A SELF-INSURANCE PLAN FOR THE STATE PROPERTIES OF VIRGINIA

by

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CHAPTER I

INTRODUCTION

In 1956 several members of the Virginia General Assembly took an interest in the possible savings to be had in the establishment of a State self-insurance fund to replace commercial fire insurance on public properties. The members of the insurance industry maintain that self-insurance plans usually violate basic insurance principles and are unsafe and unsound. In fact this purported violation of seemingly mystic principles and/or practices has been the Maginot Line of those opposing adoption of a self-insurance plan.

It is the objective of this paper to discuss pertinent insurance principles and practices and embody them in a criterion which will be used to evaluate a self-insurance program as might be established in the State. Also, the arguments against a self-insurance plan will be examined for their validity. Lastly, some advantages of such an undertaking will be discussed.

In this first chapter the historical background of the various insurance plans of other states will be discussed.

HISTORICAL BACKGROUND OF SELF-INSURANCE PLANS

In an attempt to reduce the cost of fire insurance on their buildings, many states have contemplated the idea of becoming a self-insurer. Since

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[1] This statement is based on many personal interviews with insurance representatives during the annum of 1960-61 and opposing testimony by members of the insurance industry at the July 1961 Public Hearing before the VALC committee at Richmond.

1897, nineteen states have become self-insurers, and many more have made formal studies of the possibilities of such a plan.

Iowa established a Contingent Fund in 1897, which is still in existence, to restore or repair state property destroyed by fire, storm, riot, or any other cause. Since that date eighteen additional states have adopted public property insurance. These state plans generally provide insurance for state-owned buildings against loss by fire. In some cases, these funds also insure public property against losses resulting from tornado, lightning and similar risks.[2]

Of the nineteen states which established public property insurance funds between 1897 and 1960, eight have abolished them or permitted them to lapse. Colorado abolished its State Fire Loss Fund in 1939; Georgia abandoned its Fire Insurance Sinking Fund in 1936 after little more than a year's operation; Montana repealed its State Fund Act in 1936; New Jersey discontinued its fund in 1935; Minnesota, South Dakota, and Tennessee allowed their funds to lapse in the 1930's; and Rhode Island's fund was abolished in 1948.[3] With the exception of Rhode Island's plan, all discontinuances occurred during the depression years when tax receipts were very low and adequate funds were hard to maintain.

The following tables are a report of the practice of the several states in their insuring of state buildings, including how the insurance is placed and total provided coverage. There are twelve states reporting programs of self-insurance of various forms. The others purchase

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[2] Government Insurance in the United States, (New York, Association of Casualty and Surety Companies, 1950), p. 72.

[3] Ibid., p. 72.

TABLE I

STATUS AND PLACEMENT OF STATE PROPERTY INSURANCE IN THE USA
AS OF JULY, 1960[4]

Alabama - Handled by Director, Department of Finance
Alaska - Handled by Department of Administration
Arkansas - Handled by State Purchasing Agent
California - Insurance procured through State Department of Finance
Colorado - Handled by State Purchasing Agent

Delaware - Governor, State Auditor, and Commissioner determine amount. The Commissioner determines what manner of insurance.
Florida - Handled by Director of State Fire Insurance Fund
Georgia - Allocated by the Governor
Hawaii - Handled by the Department of Accounting and General Services
Idaho - Handled by the Commissioner of Insurance - Political Patronage

Illinois - Handled by the Governor, who gives written release when there is a loss.
Iowa - Loss provided for by Act of Legislature
Kansas - Insurance placed by the Division of Purchases
Kentucky - Handled by Kentucky Insurance Department
Louisiana - Handled by Division of Administration, Office of the Governor

Maine - Allocated by Governor and Governor's Executive Council
Maryland - Placed by State Treasurer
Michigan - Placed through State Administration Board at recommendation of Commissioner of Insurance
Minnesota - Placed by Division of Procurement (only prison insured)
Missouri - Replacement of Losses made through legislative action

Montana - Placed by State Board of Examiners
Nebraska - No Insurance - No Provision
Nevada - Placed by the State Board of Finance
New Hampshire - No Insurance - No Provision
New Jersey - Handled by the Insurance Advisory Committee

New Mexico - Handled by the Department of Insurance
New York - Placed by the Division of Standards and Purchase
North Carolina - Placed by the North Carolina Insurance Department
North Dakota - Handled by the Insurance Department
Ohio - Handled by the Insurance Department

TABLE I (Continued)

STATUS AND PLACEMENT OF STATE PROPERTY INSURANCE IN THE USA
AS OF JULY, 1960[4]

Oklahoma - No Insurance
Oregon - Handled by Services Division of the Department of Finance and Administration (Funds by Legislative Action)
Pennsylvania - General Assembly Appropriations
South Carolina - Handled by the State Budget and Control Board
South Dakota - No Insurance

Texas - Insurance purchased by each agency (mostly educational institutions insured)
Utah - Placed by a central agency under the Purchasing Department
Washington - No Insurance - No Provision for Losses
West Virginia - Handled by the State Board of Insurance
Wisconsin - State Insurance Fund under direction of Insurance Commissioner

Wyoming - Handled by the Purchasing Agent, who is Budget Officer

[4]Report of the Bureau of Property Records and Insurance, Stewart R. Moore, Chief of Bureau, (Richmond, Virginia, 1961). This report made at the request of the VALC was compiled by questionnaire sent to forty-nine States; eight did not reply.

TABLE II

STATE PROPERTY VALUES WITH EXTENT AND TYPE OF INSURANCE COVERAGE SHOWN 5

DIVISION OF THE BUDGET
BUREAU OF PROPERTY RECORDS AND INSURANCE

STATUS OF STATE PROPERTY INSURANCE IN THE USA AS OF JULY 1960

STATE	STATE PROPERTY VALUES		FIRE LOSSES			ARE STATE BUILDINGS & CONTENTS INSURED?				TYPE OF INSURANCE CO.		INSURANCE PLACED BY:		SELF-INSURANCE	SINKING FUND	REMARKS
						FIRE		EXTEND.		STOCK ONLY	STOCK & MUTUAL	CENTRAL AGENCY	EACH INSTITUTION			
	BUILDINGS	CONTENTS	1959	1958	1957	YES	NO	YES	NO							
ALASKA	$ 75,000,000	$ Included	$ 0	$ 0	$ 0	X		X			X	X		No	No	
ALABAMA	301,529,502	57,282,442	563,923	355,465	235,022	X		X		X		X		Yes	Yes	Part self-ins; part stock cos.
ARIZONA																
ARKANSAS	97,433,104	Included	438,367	0	0	X		X		X			X	No	No	
CALIFORNIA	500,000,000	Included	12,257	0	0	X		X		X		X		No	No	$50,000,000 insurance on Port bldgs. only; no other insurance
COLORADO	150,000,000	50,000,000	0	3,813	1,617	X		X			X	X		No	No	
CONNECTICUT																
DELAWARE	52,000,000	8,000,000	83,442	36,024	14,285	X		X			X	X		No	No	
FLORIDA	157,717,110	43,915,638	18,520	7,870	142,632	X		X		X		X		Yes	Yes	75% value self-insured; 25% value stock companies
GEORGIA	160,000,000	Included	av116,386	av116,386	av116,386	X		X		X		X		No	No	Gov. gives insurance to favorites
HAWAII	71,404,531	31,144,699	26,256	205,087	185,432	X		X						Yes	No	
IDAHO	100,000,000	Included	5,000	12,000	70,000	X		X			X	X		No	No	
ILLINOIS	Unknown	Unknown	av100,500	av100,500	146,750	X		X						Yes	No	$300,000 appropriated each biennium for losses
INDIANA																
IOWA	Unknown	Unknown	0	0	0		X		X					No	No	No provision for ins. or loss
KANSAS	Unknown	Unknown	0	0	1,000	X		X			X	X		No	No	Ins. on revenue bond proj. only
KENTUCKY	190,815,000	32,100,000	258,000	31,750	73,825	X		X		X		X		Yes	Yes	1st $300,000 insurance by State
LOUISIANA	242,800,000	Included	50,437	151,065	70,565	X		X		X		X		No	No	
MAINE	90,265,600	21,363,400	45,938	14,737	20,004	X		X		X		X		No	No	
MARYLAND	245,725,220	Included	184,200	39,693	54,891	X		X		X		X		No	No	
MASSACHUSETTS																
MICHIGAN	Unknown	171,048,560	707,559	502,698	258,411	X*		X		X		X		No	Yes	*Partly-**Not less than $250,000
MINNESOTA	Unknown	Unknown	0	0	0	*		*		X		X		No	No	*Prison(only) insured for $6,000,000
MISSISSIPPI																
MISSOURI	Unknown	Unknown	2,295	2,365	0		X		X					No	No	Losses Appropriated by Legislature
MONTANA	91,000,000	11,000,000	av64,700	av64,700	av64,700	X		X				X	X	No	No	
NEBRASKA	Unknown	Unknown	12,155	1,174	1,659		X		X					No	No	
NEVADA	21,768,850	1,795,515	0	0	0	X		X		X		X		No	No	
NEW HAMPSHIRE	Unknown	Unknown	0	0	0		X		X					No	No	
NEW JERSEY	275,000,000	25,000,000	78,823	34,719	37,366	X			X	X		X		No	No	
NEW MEXICO	Unknown	Unknown	0	0	0	X		X			X		X	No	No	Prop. Ins'd. for 75% of value
NEW YORK	Unknown	Unknown	0	0	0		X		X					No	No	

TABLE II (CONTINUED)

STATE PROPERTY VALUES WITH EXTENT AND TYPE OF INSURANCE COVERAGE SHOWN[5]

