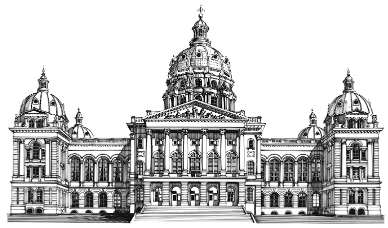
ISSUE REVIEW

Iowa Legislative Fiscal Bureau



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Underground Storage Tank Insurance Program

ISSUE

The purpose of this ***Issue Review*** is to present financial issues associated with the transition of the State's Underground Storage Tank Insurance Program to a private insurer.

Due to impending federal requirements and the goal to protect the environment from pollution caused by leaking underground petroleum storage tanks, the 1989 Legislature passed HF 447 (Petroleum Underground Storage Tank Act). Section 52 of that Act established a State-administered insurance program. Since that time, the State has received premiums from tank owners and paid claims for those that have had petroleum releases eligible for State financial assistance.

The 1998 Legislature enacted HF 2490 (Underground Storage Tank Insurance Act) to establish a procedure to transition the State-administered program to one run by the private sector. The Act created a separate Underground Storage Tank Insurance Board and established the procedures required for privatization of the insurance program. House File 2490 directed the Comprehensive Underground Storage Tank Board to transfer, no later than July 1, 2004, "all moneys in the (Insurance) Fund…to an independent nonprofit entity…owned and operated by insureds, as determined by the Comprehensive Underground Storage Tank Board."

AFFECTED AGENCIES

Comprehensive Underground Storage Tank Fund Board
Underground Storage Tank Insurance Board

CODE AUTHORITY

Section 455G.11, Code of Iowa

BACKGROUND

In the mid-1980's the federal government began setting requirements and timetables for gas stations and other operators of underground petroleum storage tanks to begin showing financial responsibility for environmental contamination due to the release of petroleum from storage tanks. At that time, private insurance was either unavailable, or was very expensive. The 1989 Legislature passed HF 447 to address this, and other problems facing the petroleum industry.

House File 447 addressed the issue of lack of affordable insurance by establishing a State-administered insurance program which would operate from FY 1989 through FY 2004. The insurance rates established in the original legislation were projected to be heavily subsidized by the State for the first five years, and were to move to an actuarially sound basis in FY 1995. The fiscal note for HF 447 projected a State subsidy for the insurance program of approximately $70.0 million.[1] Section 455G.11(5)(a), Code of Iowa, provided that if any funds remained in the insurance program after all claims were paid, the excess would be returned to the insureds on a prorated basis. [2]

With the passage of HF 2490 in 1998, the Legislature established a procedure for passing any insurance program surplus along to the underground storage tank owners by allowing the formation of an insurance entity owned and operated by insureds, and by transferring moneys in the Fund to that entity. This procedure has three advantages:

1. It allows for a seamless transition from one insurer to another, with retention of the original date of coverage (leaks that have occurred but are not reported would still be covered by the new insurer, as long as the contamination occurred during the time the site was insured through the State).
2. It allows some of the insureds to benefit from any profit made during the time the State operated the program. The insureds under the State program would benefit under the private program because the excess funds would be used to pay dividends or reduce premiums. However, those that have paid into the Fund in the past, but do not join the mutual insurance company cannot benefit.[3] Conversely, those that never purchased insurance under the State program could benefit by joining the mutual insurance company and receiving dividends or reduced premiums.[4]
3. It relieves possible pressure on the State to pay for sites that leaked during the State's insurance coverage period, but were not reported until after the policy expired (the State would not be legally required to pay the claims, but constituent pressure could develop to do so). The business plan proposed by the mutual company (discussed below) would pay any such claims from the assets of the company.

The Petroleum Marketers of Iowa, working with the Underground Storage Tank Insurance Board, have developed a proposal designed to transition the insurance program to a mutual insurance company owned and operated by the industry. The proposal would create a private mutual insurance company, called the Petroleum Marketers Mutual Insurance Company (PMMIC). The proposal was first presented to the Comprehensive Underground Storage Tank Board in July 1999. The proposed timeline concludes with a transfer of assets from the Insurance Fund to the Company in March 2000.

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[1] The Fiscal Note was based on an actuarial study conducted at the request of the Legislature by the actuarial firm of Alexander & Alexander, Inc.

[2] This provision was removed in Section 21 of HF 508 (Underground Storage Tank Act of 1995).

[3] The State has insured approximately 3,700 sites during the course of the program, with about 2,587 different insureds. However, during FY 1999, the number of insureds was about 1,372. The 1,215 difference represents a rough estimate of the number of individuals who paid insurance premiums in the past, but no longer operate underground storage tanks. Those persons would not benefit from a transfer of all Insurance Fund assets to the new mutual company.

[4] The entities that did not participate in the Insurance Fund are the large, self-insured oil companies. If the premiums are low or the dividends high due to the surplus cash held by the new mutual company, the large oil companies may join to access those benefits. Similarly, if the new mutual company offers insurance outside of the State of Iowa, or offers other types of insurance, purchasers of those policies could benefit from the accumulated surplus.

