



Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

April 23, 2003

Joint Committee on Finance

Paper #457

Segregated Fund Transfers (Insurance)

[LFB 2003-05 Budget Summary: Page 277, #3]

CURRENT LAW

Patients Compensation Fund. The patients compensation fund (PCF) pays that portion of meritorious medical malpractice claims which exceeds the provider liability limits of \$1 million per claim and \$3 million per policy year in the aggregate. Health care providers must obtain primary medical malpractice insurance up to the liability limits. Providers then also pay for the protection of the excess medical malpractice liability insurance that PCF offers through an annual assessment.

PCF is held in trust for the purpose of providing medical malpractice coverage and to compensate patients and may not be used for any other purpose. In addition, claims are paid in the order received within 90 days, unless appealed, and if there are insufficient funds, the claims are immediately payable in the following year in the order in which they were received.

Local Government Property Insurance Fund. The local government property insurance fund (LGPIF) makes property insurance available for tax-supported local government property, such as government buildings, schools, libraries, and motor vehicles.

LGPIF is held in trust for the benefit of insureds and other proper claimants. Funds from LGPIF may not be spent for any other purpose of the state and may be borrowed by the state only pursuant to normal and usual investment practices. In addition, under current law, if LGPIF does not have sufficient assets to pay claims that are due, funds from the general fund sufficient to pay the losses will be transferred to LGPIF. LGPIF is then required to repay the general fund once it has sufficient assets.

State Life Insurance Fund. The state life insurance fund (SLIF) provides up to \$10,000 of basic life insurance coverage for Wisconsin residents.

SLIF is held in trust for the benefit of insureds and other proper claimants. Funds from SLIF may not be spent for any other purpose of the state and may be borrowed by the state only pursuant to normal and usual investment practices. In addition, SLIF is required to maintain a ratio of surplus to assets between 7% and 10%. Excess surplus must be returned to the policyholders annually by dividend payments.

GOVERNOR

Patients Compensation Fund. Delete \$83,600 SEG annually for the administration of PCF and transfer the funds to the general fund in 2003-04 and 2004-05, notwithstanding current law that states PCF is held in trust for the purpose of providing medical malpractice coverage and to compensate patients and may not be used for any other purpose.

In addition, create a sum sufficient GPR appropriation to pay any portion of a medical malpractice claim that PCF is required to pay but is unable to pay because of insufficient funds. Make the claims payable within 90 days from PCF, but if PCF has insufficient funds, the claims are payable within 90 days from the sum sufficient GPR appropriation. The sum sufficient GPR appropriation would be subject to the same review, assessment, and withdrawal processes as PCF.

Local Government Property Insurance Fund. Delete \$75,100 SEG annually for the administration of LGPIF and transfer the funds to the general fund in 2003-04 and 2004-05, notwithstanding current law that states LGPIF is held in trust for the benefit of insureds and other proper claimants, that funds from LGPIF may not be spent for any other purpose of the state, and that funds from LGPIF may be borrowed by the state only pursuant to normal and usual investment practices.

State Life Insurance Fund. Delete \$59,500 SEG annually for the administration of SLIF and transfer the funds to the general fund in 2003-04 and 2004-05, notwithstanding current law that states SLIF is held in trust for the benefit of insureds and other proper claimants, that funds from SLIF may not be spent for any other purpose of the state, and that funds from SLIF may be borrowed by the state only pursuant to normal and usual investment practices. In addition, transfer the funds notwithstanding that SLIF is required to maintain a ratio of surplus to assets between 7% and 10% and distribute excess surplus to the policyholders annually by dividend payments.

DISCUSSION POINTS

1. This item is part of the Governor's initiative to reduce the operating costs of state government and to use projected savings to increase revenue to the general fund. The bill would reduce the administrative appropriation of each of OCI's three segregated funds by approximately 10% and lapse these amounts to the general fund in each year of the 2003-05 biennium. Base funding for the administration of PCF is \$837,800 SEG, \$772,200 SEG for the administration of LGPIF, and \$611,800 for the administration of SLIF.