DIVISION OF THE BUDGET
BUREAU OF PROPERTY RECORDS AND INSURANCE

STATUS OF STATE PROPERTY INSURANCE IN THE USA AS OF JULY 1960

STATE	STATE PROPERTY VALUES		FIRE LOSSES			ARE STATE BUILDINGS & CONTENTS INSURED?				TYPE OF INSURANCE CO.		INSURANCE PLACED BY:		SELF-INSURANCE	SINKING FUND	REMARKS
						FIRE		EXTEND.		STOCK ONLY	STOCK & MUTUAL	CENTRAL AGENCY	EACH INSTITUTION			
	BUILDINGS	CONTENTS	1959	1958	1957	YES	NO	YES	NO							
NORTH CAROLINA	$355,000,000	$ 63,000,000	$ 40,000	$ 150,000	$ 175,000	X		X		X		X		Yes	Yes	First $250,000 ins. by State; $2,400,000 sinking fund
NORTH DAKOTA	Unknown	Unknown	0	3,508,601	0	X		X						Yes	Yes	Fire & Tornado $8,000,000 sinking fund
OHIO	Unknown	Unknown	0	0	0	X		X						Yes	-	
OKLAHOMA	Unknown	Unknown	0	0	0		X		X					No	No	
OREGON	251,477,009	75,836,159	30,600	83,150	33,051	X		X		X		X		Yes	Yes	$3,000,000 sinking fund; stock co.ins.on revenue bond projects
PENNSYLVANIA	Unknown	Unknown	0	0	0		X		X					No	No	
RHODE ISLAND																
SOUTH CAROLINA	138,936,663	Included	25,539	0	0	X		X						Yes	Yes	$13,398,855 sinking fund
SOUTH DAKOTA	Unknown	Unknown	0	0	0		X		X					No	No	
TENNESSEE																
TEXAS	554,403,381	Included	0	0	0	*X		*X		X			X	No	No	*Mainly Educational Institutions
UTAH	90,000,000	Included	14,154	15,600	57,976	X			X	X		X		No	No	
VERMONT																
VIRGINIA	255,977,282	57,143,623	av80,195	av80,195	av80,195	X		X			X		X	No	No	Hwys. & Parks bldgs. uninsured
WASHINGTON	Unknown	Unknown	0	0	0		X		X					No	No	
WEST VIRGINIA	36,191,120	Included	50,000	0	0	X		X			X	X		No	No	
WISCONSIN	317,636,785	Included	115,481	41,704	50,515	X		X						Yes	Yes	
WYOMING	23,726,795	Included	263	0	0	X		X			X	X		No	No	

[5]This table was provided by the Virginia Bureau of Property Records and Insurance.

TABLE XIX

STATE PUBLIC PROPERTY INSURANCE FUNDS
STATEMENT OF OPERATIONS, 1948-1949[6]

State	Assets	Total Insurance	Total Losses Paid	Operating Expenses
Alabama	1,420,025	88,886,938[a]	334,495[b]	21,053
Florida	1,866,746	42,231,584[c]	36,557[c]	7,756
Kentucky	1,000,000	no information	226,318	35,317
Michigan	1,692,088	258,225,270	170,185	1,233
North Carolina	310,650	150,000,000[d]	10,408[e]	f
North Dakota	2,428,018	78,573,372[g]	165,132[h]	13,362
Oregon	419,407	58,000,000	235,686[h]	j
Pennsylvania	606,666	no information	97,378	7,223
South Carolina	4,461,141[k]	85,003,761	173,533[l]	21,104
Wisconsin	6,665,463	194,484,933[m]	82,080	22,050

[a] Before deduction for reinsurance
[b] Reinsurance recoveries not deducted
[c] Excludes excess insurance
[d] Total valuation of state property, May, 1949
[e] Paid in 1948; losses paid up to 50% of value
[f] Fund does not pay operating expenses, as they are included in the expense of the North Carolina Insurance Department
[g] Includes reinsurance of $6,726,468
[h] Losses paid in 1947 and 1948
[j] No expenditures are made from fund except for losses paid. Administrative costs are appropriated by Legislature as part of operation of Oregon State Board of Control
[k] Includes assets of $698,965 in Reinsurance Sinking Fund
[l] Includes losses paid by Reinsurance Sinking Fund
[m] Includes fire and lightning, extended coverage, tornado, wind and hail, sprinkler leakage, motor vehicle and inland marine--for all state property and such county, school and municipal property and libraries as choose to insure in the state fund.

[6] Government Insurance in the United States, (New York, Association of Casualty and Surety Companies, 1950), pp. 76,77.

commercial protection with placement handled by various state officials.

Of the eleven states which have self-insurance programs, there is a complete report taken from a special study prepared by the Department of Research of the Association of Casualty and Surety Companies. Iowa is not included because its contingent fund is financed out of the general funds of the State, and no specific amount per year is set aside by law.

AN EXAMINATION OF MICHIGAN'S RECORD

Incorporated in the argument against self-insurance by a state will inevitably be a reference to the apparent failure of Michigan's plan, although Michigan has not abolished its program.

Michigan set up a State Insurance Fund in 1913, by an act of Legislature. Each division of the Government was charged an arbitrary flat rate based on a property valuation under the jurisdiction of each unit. After a specified amount was reached in the fund, premiums were suspended unless payments for losses drained the fund to a danger point, at which time assessments would be made to restore the fund to a safe level.

There was an amendment to the Act in 1945 which set the level of the State Fund at $5,000,000. The perils that were to be insured against were similar to those covered by the private companies' fire and extended coverage policies. Each building covered under the program would be insured at its replacement cost. The premiums charged the divisions would be based on rates the same as those set up by the private rating bureau licensed in the State.

In 1946, State liquor stocks and the serums of the State Health Laboratories were exempted from coverage under the State Fund by the

Legislature. These were to be insured by private companies. The following session caused a reduction in the maximum to be accumulated in the fund from $5,000,000 to $1,750,000.

The Commissioner of Insurance had charge of the Fund; all evaluations, premium calculations and adjustments were handled by the Insurance Departments, and expenses were chargeable to the fund. The fund worked well, and only in one year, 1950, did payments for losses exceed premium income.

The Fund was nearly to the statutory limit of $1,750,000 when its apparent failure occurred. There was a fire loss to the State Office Building of $3,271,993 in 1951; a riot and ensuing fire occurred at the Southern Michigan prison which caused damage to the extent of $1,483,970. The State Insurance Fund paid only $575,000 on the losses of $6,755,963. There remained in the fund $360,000.[7] The Legislature of the State had to appropriate the remaining moneys from the General Treasury, an indication that the plan had failed.

It might be said that this disaster would not have been so severe had the Legislature allowed the Fund to accumulate to the $5,000,000 level as was set in 1949. Furthermore, the insurance companies were very quick to point out the failure of this program based on the losses of one year, losses which far exceeded the accumulated fund. But the program should be viewed in its entirety, dating from 1913, to be judged a complete failure. If the savings from the program since its inception were calculated and then compared to the necessitated $5,840,963 appropriation of 1951, a far brighter picture would present itself for observation.

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[7]George S. Hanson, State and Municipal Self-Insurance, (New York, National Association of Insurance Agents, 1953), p. 25.

A SUCCESSFUL STATE PLAN

South Carolina was the first State to establish a program of self-insurance based on sound economical principles. This plan has proved itself to be durable over the years since its inception in 1900, and might well be used as an argument for self-insurance. The Insurance Sinking Fund of South Carolina insures State properties against all perils covered under the commercial policies with extended coverage.

The administration of the fund is in the hands of the State Sinking Fund Commission. Municipal properties are not included in the properties insured. The fund charges premiums comparable to what private companies would charge, but only at 65% to 80% of the commercial rate.

South Carolina's fund originally reinsured part of its risk with private companies, but after two serious fires, reinsurance connections refused to renew their contracts. The Reinsurance Fund was created in 1927 to fill the need caused by termination of reinsurance contracts. This new fund was established by transferring $60,000 from the Insurance Sinking Fund as a yearly premium. In 1947 the annual premium to the Reinsurance Sinking Fund was raised to $180,000. At the present time the Reinsurance Fund pays all losses above $25,000 on brick buildings and all losses exceeding $10,000 on brick veneer and frame buildings.[6]

Because the State is engaged in an expansion program for its schools and other public properties, the Sinking Fund is enlarging the total

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[6]George S. Hanson, State and Municipal Self-Insurance, (New York, National Association of Insurance Agents, 1953), p.35, (hereafter referred to as George S. Hanson, State and Municipal Self-Insurance, p, 2.

insurance in force at a rapid stride. The Inspection and Rating Bureau provides advisory rates on properties to the Sinking Fund Commission which modifies or reduces them in accordance with the general management practices of the Fund. Only buildings which have an AAA rating are eligible for full insurance; all others are insured for only 75% of their value. The Sinking Fund contains as of July 1960, $13,398,855; insurance in force is $138,936,663.[9]

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[9] Ibid., p. 36

CHAPTER II

THE HISTORY OF THE SELF-INSURANCE MOVEMENT IN VIRGINIA

THE PRESENT PROGRAM OF INSURING PRACTICES

Virginia belongs to the majority of states in that it is not a self-insurer. Insurance is placed by the various individual institutions on all buildings worth $100 or more. Insurance in most cases is carried for fire damage only.

With the exception of five institutions, reliance is placed upon the advice of the insuring agent as to the placement of insurance. These exceptions are the Virginia School for the Deaf and the Blind, the Department of Highways, the Department of Mental Hygiene and Hospitals, Virginia Military Institute, and the Virginia Museum of Fine Arts.[1] These institutions obtain the advice of professional insurance advisors before they place any insurance.