CURRENT SITUATION

Through June 1999, the insurance program has received $33.2 million in revenue and paid $3.5 million in expenses. The June 30, 1999, cash balance in the Insurance Fund is $29.7 million, with about $3.0 million in reserve for reported claims that have not been paid (all numbers are approximate).

UST Insurance Fund

FY 1990 - FY 1999 *

(Dollars in Millions)

	Amount	% of Premiums
Net Premiums **	$ 25.1	
Interest	8.0	
Other	0.1	
Total Revenue	$ 33.2	
Administration	$ 2.9	11.6%
Claims	0.6	2.4%
Total Expense	$ 3.5	14.0%
Ending Balance	$ 29.7	

* Excludes the installer portion.

** Net of refunds.

The insurance policies written by the State are "claims made" policies, which means that shortly after the expiration of the last policy, all State liability for any leaks not yet reported will be extinguished. Therefore, absent a huge influx of claims in FY 2000, it appears that the projection of a sizable subsidy for the insurance program was not accurate. Instead, it appears the insurance program was profitable.

The proposal for a mutual insurance company presented by the Petroleum Marketers of Iowa contemplated the transfer of $30.4 million from the Insurance Fund. The proposal contained a five-year revenue and expenditure projection. The following table presents a financial summary of that proposal. A more detailed spreadsheet is included as **Attachment 1**.

Petroleum Marketers Mutual Insurance Company Proposal

(Dollars in Millions)

	Five Year Total
Beginning Balance	$ 30.4
Total Revenue	$ 22.6
Total Available	$ 53.0

Expenses	
Administration	$ 4.7
PMMIC Claims	12.3
Prior UST Claims	8.7
Total Expense	$ 25.7
Surplus	$ 27.2
Ratio of surplus to premiums (end of year 5)	8.00

The projection shows that after paying $8.7 million in claims that occurred prior to the creation of the mutual insurance company (prior UST claims), the Company would end the fifth year of operation with $27.2 million, eight times the fifth-year premium revenues of the company.

The proposal also shows the Company projects paying or reserving for future payment a total of $21.1 million in claims during the first five years. This compares to $3.6 million during the nine years of State insurance. Further, the projection shows the Company would expend $4.7 million on administration (30.0% of premiums) during that time period, compared to $2.9 million for nine years of State program administration (11.6% of premiums).

ALTERNATIVES

- The Legislature could consider returning a portion of the surplus money in the Insurance Fund to the premium payers prior to transferring all assets to the proposed new mutual company. This action would return a portion of the excess premiums each insured paid, whether they are insuring tanks with the mutual company or not. The amount to be returned could be prorated, based on the amount of premiums paid by each insured during the life of the State insurance program. This would be consistent with the language of the original underground storage tank law. **Attachment 2** shows what would happen to the mutual insurance company's financial proposal if $15.0 million were returned to the premium payers prior to the transfer of assets to the mutual company. [5] At the end of the fifth year, the mutual company would have a surplus equal to 2.6 times the annual company premium revenue. This action would also either reduce the dividends paid to the mutual company owners, or increase the insurance premiums that would otherwise be paid, or both.
- The Underground Storage Tank Board or the Legislature could evaluate the amount paid by the insurance program for administration during the life of the program and determine if the amount was appropriate. The cost of administering the Underground Storage Tank Program has been split between the Remedial Program (funded by taxes) and the Insurance Program (funded by insurance premiums). [6] The business plan put forward by the proposed mutual company indicates an administrative expense ratio of 25.0% of premiums paid (excluding profit and premium taxes) is expected. Since inception, the insurance program has paid a total of $2.9 million for administration, 11.6% of net premiums paid. If the Insurance Program had paid the

[5] Approximately $25.1 million has been paid in insurance premiums since the beginning of the program. If $15.0 million were returned to the insureds prior to repayment, each insured would receive about $600 for each $1,000 of paid premiums. Over 2,000 insureds would receive refunds of $1,000 or more, while 280 would receive refunds in excess of $10,000. The largest refund would exceed $1.1 million. Under this alternative, 1,200 individuals and companies that contributed to the Insurance Program surplus, but did not insure tanks in FY 1999, would receive an average refund of $3,000.

[6] This would include the fee paid to the Fund Administrator, Williams and Company, along with other State government expenses that were never billed to the Insurance Fund, such as the Attorney General, Treasurer's Office, Board expenses, State official and employee time, and other indirect costs.

projected 25.0% during the life of the Program, the Underground Storage Tank Remedial Program would have $3.3 million more, while the Insurance Program balance would be lower by $3.3 million.

- The Legislature could consider prohibiting the new mutual insurance company from adopting dividend or premium policies which would in effect, distribute the accumulated Insurance Fund surplus to future mutual company members who did not contribute to the creation of the surplus, or did not contribute to the same degree as others.
- The Legislature or the Comprehensive Underground Storage Tank Board could delay the transfer until some time beyond March 2000. Transfer of the insurance program to the private sector is not required until July 1, 2004.
- No action by the Legislature is required. If the Petroleum Marketers Mutual Insurance Company proposal is acceptable to the Underground Storage Tank Insurance Board and the Comprehensive Underground Storage Tank Board, the surplus will be transferred to the new mutual company and distributed to the members by a method determined by the Company.