Legal Issues

2. Wisconsin Legislative Council staff have indicated that there are at least three legal issues that may be raised with respect to the proposal to transfer funds from the three segregated funds to the general fund: (a) whether transferring the funds amounts to a taking of property in violation of the Fifth Amendment of the United States Constitution and Article I, Section 13 of the Wisconsin Constitution; (b) whether transferring the funds amounts to an impairment of contract in violation of Article I, Section 10 of the United States Constitution and Article I, Section 12 of the Wisconsin Constitution; and (c) whether transferring the funds amounts to a violation of trust fund principles. Wisconsin Legislative Council staff indicate that there is very little case law applying these laws in these types of situations. Thus, it is not possible to predict with certainty how a court would rule.

3. There is a four-step process to analyze a takings claim. First, it must be determined whether a private property interest exists. Second, if so, it must be determined whether private property has been taken. Third, if so, it must be determined whether the private property was taken for a valid public use. Finally, if so, it must be determined whether just compensation was provided.

4. Wisconsin Legislative Council staff indicate that although there may be meritorious legal arguments regarding whether the transfer of funds from PCF and LGPIF to the general fund is a taking of property, the transfer may be able to survive a legal challenge. Even if a private property interest exists and has been taken, the creation of a sum sufficient GPR appropriation to make any potential claimants whole should PCF or LGPIF be unable to do so could qualify as just compensation.

5. However, Wisconsin Legislative Council staff indicate that a transfer from SLIF to the general fund appears more problematic. Because the policyholders receive excess surplus as dividend payments, the policyholders have a clear property interest in SLIF. No provision is made to compensate the policyholders for the loss of dividends. In addition, because neither current law nor the bill provides for the general fund to pay for any claims that SLIF is unable to pay, transferring funds from SLIF to the general fund could be taking personal property without just compensation.

6. There is a three-step process to analyze an impairment of contract claim. First, it must be determined whether the challenged statute has operated as a substantial impairment of a contractual relationship. Second, if the legislation is found to substantially impair a contractual relationship, it must be determined whether there exists a significant legitimate public purpose behind the legislation. Finally, if such a public purpose exists, it must be determined whether the challenged legislation is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation's adoption.

7. Wisconsin Legislative Council staff indicate that although there may be meritorious legal arguments regarding whether the transfer of funds from PCF and LGPIF to the general fund impairs a contract, the transfer may be able to survive a legal challenge. Arguably, there is no

impairment of contract because all that is being changed is the source of funding. The parties' rights and duties remain the same. Even if an impairment were found, the sum sufficient GPR appropriation that would be created under the bill relating to PCF, and the current sum sufficient appropriation for LGPIF, could be a reasonable condition and appropriate to the public purpose of the transfer.

8. However, Wisconsin Legislative Council staff indicate that a transfer from SLIF to the general fund appears problematic. Under current law, there appears to be a clear contract that provides for the SLIF surplus to be returned to the policyholders as dividends. Reducing the surplus could interfere with that contract, and there appears to be no reasonable condition or appropriateness to the public purpose of the transfer.

9. To analyze a claim of a violation of trust fund principles, the statutory purpose of the trust fund must first be determined. It must then be determined whether or not a specific action violates the purpose of the trust fund.

10. For a violation of trust fund principles claim regarding PCF, LGPIF, and SLIF, it could be argued that any violation of the statutorily stated purpose of the trust would be remedied by amending current law to reflect that the transfer would occur notwithstanding the statutorily stated purpose of the trust. This provision is included in the Governor's bill.

Contracted Services

11. LGPIF contracts for a variety of services. LGPIF contracts with ASU to perform the following services: (a) underwriting and issuance of policies and endorsements; (b) collecting premiums; (c) accounting; (d) preparation of statutory annual statements; (e) claims handling; (f) investigations; (g) adjustments and certifications that payments are appropriate under the insurance policy. OCI indicates that a decision was made approximately 20 years ago to contract for these services, rather than to hire staff to perform these functions.

