because of the substantial premium increases charged to many agencies, it is important that BRIM establish a premium structure based on accurate exposure data, particularly for property and general liability coverage, that is effectively communicated to BRIM's Underwriting Department. In this manner, premium increases will accurately reflect each insured's level of loss exposure.

## **Recommendations**

7. *BRIM should examine its current methods for documenting loss exposure and ensure that the current ARMTECH study adequately addresses the need for accurate data.*
8. *BRIM should make the use of appraisal or other data for state property value verification, a priority.*
9. *BRIM's Underwriting Department should establish regular communications with the Loss Control Department for the purpose of obtaining accurate loss exposure data on insureds when determining premium levels.*

# Appendix A: Transmittal Letter

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## WEST VIRGINIA LEGISLATURE *Performance Evaluation and Research Division*

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John Sylvia  
Director

October 27, 2003

Charles E. Jones, Jr., Executive Director  
West Virginia Board of Risk and Insurance Management  
90 MacCorkle Avenue S.W., Suite 203  
South Charleston, West Virginia 25303

Dear Mr. Jones:

This is to transmit a draft copy of the report on the Preliminary Performance Evaluation of the Board of Risk and Insurance Management. This report is scheduled to be presented during the November 16-18, 2003 interim meeting of the Joint Committee on Government Operations to be held in Charleston, West Virginia. A representative from your agency is expected to be present at the meeting to orally respond to the report and answer any questions the Committee may have. We will inform you of the exact time and location once the information is available.

We need to schedule an exit conference to discuss any concerns you may have with the report. We would like to have the meeting with you by Friday, October 31, 2003. Please notify us to schedule an exact time. In addition, we need your written response by noon on Wednesday, November 5, 2003 in order to include it in the final report. If your agency intends to distribute additional material to committee members at the meeting, please contact the House Government Organization staff at 340-3192 by Thursday, November 13, 2003 to make arrangements. Thank you for your cooperation.

We request that your personnel treat the draft report as confidential and that it not be disclosed to anyone not affiliated with your agency.

Sincerely,

Handwritten signature of John Sylvia in cursive script.  
John Sylvia

Enclosure

JS/rk

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*Joint Committee on Government and Finance*



# Appendix B: Agency Response

**STATE OF WEST VIRGINIA**  
**DEPARTMENT OF ADMINISTRATION**  
**BOARD OF RISK AND INSURANCE MANAGEMENT**



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BOB WISE  
GOVERNOR

TOM SUSMAN  
ACTING CABINET SECRETARY

November 5, 2003

John Sylvia, Director  
West Virginia Legislature  
Performance Evaluation and Research Division  
Building 1, Room 314  
1900 Kanawha Boulevard, East  
Charleston, West Virginia 25305-0610

**R E C E I V E D**  
NOV 06 2003

PERFORMANCE EVALUATION AND  
RESEARCH DIVISION

Dear Mr. Sylvia:

On behalf of the Board members and the staff of the West Virginia Board of Risk and Insurance Management (BRIM), we acknowledge receipt of the Draft Report on the Preliminary Performance Evaluation received October 27, 2003. We are appreciative of the time and effort expended by you and your staff in completing the analysis and proposed recommendations. Herewith is our response to those recommendations.

### Recommendation 1

BRIM should evaluate recent premium rate increases following the release of ARMTECH's actuarial study, in order to determine if premium rate structures reflect accurate loss exposure data and adequately address BRIM's unfunded liability.

### **BRIM's Response**

Several months ago, BRIM initiated a process to determine upon receipt of our independent actuarial study, that premium rate structures accurately reflect loss exposure data thereby addressing BRIM's unfunded liability. We are approximately ninety per cent (90%) complete with this process.

**Recommendation 2**

BRIM should maintain separate financial statements for each subsection of the SB3 Program to differentiate the various types of entities included in the Program.

**BRIM's Response**

We believe that implementing such a procedure would identify the financial shortcomings of a particular rate group, i.e., the County Commissions. However, in view of the difficulty most of the entities have in obtaining coverage other than that provided by BRIM, it is felt that the cost of doing so far outweighs the benefit. BRIM establishes premiums based on actuarial projections with the "pool" concept in mind. While the County Commission experience viewed by itself is too drastic to support a county commission "pool" alone, within the BRIM pool the county commissions share in the expenses and losses proportionately with other entities. In other words, a particular rate group might have fewer losses than another rate group and may in fact subsidize another rate group in a particular year. Conversely, that same rate group may be subsidized next year, dependent upon loss history. Implementing separate financial statements within the Senate Bill 3 classification, would identify a rate group that has poor experience. However, obtaining actuarial rate projections by rate group, which BRIM does anyway, identifies historically those rate groups that cost the most.

**Recommendation 3**

BRIM should carefully evaluate actuarial projections for future claims losses from the BRIM II program and make sufficient claims loss allowances to compensate for the projected fiscal impact.

**BRIM's Response**

BRIM has contracted an independent actuarial study to determine the claim runoff of those entities that will remain and not novated to the physician's mutual. The actuary is developing a five year financial plan to address those projected claims.

**Recommendation 4**

The Legislature should consider expanding the number of positions in BRIM's Loss Control Department in order to provide an adequate number of Loss Control Specialists to monitor the efforts of vendors, the compliance of insureds with loss control recommendations and to reduce the need to employ outside vendors.

**BRIM's Response**

Brim agrees.

**Recommendation 5**

BRIM and its loss control vendors should design a system for categorizing loss control recommendations that ranks them according to their level of importance in order to facilitate the monitoring of action plans.

**BRIM's Response**

BRIM agrees.

**Recommendation 6**

BRIM should comply with Recommendation 4 of PERD's 1997 report and implement a system of surcharges and credits, using the relative importance of loss control recommendations as criteria, as soon as possible.

**BRIM's Response**

BRIM agrees.

**Recommendation 7**

BRIM should examine its current methods for documenting loss exposure and ensure that the current ARMTECH study adequately addresses the need for accurate data.

**BRIM's Response**

BRIM began implementing a process to address this issue such that, completion of BRIM's year ended June 30, 2003 financial audit performed by an independent accounting firm, the issue of questionable exposure data was no longer indicated as a reportable condition and only mentioned in the management letter.

**Recommendation 8**

BRIM should make the use of appraisal, or other data for state property value verification, a priority.

**BRIM's Response**

BRIM has not undertaken this project at this time, due to other processes that have taken a greater priority. BRIM's property losses are only four per cent (4%) of total losses adjudicated. Although this project has merit, it was felt that resources could be better utilized elsewhere.

**Recommendation 9**

BRIM Underwriting Department should establish regular communications with the Loss Control Department for the purpose of obtaining accurate loss exposure data on insureds when determining premium levels.

**BRIM's Response**

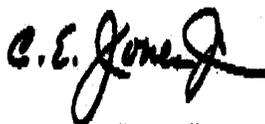
BRIM has improved communication through various Loss Control reporting forms from the Loss Control Department to the Underwriting Department. Efforts to also implement a format for return communication for the Underwriting Department to the Loss Control Department will be initiated.

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John Sylvia, Director  
November 5, 2003  
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It is hoped that our plan of action addresses the recommendations made by the Legislative Auditor for this Performance Evaluation. Should you have any questions, please do not hesitate to contact me.

Sincerely,



Charles E. Jones, Jr.  
Executive Director

CEJ/cjs

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