There is a wide placement of insurance among the various agencies by institutions. These agents in turn, providing the risk and corresponding premium are large, place the risk with the several companies whose lines they carry. The exact amount of the premium and assumed risk assigned to a company is usually left to the discretion of the agent.

Prior to 1961, most of the institutions insured their properties under a policy giving blanket coverage. Several buildings in different locations may be insured under a blanket policy, as may different kinds of property at

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[1]Report of the Division of the Budget to the VALC, L. M. Kuhn, Director, (Richmond, 1961.)

TABLE IV

VIRGINIA PUBLIC INSTITUTIONS OR AGENCIES AND THEIR INSURING AGENTS OF RECORD, 1960[2]

INSTITUTIONS OR AGENCIES	AMOUNT OF INSURANCE	ANNUAL PREMIUM	AGENT OF RECORD
Education			
Longwood College	5,110,725	4,726	Garland & Harwood Farmville
Madison College	4,098,600	6,126	C. G. Price & Sons Harrisonburg
Mary Washington College	8,462,795	6,921	Roger Clark Agency Fredericksburg
Medical College of Virginia	12,480,281	13,085	Tabb, Brockenbrough & Ragland Richmond
Radford College	3,861,292	3,410	Geisen-Caldwell Radford
Richmond Professional Institute	3,646,900	3,456	Davenport Ins. Corp. Richmond
University of Virginia	12,513,240	16,491	Hanckel-Citizens Charlottesville Royal Globe Richmond
Clinch Valley College	725,000	1,350	Norton Ins. Agcy. Norton
Virginia Military Institute	7,362,484	6,818	R. Reid Agnor, Jr. W. L. Foltz & Son General Ins. & Bonds Lexington
Virginia Polytechnic Institute	18,600,000	21,140	Charles Lunsford Sons & Izard Roanoke

TABLE IV (Continued)

VIRGINIA PUBLIC INSTITUTIONS OR AGENCIES AND THEIR INSURING AGENTS OF RECORD, 1960[2]

INSTITUTIONS OR AGENCIES	AMOUNT OF INSURANCE	ANNUAL PREMIUM	AGENT OF RECORD
Virginia School for the Deaf & Blind	2,614,400	3,639	General Adjustment Bureau Harrisonburg
Virginia State College Petersburg	8,435,000	11,742	R. S. Terrie Agcy. Petersburg
Virginia State College Norfolk	2,290,000	2,800	Henderson & Phillips Norfolk
Virginia State School	1,470,500	1,937	W. R. Walker, Jr. Newport News
College of William & Mary Williamsburg	10,256,750	8,636	John Chappell Agcy. Richmond
College of William & Mary Norfolk Extension	1,964,000	3,997	John Cahill Ins. Norfolk
Woodrow Wilson Rehab. Center	779,000	1,897	W. J. Perry Corp. Staunton
Department of Health			
Blue Ridge Sanatorium	1,267,300	2,765	City Mort. & Ins., Co. Charlottesville
Catawba Sanatorium	3,781,000	3,494	Gittens & Morton Salem

TABLE IV (Continued)

VIRGINIA PUBLIC INSTITUTIONS OR AGENCIES AND THEIR INSURING AGENTS OF RECORD, 1960[2]

INSTITUTIONS OF AGENCIES	AMOUNT OF INSURANCE	ANNUAL PREMIUM	AGENT OF RECORD
Piedmont Sanatorium	1,971,270	2,508	Jones & Company Crews Nottoway Ins. Agcy. Crews L. S. Hillaman & Co. Burkeville Garland & Harwood Farmville
Department of Mental Hygiene & Hospitals			
Central State Hospital	9,374,865	8,850	Petersburg Ins. Co. Petersburg
DeJarnette State Sanatorium	869,217	814	R. W. Eastman Ins. Staunton
Eastern State Hospital	8,393,143	6,180	G. R. Brooks Agcy. Williamsburg
Lynchburg Training School and Hospital	7,046,040	5,676	Thos. J. Ingram, Jr. Lynchburg
Petersburg Training School	572,589	528	Petersburg Ins. Co. Petersburg
Southwestern State Hospital	7,689,600	4,998	H. M. Elliott Abingdon
Western State Hospital	9,070,900	9,684	Staunton Ins. Agcy. Staunton

TABLE IV (Continued)

VIRGINIA PUBLIC INSTITUTIONS OR AGENCIES AND THEIR INSURING AGENTS OF RECORD, 1960[2]

INSTITUTIONS OF AGENCIES	AMOUNT OF INSURANCE	ANNUAL PREMIUM	AGENT OF RECORD
Miscellaneous			
Commission of Game & Inland Fisheries	564,000	2,414	DeJarnette & Paul Richmond
Buildings & Grounds	13,491,392	8,178	Tabb, Brockenbrough & Ragland Richmond
Gunston Hall	297,948	790	Paul & Streat Richmond
Department of Highways	1,245,938	3,176	Mutual Insurers Richmond
Department of Military Affairs	436,300	2,538	John Cahill Ins. Norfolk
Department of State Police	1,734,878	3,841	E. E. Goodwyn Corp. Emporia
Virginia Museum of Fine Arts	6,679,383	4,653	Davenport Ins. Corp. Richmond
Virginia Truck Experiment Station	521,400	1,102	Henderson & Phillips Norfolk

TABLE IV (Continued)

VIRGINIA PUBLIC INSTITUTIONS OR AGENCIES AND THEIR INSURING AGENTS OF RECORD, 1960[2]

INSTITUTIONS OF AGENCIES	AMOUNT OF INSURANCE	ANNUAL PREMIUM	AGENT OF RECORD
Miscellaneous			
A. B. C. Board	14,456,082	28,994	Elliott Ins. Agcy. Boswell & Curtis Jordon-Palmore Agcy. Tabb, Brockenbrough & Ragland McCue, Alsop & Elliot Goddin, Goodrich & Robertson Richmond Ethridge, Baylor, Hofheimer, Inc. W. Taylor Johnson Co. Baldwin Bros. & Taylor Norfolk International Ins. Co. Alexandria Crowle & Company Fifer & Agner Staunton Pierce Ins. Agency Christiansburg Patton, Temple & Williamson Danville

[2]Report of the Bureau of Property Records and Insurance, Stewart R. Moore, Chief of Bureau, (Richmond, 1959), pp. 1-2.

a single location. The actual policy is written subject to a controlling form that is dictated by the Bureau of Insurance of the State Corporation Commission, which is one of the more than 100,000 forms of the bureau covering all types of insurable interests.[3]

The Bureau of Insurance was established in 1906 by the Legislature. It is responsible for the regulation of the insurance business done in Virginia, but it has no direct control over the placement of insurance. Also, the Bureau has no control over the length of a term for which policies are written. It keeps no central records other than those necessary to its financial regulation, licensing, and certification of agents and companies.

FIRST LEGISLATIVE INTEREST

Because there was no place of central records, little information was available that might lend itself to analysis. Prospective proponents of self-insurance could not support their thoughts with any facts and had not the time, nor knowledge, to assemble argumentative statistics. Because of this there was little current legislative interest until the first Virginia Advisory Legislative Council's study in 1956 and 1957.

This advisory body of legislators and prominent State citizens, who make studies on various subjects and report their findings and conclusions to the General Assembly, was asked to study the possibility of the State's becoming a self-insurer.[4] The Chief Patron of the Resolution, C. W. Cleaton, a member of the Council and of the House of Delegates, was chosen to serve

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[3]Personal Correspondence, Chief Commissioner C. W. Harris, Virginia Deputy Commissioner of Insurance, July 27, 1961.

[4]House Joint Resolution 98, (Richmond, Division of Purchase and Printing, 1956).

Form 136V—Virginia
(Edition July, 1947)

STATE, COUNTY OR CITY PROPERTY—BLANKET
(90% Co-Insurance)

Attached to and forming part of Policy No.....of the

.....Insurance Company, of.....

Issued at its....., Va. Agency. ....., Agent.

$.....On all their buildings now existing or hereafter erected or acquired, and all additions thereto adjoining and communicating, attachments, extensions, improvements and permanent fixtures attached thereto; and on all their contents of every kind and description therein or while located within 100 feet thereof if in the open or in vehicles, including their contents in and improvements to any buildings leased or otherwise occupied by them; and on the insured's interest in and/or legal liability for similar property belonging in whole or in part to others, but held by the insured on

storage or otherwise; and on bullion and manuscripts; except as hereinafter specifically excluded; situated.....

.....

....., State of VIRGINIA,

and occupied for.....

Exclusions—It is understood and agreed that this policy does not cover the following properties: accounts, bills, currency, deeds, evidences of debt, money, securities nor motor driven vehicles.

Foundation Exclusion Clause (Does.....apply)—It is stipulated that brick, stone or concrete **foundations, piers or other supports,** which are below the under surface of the lowest floor of basement (or basements), or where there is no basement, which are below the surface of the ground for the within described buildings and machinery, and also **cost of all excavations** of whatever nature, **are not included in this insurance,** and in no event will be taken as a part of the valuation of the buildings for the purpose of arriving at the Insured's contributory proportion in the application of the Co-Insurance Clause.

The **foundations and cost of excavations** above described being exempted from the application of the Co-Insurance Clause of this policy, and **not being covered** by this insurance, it is expressly stipulated that in the event of loss, if the insurance company should elect to rebuild, and it should be found necessary on account of statutory or other cause to replace said foundations or restore said excavations, in whole or in part, the cost of doing so shall be at the expense of the Insured.

Co-Insurance Rider—The rate on the property herein described, without a co-insurance clause is 100 .....% higher than the rate at which the policy is written; and in consideration of the lower rate being used, the 90% co-insurance clause is attached to and made a part of this policy.