12. LGPIF contracts with Insurance Services Office to obtain quotes and provide surveys of properties and blanket average loss cost factors for the purpose of underwriting each insured. LGPIF uses the rate factors provided by Insurance Services Office when it sets rates.

13. LGPIF contracts with American Appraisal Associates, which performs valuation services for LGPIF. The valuation services establish the replacement cost and insurance value for insured government property. This contract supports LGPIF's policy to establish insurance values for government property reflected on the insurance statement of values to take the onus off of the local governmental entity for purchasing the right amount of insurance.

14. Finally, LGPIF contracts with Merchant Consulting, which maintains the computer system. The computer system is currently a disk operating system, but is scheduled to be upgraded to a windows-based system in fiscal year 2003-04.

15. In 2002-03, LGPIF contracted for professional services in the amount of \$623,850. The vendors for these contracts were selected through a request for proposal process, so,

presumably, OCI is receiving the lowest rate available for the services. OCI could modify the contracts, but would have to accept a reduction in contracted services proportionate to the reduction in its budget. As a result, the transfer of funds from LGPIF would reduce services that OCI believes are vital to LGPIF. The 2002-03 LGPIF administrative appropriation also supports: (a) salaries and fringe benefits for 1.07 positions (\$76,200); (b) an actuarial study (\$20,000); (c) supplies and services (\$41,450); and (d) unallotted reserve (\$10,000).

16. SLIF also contracts for a variety of services. SLIF contracts with Mercer Risk, Finance and Insurance Consulting Inc., which provides actuarial services because SLIF does not have any staff actuarial positions. SLIF contracts with Management Data Incorporated (MDI), which provides computer and programming services for the SLIF insurance computer system. SLIF's computer system is a proprietary system, so only MDI can legally do the programming. SLIF contracts with Optimum Reinsurance, which provides reinsurance coverage. Finally, SLIF contracts with Sungard Insurance Systems, which provides reports and annual statement preparation. To perform these services internally, OCI indicates that a special software system would have to be purchased.

17. In fiscal year 2002-03, SLIF contracted for services in the amount of \$132,000. SLIF is budgeted \$594,900, which, in addition to the contracts, supports: (a) salaries and fringe benefits for 4.57 positions (\$243,200); (b) supplies and services (\$212,600); and (c) unallotted reserve (\$7,100). OCI would be in a better position to absorb a reduction of \$59,500 from SLIF than absorbing a reduction of \$75,100 from LGPIF.

18. To leave the current contracts intact for LGPIF and SLIF, as well as avoid any potential legal issues, the Committee could choose to lapse program revenue funds to the general fund from OCI's PR general operations appropriation, rather than transfer to the general fund from one or more of the segregated funds. However, the bill also would lapse \$1,226,800 PR in both 2003-04 and 2004-05 from OCI's general program operations appropriation and eliminate the requirement that the general fund repay the \$850,000 loan made by OCI to support administrative costs of the private employer health care coverage program. In addition, 2003 Wisconsin Act 1 lapsed \$5,653,500 PR from the unallocated balance of OCI's general program operations appropriation to the general fund. Further, OCI estimates a closing balance for its PR general operations appropriation at \$702,800 in 2003-04 and -\$191,100 in 2004-05. Consequently, any proposal that would increase spending from this source would require OCI to increase PR revenues to maintain a positive balance in the program revenue account.

19. Finally, in light of the legal and contractual issues raised by the Governor's proposals to transfer premium revenue paid by insureds into the general fund, the Committee could delete all three SEG funding transfers in the bill. Instead, the Committee could reduce funding from the agency's PR-funded general program operations budget by the combined total of these SEG reductions (-\$218,200 PR annually) and transfer this amount to the general fund. This alternative would: (a) meet the Governor's objective of reducing the agency's state operations costs; (b) not result in a loss of GPR revenue, compared to the bill; and (c) not require OCI to increase PR revenue to support the agency's operations. Instead, OCI would be required to reduce budgeted general program operations costs.