BUDGET IMPACT

If the Legislature or the Underground Storage Tank Board determines a more equitable distribution of administrative costs should have been used in the past, the Remedial Fund portion of the Underground Storage Tank Program could have as much as $3.3 million more to pay cleanup costs for past contamination.

There would be no fiscal impact to the State if the Legislature were to direct that a portion of the surplus Insurance Fund money be returned to the insureds prior to transfer to the private mutual insurance company.

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Underground Storage Tank Insurance Program

Proposed Mutual Insurance Company Balance Sheet and Cash Flow Statement

$30.4 million transferred from the State Insurance Program

	Year 1	Year 2	Year 3	Year 4	Year 5	Five Year Total
Beginning Cash & Investments	$ 30,400,000	$ 31,623,512	$ 32,924,232	$ 34,306,642	$ 35,775,474	$ 30,400,000
Premiums Paid	2,828,709	2,963,554	3,104,826	3,252,833	3,407,896	15,557,818
Investment Income	1,292,000	1,343,999	1,399,280	1,458,032	1,520,458	7,013,769
Total Income	$ 4,120,709	$ 4,307,553	$ 4,504,106	$ 4,710,865	$ 4,928,354	$ 22,571,587
Total Available	$ 34,520,709	$ 35,931,066	$ 37,428,338	$ 39,017,508	$ 40,703,827	$ 52,971,587
Administrative Expense	848,613	889,066	931,448	975,850	1,022,369	4,667,345
PMMIC Loses Paid	1,451,286	1,520,469	1,592,950	1,668,886	1,748,441	7,982,032
UST Fund Losses	597,298	597,298	597,298	597,298	597,298	2,986,490
Total Expenses Paid	$ 2,897,197	$ 3,006,833	$ 3,121,696	$ 3,242,034	$ 3,368,108	$ 15,635,867
Ending Cash & Investments	$ 31,623,512	$ 32,924,232	$ 34,306,642	$ 35,775,474	$ 37,335,720	$ 37,335,720
PMMIC Liabilities	1,898,117	2,472,363	3,073,981	3,147,985	4,364,626	4,364,626
UST Fund Liabilities	8,112,917	7,515,619	6,918,320	6,321,022	5,723,724	5,723,724
Total Liabilities	$ 10,011,034	$ 9,987,982	$ 9,992,301	$ 9,469,007	$ 10,088,350	$ 10,088,350
Surplus (Net Worth)	$ 21,612,479	$ 22,936,250	$ 24,314,341	$ 26,306,467	$ 27,247,370	$ 27,247,370
Ratio of Surplus to Premiums	7.64	7.74	7.83	8.09	8.00	

Source: Petroleum Marketers Mutual Insurance Company Proposal - July 1999

Proposed Mutual Insurance Company Balance Sheet and Cash Flow Statement

$15.4 million transferred from the State Insurance Program

	Year 1	Year 2	Year 3	Year 4	Year 5	Five Year Total
Beginning Cash & Investments	$ 15,400,000	$ 15,986,012	$ 16,622,139	$ 17,311,710	$ 18,058,256	$ 15,400,000
Premiums Paid	2,828,709	2,963,554	3,104,826	3,252,833	3,407,896	15,557,818
Investment Income	654,500	679,406	706,441	735,748	767,476	3,543,570
Total Income	$ 3,483,209	$ 3,642,960	$ 3,811,267	$ 3,988,581	$ 4,175,372	$ 19,101,388
Total Available	$ 18,883,209	$ 19,628,972	$ 20,433,406	$ 21,300,290	$ 22,233,628	$ 34,501,388
Administrative Expense	848,613	889,066	931,448	975,850	1,022,369	4,667,345
PMMIC Loses Paid	1,451,286	1,520,469	1,592,950	1,668,886	1,748,441	7,982,032
UST Fund Losses	597,298	597,298	597,298	597,298	597,298	2,986,490
Total Expenses Paid	$ 2,897,197	$ 3,006,833	$ 3,121,696	$ 3,242,034	$ 3,368,108	$ 15,635,867
Ending Cash & Investments	$ 15,986,012	$ 16,622,139	$ 17,311,710	$ 18,058,256	$ 18,865,521	$ 18,865,521
PMMIC Liabilities	1,898,117	2,472,363	3,073,981	3,147,985	4,364,626	4,364,626
UST Fund Liabilities	8,112,917	7,515,619	6,918,320	6,321,022	5,723,724	5,723,724
Total Liabilities	$ 10,011,034	$ 9,987,982	$ 9,992,301	$ 9,469,007	$ 10,088,350	$ 10,088,350
Surplus (Net Worth)	$ 5,974,979	$ 6,634,157	$ 7,319,409	$ 8,589,250	$ 8,777,171	$ 8,777,171
Ratio of Surplus to Premiums	2.11	2.24	2.36	2.64	2.58	

Source: Petroleum Marketers Mutual Insurance Company Proposal - July 1999 (modified)