Co-Insurance Clause—(Percentage)—It is a part of the consideration of this policy, and the basis upon which the rate of premium is fixed, that the insured shall at all times maintain insurance on each item of property insured by this policy of not less than 90 per cent of the actual cash value thereof, and that, failing so to do, the insured shall be an insurer to the extent of such deficit, and in that event shall bear his, her or their proportion of any loss.

In the event that an aggregate claim for any loss is less than Ten Thousand Dollars ($10,000), (provided, however, such amount does not exceed five per cent (5%) of the total amount of insurance upon the property described herein and in force at the time such loss occurs) no special inventory or appraisement of the undamaged property shall be required. If this policy be divided into two or more items, the foregoing conditions shall apply to each item separately.

Fire Protection Clause (Does.....apply)—In consideration of the rate at which this policy is written it is stipulated that the Insured shall exercise due diligence in maintaining in complete working order all equipment and services, installed for the detection, prevention and extinguishment of fire in the property covered by this policy and under the control of the Insured. It is further stipulated that no change shall be made in any sprinkler system, its water or chemical supplies, or any watchman service without the approval in writing of this Company, either direct or through the Rating Bureau having jurisdiction.

Permission Granted—(1) For the within described buildings to be unoccupied (not vacant) during the usual vacation incident to the class, upon condition that the furniture will remain in the building during the time of unoccupancy; (2) For such use of the premises as is usual and incidental to the occupancy as herein described.

Permits for Motion Picture Machines No. A—In consideration of the compliance by the insured with the following warranties, permission is hereby granted to use a motion picture machine in the building described in this policy.

It is Warranted—That the booth and motion picture machine shall be installed in accordance with the requirements of the National Board of Fire Underwriters.

That no claim shall be made for any loss or damage to the motion picture machine, its parts, or the films from fire originating in the machine or in the booth containing the same.

That smoking shall not be permitted in the booth.

That the motion picture machine will be operated solely for the benefit of the public school named in the policy and that each and every performance shall be directly under the supervision of the superintendent of said school and (or) the members of the School Board.

The permission hereby granted is operative only when not in violation of any law, statute or municipal restriction.

Alterations and Repairs Permit—Permission granted during the life of this policy to make alterations, additions or repairs including the construction of new buildings on the premises described herein, and this policy (so far as it applies to buildings) shall also cover in accordance with its conditions, all materials and supplies therefor, therein or adjacent thereto, and such alterations, additions or new buildings and (so far as it applies to contents of such buildings) shall extend to cover in such additions and new buildings

Automatic Reinstatement Clause—The amount of insurance hereunder involved in a loss payment of not more than One Hundred Dollars ($100) for this policy shall be automatically reinstated.

Electrical Apparatus Clause—If electrical appliances or devices (including wiring) are covered under this policy, this Company shall not be liable for any electrical injury or disturbance to the said electrical appliances or devices (including wiring) caused by electrical currents artificially generated unless fire ensues, and if fire does ensue this Company shall be liable only for its proportion of loss caused by such ensuing fire.

THE PROVISIONS PRINTED ON THE BACK OF THIS FORM ARE HEREBY REFERRED TO AND MADE A PART HEREOF UNLESS INDICATED TO THE CONTRARY.

(CONTINUED—OVER)

NOTE - This is a POLICY WITH CO-INSURANCE

Brick-on-Edge, Tile, Cement or Metal Flue Warranty (Applicable only if rated Fourth Class or Country)—In consideration of the reduced rate at which this policy is issued, it is warranted by the insured that the buildings and additions thereto, described in this policy, contain no brick-on-edge, tile, terra cotta, cement or metal flue; nor any metal smoke pipe carried through a combustible partition, floor or ceiling; and it is further warranted that no such flue and/or metal pipe shall be erected during the term of this policy.

If this warranty is violated in any particular, this policy shall be null and void.

Breach of Warranty Clause—Provided, where it is stipulated in this policy, that, without the consent of the insurer endorsed hereon or added hereto, the breach of a warranty or condition shall void the policy, it shall be held such breach does not in fact void the policy, but only suspends the operation of the policy during the time the breach continues. Provided, further, that no breach shall suspend the insurance under this policy except upon property wherein or whereon the breach of warranty or condition existed at the time of the fire; unless a loss or damage by or from fire originating in or communicated to such property shall extend to or be sustained in and/or on other property insured hereunder.

Warranties or Conditions Clause—This policy shall not be affected by failure of the insured to comply with any of the warranties or conditions endorsed hereon in any portion of the premises over which the insured has no control.

Loss Payable Clause—Loss or damage, if any, under this policy, shall be payable to Commonwealth of Virginia for benefit of Literary Fund as mortgagee (or trustee), as interest may appear, and this insurance as to the interest of the mortgagee (or trustee) only therein, shall not be invalidated by any act or neglect of the mortgagor or owner of the within described property nor by any foreclosure or other proceedings or notice of sale relating to the property, nor by any change in the title or ownership of the property, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy.

Provided, That in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee (or trustee) shall, on demand, pay the same.

Provided also, That the mortgagee (or trustee) shall notify this Company of any change of ownership or occupancy or increase of hazard which shall come to the knowledge of said mortgagee (or trustee) and, unless permitted by this policy, it shall be noted thereon, and the mortgagee (or trustee) shall, on demand, pay the premium for such increased hazard for the term of the use thereof; otherwise this policy shall be null and void.

This Company reserves the right to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee (or trustee) for ten days after notice to the mortgagee (or trustee) of such cancellation, shall then cease, and this Company shall have the right, on like notice, to cancel this agreement.

In case of any other insurance upon the within described property, this Company shall not be liable under this policy for a greater proportion of any loss or damage sustained than the sum hereby insured bears to the whole amount of insurance on said property, issued to or held by any party or parties having an insurable interest therein, whether as owner, mortgagee or otherwise.

Whenever this Company shall pay the mortgagee (or trustee) any sum for loss or damage under this policy and shall claim that, as to the mortgagor or owners, no liability therefor existed, this Company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may at its option pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with interest, and shall thereupon receive a full assignment and transfer of the mortgage and of all such other securities; but no subrogation shall impair the right of the mortgagee (or trustee) to recover the full amount of claim. This clause applicable to buildings only.

(Virginia—Form No. 136V—July, 1947)

as Chairman of the committee. Serving with him were seven prominent legislators, businessmen, and insurance agents.[5]

Their activities and findings are drawn from the published report of the Council, based on the findings of the Committee, to the Governor and General Assembly, presented December 18, 1957.[6]

> "The Committee commenced its work by requesting the Division of the Budget to prepare a survey of State Fire Insurance. This tabulation showed that there was considerable variation in the extent of coverage on the various State properties. In an effort to determine the manner in which the insurance is handled by the various institutions and agencies of the State, the Committee invited representatives from a number of institutions and agencies to confer with them and discuss their insurance practices. A public hearing was also conducted at which time the public was given an opportunity to express their views on this subject."

From these meetings and investigations the committee made the following conclusions and recommendations:

1. The adoption by the State of a program of full self-insurance at this time seems neither practicable nor desirable.

2. The State should make use of the "deductible" features which have been recently approved by the State Corporation Commission for fire and extended coverage insurance policies in Virginia. The following schedule is suggested:

   a. Replacement value more than $50,000 but not more than $100,000 - $25,000 deductible.

   b. Replacement value more than $100,000 but not more than $250,000 - $50,000 deductible.

   c. Replacement value more than $250,000-$75,000 deductible.

3. There should be established as a function of the Division of the Budget the maintenance of a complete and up-to-date

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[5]Self-Insurance for State Properties, House Document No. 73, Richmond (Division of Purchase and Printing, 1958), pp. 5-6.

[6]Ibid., p. 6.

card file showing the physical factors as to all buildings owned by the Commonwealth and agencies thereof and showing the insurance, if any, thereon, together with other relevant data. This function should be in charge of a person familiar with property insurance who would advise with the several agencies as to the insurance which they require and how premium savings can be effected. All risks at a particular location should be covered under one policy with the coverage being apportioned among local agents in the area where the property is located.

4. The insurance companies should be requested to intensify their inspection activities concerning State property which they insure in order to advise the State as to the best practices which can be followed to prevent losses and reduce premiums.

It is interesting to note that the investigating committee ran into the familiar problem of lack of conclusive information. In the discussion of conclusions and recommendations in the report, the council stated that the State's present program lacked coherence and unity. With no central records available, the program was one of piecemeal buying of policies often not suited to the needs of the institution or economically sound.

The Council recommended the passage of a bill calling for the establishment of a Bureau of Property Records and Insurance in the Division of the Budget. This Bureau would gather and maintain the necessary records to lend unity to the State's insurance program. The Head of the Bureau would advise the various agencies on their insurance program and how risks and premiums might be reduced. Until the time when sufficient records for analysis were available and until the possibilities latent in new deductible policies were fully examined, it was felt that the whole subject of whether the State might become a self-insurer should be postponed.[7]

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[7] Ibid., p. 8.

BUREAU OF PROPERTY RECORDS AND INSURANCE

The recommendations of the VALC were incorporated in House Bill 169, which established the Bureau of Property Records and Insurance on July 1, 1958. The Head of the Bureau was to be appointed by the Governor; he was not to have the authority to place or to recommend that the insurance to be carried by the various institutions and agencies be placed with any particular insurance agency or agencies. Stewart R. Moore was appointed as Chief of the Bureau, September 5, 1958, and work was begun.