Under the bill, \$12,774,000 PR in 2003-04 and \$12,801,400 PR in 2004-05 would be provided to support OCI's general regulatory functions. A reduction of \$218,200 annually would represent a decrease of approximately 1.7% of the total amounts budgeted for this purpose in each year of the biennium.

ALTERNATIVES

A. Patients Compensation Fund

1. Approve the Governor's recommendation to delete \$83,600 SEG annually for the operation of PCF and transfer these amounts to the general fund in 2003-04 and 2004-05.

2. Delete the provision. Instead, lapse \$83,600 PR annually from OCI's PR general operations appropriation. Under this alternative: (a) SEG funding for the administration of PCF would be restored; and (b) the Governor's recommended revenue transfer to the general fund would be from general insurance fee revenue, rather than revenue from the segregated fund.

<u>Alternative A2</u>	<u>SEG</u>
2003-05 FUNDING (Change to Bill)	\$167,200

3. Delete provision. Under this alternative: (a) SEG funding for the administration of PCF would be restored; and (b) estimated general fund revenues would be reduced by \$83,600 annually.

<u>Alternative A3</u>	<u>GPR</u>	<u>SEG</u>
2003-05 REVENUE (Change to Bill)	-\$167,200	\$0
2003-05 FUNDING (Change to Bill)	\$0	\$167,200

B. Local Government Property Insurance Fund

1. Approve the Governor's recommendation to delete \$75,100 SEG annually by reducing annual funding budgeted for the operation of LGPIF and transferring the funds to the general fund in 2003-04 and 2004-05.

2. Delete the provision. Instead, lapse \$75,100 PR annually from OCI's PR general operations appropriation. Under this alternative: (a) SEG funding for the administration of LGPIF would be restored; and (b) the Governor's recommended revenue transfer from the general fund would be from general insurance fee revenue, rather than revenue from the segregated fund.

<u>Alternative B2</u>	<u>SEG</u>
2003-05 FUNDING (Change to Bill)	\$150,200

3. Delete provision. Under this alternative: (a) SEG funding for the administration of LGPIF would be restored; and (b) estimated general fund revenue would be reduced by \$75,100 annually.

<u>Alternative B3</u>	<u>GPR</u>	<u>SEG</u>
2003-05 REVENUE (Change to Bill)	- \$150,200	\$0
2003-05 FUNDING (Change to Bill)	\$0	\$150,200

C. State Life Insurance Fund

1. Approve the Governor's recommendation to delete \$59,500 SEG annually by reducing annual funding budgeted for the operation of SLIF and transferring the funds to the general fund in 2003-04 and 2004-05.

2. Delete the provision. Instead, lapse \$59,500 PR annually from OCI's PR general operations appropriation. Under this alternative; (a) SEG funding for the administration of SLIF would be restored; and (b) the Governor's recommended revenue transfer from the general fund would be from general insurance fee revenues, rather than from the segregated fund.

<u>Alternative C2</u>	<u>SEG</u>
2003-05 FUNDING (Change to Bill)	\$119,000

3. Delete the provision. Under this alternative: (a) SEG funding for the administration of SLIF would be restored; and (b) estimated general fund revenue would be reduced by \$59,500 annually.

<u>Alternative C3</u>	<u>GPR</u>	<u>SEG</u>
2003-05 REVENUE (Change to Bill)	- \$119,000	\$0
2003-05 FUNDING (Change to Bill)	\$0	\$119,000

D. General Program Operations Reduction

1. Rather than choose any of the alternatives under A, B, or C, delete all of the Governor's recommendations relating to this item. Instead, reduce the agency's general program operations budget by \$218,200 PR annually and transfer this amount to the general fund.

<u>Alternative D1</u>	<u>PR</u>	<u>SEG</u>	<u>TOTAL</u>
2003-05 FUNDING (Change to Bill)	- \$436,400	\$436,400	\$0

Prepared by: Kim Swissdorf