Both critics and proponents of self-insurance remained quiet until it became apparent what the operations of the new State Bureau might reveal. The first annual report of the Bureau of Property Records and Insurance in 1959, revealed much about the present insurance program of the State. A complementary report was drawn up for legislative purposes in the 1960 session of the General Assembly. A resume follows:

1. First compilation of property and insurance records made by January 1, 1959.

2. As of January 1, 1959, the bureau had record of 4,986 buildings and contents owned by the State. Of these, 3,260 were insured, 1,726 were uninsured. Total fire insurance amounted to $226,066,852. In addition, Builder's Risk insurance amounting to $18,035,662 was carried on 40 construction projects.

3. The records have been under constant review. As required by the Act, notices have been sent to all agencies and institutions concerning insurance expirations and renewals.

4. As of January 31, 1959, insurance premiums due for all insurance on State buildings and contents totalled $282,573 for 1959, $272,187 for 1960, and $262,922 for 1961.

5. As of September 1, 1959, there were 5,113 State-owned buildings and structures on record with a total insurable value of $222,058,518. Contents in these buildings and in rented buildings amounted to an additional insurable value of $47,112,917, a grand total value of $269,171,435. Of this property, 3,312 buildings valued at $215,312,981 were insured, 1,568 buildings valued at $6,745,537 and 233 buildings built by the CCC in State parks, and of unknown value, were uninsured. The total average annual premium paid by the State on these buildings and contents was $281,702.97. A check of the period January 1, 1959, to February 15, 1960, showed that the annual average cost of insurance premiums had increased in 29 instances for a total increase of $13,856.67. Premiums had decreased in 79 instances; the total premium reduction is $14,939.92 annually. Increases occurred due to new coverages and increased risks. Decreases occurred because of (1) reduction in coverage, (2) downward revision of rate due both to the action of the Rating Bureau and the activity of the Agent of Record, (3) focusing attention on inequities in the coverage by this office, (4) changes in the type of insurance, and (5) improvements in the condition of the property that would eliminate fire hazards.

   During this same period insurance coverage had increased in 28 instances for a total of $4,656,445. Insurance coverage had decreased in 9 instances for a total of $229,532 making a net increase of $4,426,913. Increases were due largely to transfer of Builder's Risk coverages to the regular insurance coverage upon State acceptance of a project. Decreases were due to sale, demolition, or depreciation of property.

6. The insurance program of each agency and institution throughout the State has been reviewed, in most cases at the site of the property. Rates of similar properties have been compared. Fire hazards have been eliminated or reduced. All these discussions have had the purposes of increased safety and lower cost of insurance coverage.

7. Insurable values of property have been checked to see that a uniform basis for establishing valuations is adhered to.

8. Methods of keeping inventories of building contents have been compared in an effort to achieve accuracy with least cost.

9. Rates of property depreciation have been generally discussed in an effort to establish uniformity for similar classes.

10. The cooperation of the State Fire Marshall has been requested and received in many instances in order that properties be inspected for fire hazards.

11. Where feasible, insurance has been written for a five year term in order to take advantage of lower premium cost.

12. A record of fire losses at all locations during the past 10 years has been established. Striking an average from this it appears that a loss of $80,016.87 per year can be expected. This compares with a current average annual premium cost of $281,702.97.

13. Consultations have been held with insurance agents, brokers of records, and institutional and agency personnel to investigate every way that insurance costs may be reduced yet maintaining proper coverage.

14. The Bureau is acting as an exchange of information for the various agencies and institutions that are interested in improving the operation of their insurance programs.

In summary, the complementary report for the period of January 1, 1959, to February 15, 1960, shows a net coverage increase of $4,426,913, and a net annual premium increase of $1,074.25. This is based on a total of 5,462 pieces of State property with an insurable value of $302,459,552, including contents.

RENEWED INTEREST IN THE 1960 SESSION OF THE GENERAL ASSEMBLY

Armed with new and current data, the proponents of self-insurance introduced new bills into the General Assembly at the 1960 session. Senate Bill 171 was introduced by State Senator H. H. Purcell, but this bill was referred to the committee on Finance and never reported out. A similar bill (No. 341) was drawn and presented to the House of Delegates but was killed in the committee on Insurance and Banking. This committee felt the objections listed in the VALC report were still valid. The members felt that the State should take advantage of a new type of preferred risk

HOUSE BILL NO. 341

Offered February 2, 1960

A BILL to provide for the insuring of certain State owned buildings and property against certain hazards; to create a fund therefor and to provide for payments into and disbursements from the same; to provide for the administration of such fund; to provide for the ascertainment of losses; to provide how the fund shall be managed, and to appropriate funds.

Patrons—Messrs. Cleaton, Harrell, Hill, Hudgins, Buck, Clark, Reynolds, Smith, R. M., Thomson, J. M., Wampler, Allen, Phillips, Pendleton, Moore, G. S., Dalton, Philpott, Hutcherson, Richardson, Smith, V. C., Camblos, Thurman, Leadbetter, Owens, Moody, Price, Compton, Mann, Winston, Newton, Pennington, James, Pope, Brown, Shreves, Elliott, Gouldman, and Manns.

Referred to the Committee on Insurance and Banking

Be it enacted by the General Assembly of Virginia:

1. § 1. Each agency, department, division, or institution of the State government having jurisdiction and control over any State structure and contents thereof shall pay into the fund hereinafter created an amount equivalent to the premium for fire and extended coverage insurance upon the same with an insurance company authorized to do business in this State. The amount of coverage shall be determined at three-fourths of market value of the property as determined by the Director of the Budget. Such payments shall be made into the fund upon the minimum basis of cost that a premium for comparable insurance would be required by any corporation authorized to write such insurance in this State, and shall be paid in such installments as the Director of the Budget may require. Whenever any building or structure is occupied by two or more agencies, departments, divisions, or institutions of the State, the payments required herein shall be prorated upon the basis of percentage of the area occupied.

§ 2. There is hereby established and created in the State treasury the State Fire and Extended Coverage Fund. Such fund shall consist of the payments required in § 1 of this act together with any appropriations made thereto by law. Such fund shall be under the management and con-

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policy which would enable it to reduce premiums in many instances.[8] This was the new property and institutional property form of blanket coverage.[9]

Both bills were similar in their essential plans; both called for a one-million dollar appropriation to meet losses that might occur until the fund could build to this amount. The eventual goal of the bill was to have a three-million dollar fund which would pay all fire losses from the interest income on the fund.[10] On the last day of the General Assembly session, Delegate Cleaton introduced House Joint Resolution 93, which called for a new VALC study on the subject of State self-insurance. The Resolution was passed, and a new sub-committee was formed with Mr. Cleaton as Chairman.

In organization and proceedings, the 1961 VALC committee followed the pattern set by the earlier committee which studied the subject.

On July 25, 1961, a public hearing was held in the Senate Chambers in order that the committee could hear any arguments for or against self-insurance by any interested member of the general public.

A number of arguments were advanced against the proposed program by insurance representatives, including the general counsel of the Virginia Association of Insurance Agents and an attorney representing the National Board of Fire Underwriters. Following this public hearing, the Roanoke World News and the Richmond Times-Dispatch reported that the report by the Virginia Advisory Legislative Committee would probably be against self-insuring.

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[8]This information was obtained from Committee Member Julian H. Rutherford in a personal interview.

[9]This policy will be discussed in Chapter III.

[10]Personal Correspondence, Delegate C. W. Cleaton, July 14, 1961.

THE CURRENT STATUS OF THE MOVEMENT

The deliberations of the committee were confidential and the trend of the study was unknown until the report of the full council was presented to the Governor on January 22, 1962. The actual findings and recommendations of the VALC were in favor of the State becoming a self-insurer but by a gradual process of placing the savings gained by a centralized insurance program into a fund that would have been formed by appropriations in the previously introduced bills. It was also reasoned that such a process would effect a collection of the necessary information, inherent in a centralized insurance program; this would later enable the State to establish a self-insurance program based on sound insurance principles with an adequate reserve to meet all contingencies.

The actual conclusions and recommendations as drawn were as follows:[11]

CONCLUSIONS

> There are problems involved in the insurance of State property other than the feasibility of the State becoming a self-insurer generally. The State is already a self-insurer on many of its properties. The State Highway Department has a successful self-insurance program for certain types of its properties.
>
> The present practice is for the insuring of the State properties to be left to the discretion of the various State institutions and and department heads. This practice results in divergent insurance programs on coverage, non-coverage, high and low deductibles, etc. Insurance practices in some cases appear to be based on concern for responsibility for blame in the event of loss rather than soundness of insurance principles.
>
> A program of self-insurance has immediate appeal as a solution to the problem and seems to offer the prospect of savings to the State. While it is both feasible and proper for the State to

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[11] Insurance on State Owned Buildings, House Document 17, (Richmond, Department of Purchases and Supply, 1962), pp. 4-5.

become a self-insurer, as do many industries with diversified risks, any program of self-insurance should be based on sound insurance principles, and provide for an adequate reserve fund to coverlosses. Because of the present decentralized method of handling insurance and the consequent varying practices concerning insurance on State buildings, it is not now possible to determine the cost of an adequate and sound system of insuring State properties through insurance with private companies. Neither is it possible to determine actually how much money the State would save as a self-insurer, nor how much money should be placed in an insurance reserve fund in order to cover the State's many risks, should the State become a self-insurer.

In those states where there is central insurance administration, essential information, now lacking in Virginia, is more readily available for study and action.

RECOMMENDATIONS

We recommend that the General Assembly authorize a substantial broadening of the authority of the Bureau of Property Records and Insurance so as to extend to that Bureau the power to supervise the amount, coverage, kind and placement of fire and extended coverage insurance throughout the State Government. The Bureau would study the advisability of various insurance plans including blanket coverage, non-coverage, a deductible program, etc.

Although final responsibility should be placed in the hands of the Bureau of Property Records and Insurance with respect to coverage, non-coverage and other provisions of policies, the placement of recommended insurance should be continued in the hands of the various State agencies.

In order to safeguard bond indentures and contractual requirements, the Bureau should have no power to alter in any way the insurance obligation of the various State agencies undertaken pursuant to bond indentures.

We recommend that the Governor appoint an Advisory Board of five persons experienced in the insurance, self-insurance, or engineering fields to advise the Bureau. This advice would be considered but would not necessarily be binding upon the Bureau.

To gain valuable experience, without committing the State to a full self-insurance program with its requirement of a large reserve fund, an Insurance Reserve Trust Fund should be created. This Fund would consist of the savings effected on account of the insurance coverage resulting from the suggested program. The savings on buildings existing as of January 1, 1961 would be computed on the basis of the difference between the previous cost of insurance and the cost under the suggested program. In computing the savings as to other structures, the basis would be the difference between the cost of insurance carried thereon and the cost of insuring the actual value

> thereof in full. This Fund would be used for the purpose of paying losses not covered by insurance, and administrative expenses of the Bureau of Property Records and Insurance, properly allocated to its insurance functions. The expenses of the Insurance Advisory Board should also be paid from this Fund.
>
> If the savings achieved are as large as now appear, it is possible that this Insurance Reserve Trust Fund might grow to the extent that it could become the basis of a full self-insurance program if such is later deemed advisable.

The bill to enlarge the powers of the Bureau of Property Records and Insurance and begin the movement toward self-insurance is to be introduced in this session of the legislature. The Governor's opinion of this step toward self-insurance is not known at this time. The bill has a good likelihood of passing the two houses and becoming law, but there will be bitter opposition by the State and National insurance interests. Regardless of the outcome, attention has been focused on the outdated and unplanned insurance program now in force; attention which should result in needed reform.

CHAPTER III

BASIC PRINCIPLES OF THE INSURANCE FUNCTION

THE NEED FOR EXAMINATION

Anyone reading this history of the self-insurance movement in Virginia might readily detect a reluctance on the part of the legislators and their appointed advisors to enter into such a program. This reluctance does not stem entirely from the opposition by the insurance industry and their lobby to the movement, but mostly from a trait universal to most public officials, both elected and appointed--cautiousness. Not any legislator wants to support anything which could later be used to discredit him at voting time, especially when such support would be in the face of heated opposition by the insurance agents of his district, many of whom are very active in community affairs.

Virginia has a conservative legislative body; but one which is interested, from a majority viewpoint, in saving on necessary expenditures. But in this instance, support of a self-insurance program would mean taking a liberal viewpoint on the government's role in the economy of the State. Viewed in part, it would seem that the State government is entering the insurance business. This is not entirely true, but a Senator or Delegate must think how a supported program can be made to look by the opposition.

Lastly, reluctance on the part of some legislators stems from the fact that they are, for the most part, laymen when it comes to considering the soundness or unsoundness of a self-insurance program. What are sound insurance practices and principles and upon what are they based? It is the purpose of this chapter to examine some of the principles basic to the insurance

industry and their application to Virginia's present problematical considerations.

MEASUREMENT OF RISK

Many people often ask how it is that insurance companies can assume the risk of compensating for a building should it be lost by fire for such a small charge dollar-wise in relation to the total value of the building. Insurance underwriters will answer that it is because they know with reasonable certainty the risks they can and do assume.

Whenever an individual or governmental unit owns property or is in a position where he or it may suffer a loss from the destruction of this property, there is an element of risk present. There is always a chance that there will be some occurrence, such as fire or lightning, which will destroy this property partially or fully. This chance of loss is risk and incorporated within this definition is uncertainty.[1]

When taken at the individual's level, risk or chance of loss cannot be measured with any degree of exactness. A great mass of statistical data must be available for collection and analysis before risk may be measured with mathematical precision. For example, if it were to be found, after all needed data is collected, that out of twenty thousand similar buildings through a wide geographical area, twenty have burned, then the mathematically calculated risk is .1% for fire destruction. To the individual owner of one of these similar buildings there is little comfort in the fact there is

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[1]Robert H. Mehr, and Emerson, Cammack, Principles of Insurance (Homewood, Richard D. Irwin, Inc., 1957), p. 621.

one chance in a thousand that it will be his building that burns, because such a loss would be ruinous. If he chose not to insure his building or buildings, he would have gambled with the odds in his favor and lost.

The above assertions are valid for an insurance company also, for one isolated building could not possibly be safely insured, regardless of its value. But it is not the individual property which is of importance to the insurance company; it is the loss experience of a large group of properties that enables the company to insure a building against loss for a relatively small premium. It is because many thousands of relatively homogenous units are insured for small premiums and because collected data will enable the reasonable prediction of the number of insured properties that will burn or otherwise be lost, that insurance companies can pay losses and administrative expenses, and still make a profit.[2]

At first glance, it may seem strange that a combination of individual risks would result in the reduction of risk. The mathematical principle which explains this is called the "law of large numbers." It might be better called the "stability of statistical frequencies," and it is one portion of the many-faced subject of probability. In essence, the law says that events which seem to be the result of pure chance occur with surprising regularity as the number of instances observed become larger.[3] The longer the period for which a prediction is desired, the more accurate the prediction will be. This is one of the reasons that an insurance company can charge less premium as the term of the coverage is increased, though by no means is this the sole factor in this reduction.

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[2]George S. Hanson, State and Municipal Self-Insurance, p. 2.

[3]Ibid., p. 3.

As the number of exposures increase, the occurrence of the loss more nearly approaches the underlying probability. A prediction of the number of fires that would occur during any one year in a moderate-sized city would be subject to question. The prediction on the basis of the total properties of similar risks within a state over a span of years would show a reliable degree of accuracy. As was stated earlier, no insurance program can be viewed too narrowly if you are to gauge its success or failure. In Michigan certainly no losses of seven million dollars in a single year would have been thought probable, or the plan would most likely not have been undertaken. But viewed in the light of ten or twenty years, this large loss could have been provided for by an ample buildup of the fund when losses were below institutional premiums, as was the case in most years. This underwriting profit, which is larger for the state with less administrative expense, should not be spent on other purposes in these profitable years but stored through investments to provide for a catastrophic loss year such as Michigan in 1951. Short sightedness by legislators is the largest single stumbling block to a state's becoming a self-insurer; for once actuarial data of authentic nature has been collected, analyzed, and subsequent predictions made, the veracity of this prediction should not be doubted in good years. This is the real scare of the Michigan bugaboo--that the parable of the grasshopper and the ants will once again prove itself true to the dismay of well-meaning legislators who have diverted the moneys of the fund. The premiums charged to state institutions or agencies should be in accord with the practice of sufficient allowance for a profit. This profit should be put in the fund to cover any future catastrophic losses.

SPREADING THE RISK

A second principle pervading insurance practices is that assumed risks should be spread in such a manner to minimize deviation from the underlying probabilities; a concentration of risks is to be avoided. Thus, risks incurred must be spread, divided, and reduced. Insurance companies obey this maxim by accepting risks in practically every state and, in fact, every country in the world, by limiting the amount accepted on any one risk and by controlling the aggregate commitments within any one vulnerable area.[4]

This does not mean that an insurance company will not insure a building whose value may be a million dollars, but rather that the company will attempt to further spread the risk by "reinsuring" with other companies. A member of the insurance industry who attempted to restrict its policies to dollarwise coverages it would be willing itself to retain, would also be eliminating a goodly portion of its potential business. By reinsuring, the company does not discharge any of its primary liability to the insured. In fact, the insured is rarely aware of the existence of reinsurance.[5] As the result of reinsuring, the company simply reduces its maximum exposure in event of loss by acquiring the right to obtain reimbursement from the reinsuring company for the reinsured portion of the loss. This enables the company to follow the basic principles of insurance practice and yet accept much greater risks.

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[4]Sense and Self-Insurance, (Melbourne, Council of Fire and Accident Underwriters, 1950), p. 2.

[5]"Reinsurance," F. C. & S. Bulletin, (New York, Association of Fidelity, Casualty and Surety Companies, 1962).

SITUATIONS THAT NECESSITATE REINSURING

The need for reinsurance arises from several situations. It must be remembered that the salesman for the insurance company is the agent; he is the alter ego of the company. If this salesman is able to insure one particular large value risk and he is a general agent, each of his represented companies will probably receive a portion of the risk. They, in turn, if the assigned risk is too great to be safely assumed and still adhere to the principle of spread risks, will reinsure; but it will be at the company level. If the agent is not a general agent but the representative of one company only, the need for reinsurance by that company on coverages written for them by that agent is more prevalent.

Sometimes very large risks are assumed by the direct writing of special company representatives. Usually reinsurance connections have already been established between the writing company and other companies before this is done, so that there is little chance of the primary insurer being burdened by a greater portion of the risk than it is willing to bear.

The result of these practices is that the property owner or present risk bearer is saved from having to seek out several different companies and/or their agents who would be willing to insure his single high-value property.

Lastly, it was pointed out that insurance companies control the aggregate commitments within any one vulnerable area. Whenever its aggregate commitments show an unbalanced apportionment, usually one portion of a state, a company will reinsure all or part of the business in that area. This may involve one or more of the agents in that area, depending upon the extent of reinsuring necessary to gain a balance of aggregate commitments. Also this borderau method of reinsurance is used

to spread the losses of an area showing a particularly poor loss record. It is readily apparent that some form of reinsurance program would be incorporated in any insurance plan adhering to sound insurance practices.

THE DICTATES OF GOOD MANAGEMENT

There is a line of departure when gambling continues its waywardly path and the service function offered by the insurance industry begins. The signpost for this fork could well indicate that the former is headed toward "unknown" and the latter toward reasonable certainty. And this brings to light the last comprehensive principle applicable--but not peculiar--to the insurance industry which will be considered by this paper. It is the omnipotent requirement of following the practices of scientifically derived predictions, good planning and fastidious management.

Pervading this requirement is the need for the adequate information upon which to base the reasonably accurate predictions that, in turn, control good planning and management in any insurance-type undertaking. In the fire insurance industry, this requirement would usually necessitate having data covering the loss experience of the properties in the geographical area to which coverage is offered for sale. This data should be available for the previous ten to fifteen years at a minimum.[6] It is reasonably accurate predictions, the responsibility of the various underwriting departments of the companies, which separates insuring from gambling. A prediction of losses that is far too low could render a company insolvent in a very short time.

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[6]H. Wayne Snider, Readings in Property and Casualty Insurance (Homewood, Richard D. Irwin, Inc., 1959), p. 93.

Of course, a loss record of the properties alone is insufficient for actually setting a premium charge. Allowance must be made for the geographical location, as with rural or urban property; type of construction, and degree of hazard. By the last, it is usually meant how hazardous by exposure to fire loss is the use to which the property is put and exposure by the use of surrounding property. An analysis of these statements will reveal a paradoxical situation; for while a rural farm house faces little danger of loss due to a fire starting in a neighboring farm, there is little comprehensive public fire protection available to the rural property owner. Thus, in escaping one situation which increases hazard and rate, he meets another. The list of conditions and situations which effect the rating is very lengthy and is not detailed here.

It should not be overlooked that the rates charged by the companies on the various established classes of property, rates supposedly based on scientifically derived predictions of losses, are still subject to further adjustment and control. The majority of states have an insurance department or bureau which passes on the validity of the rating given to a property when the premium is calculated by the local agent. All ratings are sent by the agent and other company salesmen to this agency and if it is found incorrect, a new rating and subsequent premium is necessary. In Virginia, the Bureau of Insurance must approve the rates on standard coverages before being offered for sale; thus by this practice, the Bureau actually sets the premium charge.

The insurance industry is very competitive and the companies vie for the insured's premium dollar by offering increasingly broader coverages

and lower rates. Competition is very keen between the mutual companies and the stock companies within the scope of competition left to them by the various agencies of the States.

These principles discussed briefly are universal to any insurance undertaking encompassing prudent practices, and a prospective self-insurer, such as a governmental unit, cannot but adhere to them. Any significant violation of a principle, such as acceptance of concentrated risks, would have to be compensated for by additional safe-guards such as an increase in charged premiums. This safe-guard may also take the form of a "special reinsurance fund," such as is used in South Carolina; or it may be a program of insuring with private companies all properties above a certain value or geographical concentration.

CLASSIFICATION OF PLANS

Before establishing an actual criterion to weigh Virginia's chance of success at self-insuring, differentiation should be made between an emergency reserve fund, such as is used by Iowa, North Carolina, and Oregon, and the true programs of self-insurance following established insurance principles set up in eight states.

An emergency reserve fund involves the advance appropriation by the State legislature of funds which may be used to restore or replace state property damaged by fire, or in some cases, similar hazards. The appropriation may be designed to build up over a period of time a fund of substantial size but without any particular reference to the value of the property at risk. The appropriation may be intended to pay only for losses which take place during the period for which appropriations are budgeted, and the balance

may revert to the state treasury at the expiration of that time. This type of fund in no sense provides a self-insurance program but is merely a regular and convenient manner of issuing funds from the public treasury to restore or replace the destroyed public property.[7]

The more common self-insurance fund differs from an emergency fund in that it charges specified premiums, builds up reserves, and is not dependent on yearly legislative appropriations.

Another alternative faces the constructors of a self-insurance program. Here the governmental unit may insure through a commercial company the largest and/or most hazardous risks, assuming the remainder of the risk within itself. Thus, a state reinsuring part of its properties outside the operations of a special reinsurance fund could be called a partial self-insurer. This plan offers considerable safety, but insurance companies might be unwilling to take only the State's most hazardous property to insure after being deprived of safer business. South Carolina had to establish its own fund for reinsurance after insurance companies refused the risk.

Virginia is already a risk-assumer in a small way as some 2369 low value buildings and structures are owned and uninsured.[8] Because of this, the writers of the 1962 VALC report stated that Virginia was already a partial self-insurer, but this is incorrect since a true program of partial self-insurance has a fund to provide for the losses to the properties commercially uninsured.

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[7]George S. Hanson, State and Municipal Self-Insurance, p. 2.

[8]Report of the Bureau of Property Records and Insurance, (Stewart R. Moore, Chief of Bureau, Richmond, 1961), Sheet 6.

Sometimes a public official will propose a program which he calls self-insurance, but it will actually be an assumption of risk, or no-insurance. Whenever a state discontinues payments to private companies and makes no appropriations to meet losses, but merely takes moneys from the general fund of the state to pay losses as they occur, this is no-insurance. There is a complete absence of any plan of meeting losses to public property.

AN INEXACT SCIENCE

Now that the basic principles inherent in any insurance program have been briefly examined, a criterion encompassing them can be more readily established, which could theoretically evaluate Virginia's chance of success as a self-insurer. It should here be reiterated that a self-insurance program is different from an emergency reserve fund, partial self-insurance, or no-insurance; it is a government facsimile of commercial insurance operations. The taxpayer might readily be considered both the policyholder and stockholder of this particular enterprize.

This criterion is also a numberical listing of the utopian conditions necessary for an ideal insurance undertaking and it could well be applied to the operations of private companies. As has been pointed out earlier, the basis for insurance underwriting profit is accurate predictions of losses or the risk assumed. The law of large numbers is the enabling cog in this rapidly moving wheel of underwriting science. A slight deviation from the conditions necessary for a perfect working of the law is not damning; it is not a question of permissibility of deviation, but how much is permissible before underwriting science is replaced by wholesale assumption of unknown risk.

Furthermore, the insurance industry is one offering a service function; it operates any place that risk is present and unwanted. Though their operations are scientifically based, the individual companies do not function within the confines of a sterile laboratory. The human element is omnipresent and cannot realistically be ignored. The agents might write policies on poor risks, a company may not be able to find geographically dispersed agents willing to represent it, or large losses may occur in a region where a company is monentarily out of balance in its aggregate commitments. These situations and many more can and do occur, effecting the ideal conditions necessary for insurance underwriting to function as an exact science. But the various companies do assume risks for a charge and do make a profit for their service; therefore, it is a reasonable surmise that a governmental unit could do likewise if it met the criterion, not one-hundred per cent, but with reasonable deviation only.

CHAPTER IV

A CRITERION FOR SUCCESS

The following criterion is drawn wholesale from the earlier discussion of insurance principles:

1. There must be a large number of exposure units, as to allow reasonably accurate predictions of losses which will occur in the future. In other words, the number of units should be large enough to allow statistical inferences to be made from data based on the workings of the law of large numbers.

2. The units should be as near homogenous as possible. The value of each unit should be small relatively to the total value of the properties and no one property should have an excessive value which would effect the prediction of losses. Thus, each property would contribute to the fund on a uniform basis, and the total loss of one property would not cause a large upswing in the contributions of the other properties.

3. The hazard regarding each of the properties should be relatively the same. Predictions based on buildings of different degrees of exposure are seldom as valid as predictions on uniformly hazardous properties.

4. The exposure units should be distributed geographically so as to be free from the catastrophic hazard. The units should not be so close that a fire in one unit would threaten to spread to the other units.

5. There should be a stable loss experience among the properties. Where the loss experience is stable, self-insurance can be instituted more effectively and at greater savings.

6. There should be at least a ten- or fifteen-year loss record available for statistical purposes so that predictions based on a spread of years can be made.

7. The financial position of the state must be strong so that the program can be established with a reserve large enough to cover losses that might be above expectations.

When pitted against this criterion of the seven ideal conditions necessary before self-insurance could be ideally established, Virginia's public buildings

and structures show varying degrees of success. The following discussion is broken down into several parts, encompassing an examination of the ideal conditions in relation to the State properties.

1 NUMBER OF EXPOSURE UNITS

As of December 1, 1961, Virginia had some 5716 public buildings and structures.[1] This was an increase of some 246 buildings over the number reported by the Bureau of Property Records in June, 1960. Even giving allowance for some previously unreported public properties, this was a significant increase over a span of eighteen months. Each addition will increase the relative accuracy of the forecast of future losses by a small amount, enhancing the long-run prospects of a self-insurance program.

While 5716 edifices of varying types would be enough to allow the law of large numbers to operate and allow reasonably accurate forecasts of future losses, a critic might point out that some private companies have at their disposal the loss record of a larger group of buildings and structures allowing a more accurate prediction. But these companies are dealing with samples of loss data drawn from all the properties of several states with all the possibilities of error inherent in the process of making predictions based on a random sampling.

For the commercial companies to make a comparable prediction of the future losses of public buildings in Virginia by using the sample method, they would have to have a far greater mass of data than the loss record of

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[1]Unless otherwise indicated, the statistical information quoted in this chapter was drawn from the 1961 reports of the Bureau of Property Records and Insurance.

5716 various buildings and structures. In order to minimize the discrepancies caused by differences in the present conditions of the states, including climatic and geographical peculiarities, the sample has to be of such a size to compensate for the errors inherent in such a process.

Explaining this situation in a statistician's jargon is more simple. In using the loss record of Virginia's properties, assembled data of a complete universe would be dealt with. The companies' underwriters would be dealing with representative information drawn at random from a much larger universe. The sampling error would be dependent upon the sample size and the careful analysis of the assembled data needed to remove any incorporated bias.

Virginia does have enough exposure units to allow reasonably accurate predictions of future losses. Furthermore, if the State continues its building program at the present rate, there will be some seventy-five to one hundred buildings added to the total number every year. Each year this increase will offset the workings of the law of large numbers favorably, so that statistical inferences would tend toward greater accuracy.

2 HOMOGENITY OF UNITS

The 5,716 buildings and structures have a total value, including contents, of $364,630,502. They range in value from several hundred to several million dollars. The values of these properties are far from uniform, as critics of a self-insurance plan are fast to point out, but to what extent this would effect the feasibility of the plan is debatable. Of course Virginia would not be in any different position here from other states which have successfully instituted such a plan.

TABLE V

THE BUILDINGS AND STRUCTURES OF VIRGINIA
BY INSTITUTION OR AGENCY, 1961

INSTITUTION OR AGENCY	NUMBER BUILDINGS, STRUCTURES	INSURABLE VALUE BUILDINGS, STRUCTURES	INSURABLE VALUE CONTENTS
Department of Agriculture & Immigration	28	219,825	293,200
A. B. C. Board	10	1,713,000	15,494,902
Division of the Budget	34	15,898,200	783,169
Dept. Construction & Economic Development	607	2,517,182	19,300
Department of Education	354	32,130,890	4,670,420
Commission of Fisheries	1	93,300	17,500
Fisheries Lab., Virginia	4	332,200	30,000
Game & Inland Fisheries	245	584,606	45,000
Gunston Hall	11	212,150	118,000
Department of Health	170	8,786,560	825,089
Department of Highways	1838	9,177,422	353,450
Jamestown Park	15	1,064,350	501,617
Library, Virginia State			585,712

TABLE V

THE BUILDINGS AND STRUCTURES OF VIRGINIA
BY INSTITUTION OR AGENCY, 1961

INSTITUTION OR AGENCY	NUMBER BUILDINGS, STRUCTURES	INSURABLE VALUE BUILDINGS, STRUCTURES	INSURABLE VALUE CONTENTS
Medical College of Virginia	51	25,109,028	3,584,994
Department of Mental Hygiene	456	54,931,710	6,527,553
Military Affairs	130	453,000	11,000
Motor Vehicles	5	1,534,146	125,000
State Police	62	1,467,665	824,791
Water Control	2	20,900	83,884
University of Virginia	277	53,965,602	6,955,048
Virginia Commission of Visually Handicapped	4	928,500	456,250
Virginia Military Institute	72	11,015,968	1,144,046
Virginia Museum of Fine Arts	1	3,200,500	5,838,602
Virginia Polytechnic Institute	294	29,950,042	6,216,963
Virginia Truck	24	532,400	40,040
Department of Welfare	848	25,164,209	5,023,532
William & Mary	173	20,412,850	2,665,235
TOTALS ($364,650,502)		$301,416,205	$63,234,297

As a general rule, an insurance company will limit any single accepted risk to approximately, and not in excess of twenty percent of its admitted assets.[2] This is required by statutes in many of the states so that a single large loss would not jeopardize the solvency of a company. But a company will not reinsure all buildings above a certain set value, unless they are above the value to asset limit, or fail to accept risks because they are small. As has been pointed out earlier, the purpose of reinsurance is to spread the assumed risk, avoiding a concentration of insured properties. But as to the values of the accepted risks, a company will strive for a hazard pool whose median is safe in relation to the assets of the company.

Virginia would have a hazard pool more vast than most small or medium sized insurance companies. There is no one building which represents such a relative concentration of value that a self insurance would be unfeasible. The largest single value risk of the State is the Alcoholic Beverage Control Board's warehouse in Richmond, which is approximately eight million dollars worth of building and contents--mostly contents.[3] Even this titan of concentrated value represents only .02 percent of the total value of buildings and structures, which, incidentally, might well be considered assets under established business criterion.

In calculation of the maximum limit upon the acceptance of a single risk by an insurance company, non-liquid assets are used. Large sums are

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[2] Self-Insurance: State and Municipal (Chicago, Insurance Information Institute, 1960) p. 1.

[3] Personal Correspondence, C. W. Harris, Virginia Deputy Commissioner of Insurance, July 11, 1961.

invested in these non-liquid holdings so as to bolster earnings and compensate for any error in the underwriting process.

Both South Carolina and Wisconsin, whose programs of self-insurance have proved successful, list real estate as part of the assets included in their funds. This practice should be avoided because these assets, in reality office buildings and/or school buildings, could not be sold to pay for large losses.

Theoretically, if the State were to limit the acceptance of a single risk to a value of $600,000, which is 20% of the proposed maximum amount of the fund, some form of reinsurance program would be necessary. This could be done best by an establishment of a special reinsurance fund such as South Carolina was forced to do when commercial companies would not accept the over-and-above risks. This would lengthen the time period over which premiums would be collected from the State institutions or agencies, but not two-fold, as interest income from investment of the collected premiums, would shorten this period. This would also require the maintenance of a separate and supplemental fund from which all losses in excess of $600,000 to exhaustion of the additional fund would be paid.

Furthermore, if the State were to refrain from the practice of diverting the moneys of the fund into proposed building projects, it would be in a better position to pay large losses than states with accumulated larger funds tied up in real estate holdings.

Based on a relativity of values comparison, the supporters of a self-insurance program in the State could easily defend the proposed plan against the criticism of concentrated value risk assumption. But if

backs were against the wall--so to speak--what other considerations would enter into this theoretical debate?

The reports of the Bureau of Property Records and Insurance is, in a way, damning to the proponent of a Virginia self-insurance fund. For the values of the buildings throughout the State are listed at cost for the most part. This does not reflect the actual cash value of these buildings, which is the amount payable under most standard coverages. This means that depreciation would play a large role in the adjustment of one of the State's older buildings should it be lost by fire. The value placed thereon would have little meaning when this ACV criterion is brought into play during the adjusting process. Some of the State buildings are so old that they have almost an extra-ordinary value as artifacts. Depreciation, or allowance for betterment, as it is called by companies and adjusters, would limit the recovery to far less than the value listed by the Bureau's reports; so this would also diminish much of the book or greater value concentration of risk to be assumed.

It should be said that replacement cost coverage is offered under the Public and Institutional form; this was brought about by the agitation and unrest of various legislative bodies while studying the premiums paid out for standard coverage. For a small additional amount, the replacement cost coverage can be purchased to provide greater coverage.[4] But only about one-half of Virginia's buildings, value-wise rather than number-wise,

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[4] Public and Institutional Property Forms (Atlanta, Inter-Regional Insurance Conference, 1960) p. 15.

TABLE VI

THE RELATIVE VALUE OF BUILDINGS AND STRUCTURES 1961

DEPARTMENT, AGENCY	VALUE OF EACH	PERCENT OF TOTAL VALUE
Department of Agriculture & Immigration	513,025	.0014069
A. B. C. Board	17,207,902	.0470901
Division of Budget	16,681,369	.0457462
Department of Construction & Economic Development	2,536,482	.0068559
Department of Education	36,801,310	.1008221
Commission of Fisheries	110,800	.0003039
Fisheries Laboratory, Virginia	362,200	.0008933
Game & Inland Fisheries	629,606	.0017266
Gunston Hall	330,150	.0008054
Department of Health	9,611,649	.0263585
Department of Highways	9,530,872	.0260370
Jamestown Park	1,565,967	.0042944
Library, Virginia State	585,712	.0015062
Medical College of Virginia	28,694,022	.0786891
Department of Mental Hygiene	61,459,263	.1685429
Military Affairs	464,000	.0012725
Motor Vehicles	1,659,146	.0045400

TABLE VI

THE RELATIVE VALUE OF BUILDINGS AND STRUCTURES 1961

DEPARTMENT, AGENCY	VALUE OF EACH	PERCENT OF TOTAL VALUE
State Police	2,292,456	.0062867
Water Control	104,784	.0002874
University of Virginia	60,920,650	.1670659
Virginia Commission of Visually Handicapped	1,384,750	.0037975
Virginia Military Institute	12,160,014	.0333470
Virginia Museum of Fine Arts	9,039,102	.0247884
Virginia Polytechnic Institute	36,167,005	.0990827
Virginia Truck	572,440	.0015698
Welfare Department	30,187,741	.0927854
William & Mary College	23,078,085	.0632882
TOTALS	$364,650,502	1.0101900

are covered presently under the FIP plan.[5] In fact, some are not eligible for the plan under the present requirements.

Even under this type of protection, the State would have to pay out first the initial cost of replacement over and above the actual cash value before receiving this additional recompense. In addition, this process is so cumbersome and wrapped in red tape that it requires the full-time services of a State official during the rebuilding period; this is especially so when several general agents, their various companies and adjusters are involved. This would be so under the present insuring practices of many institutions and agencies.

The question of feasibility could be debated at length by both sides, but a valid argument could be presented for self-insurance even under fire from the 20% concentration of value adherers.

3 EQUALITY OF HAZARDS

The third requirement for an ideal undertaking is that each property should face relatively the same amount of hazard so that the estimate of fire loss will be more nearly accurate. A quick look at the various institutions and agencies of the State will show that the buildings and structures charged to them are not completely uniform in use or degree of exposure. The uses of these buildings and structures must vary if the institutions and agencies do the work for which they were created by the State.

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[5] See Table VIII, Chapter VI.

This will not keep the State from making an estimate which will fulfill the needs of a sound self-insurance program. Some states employ the services of a private rating bureau in determining an estimate upon which to base the rates charged by the self-insurance fund; this is done in Kentucky and South Carolina. North Carolina charges sixty-eight percent of the standard commercial rate to all the buildings it insures.[6]

The officials of the State self-insurance fund could use the valuable advice of the Property, Casualty, Fidelity, and Surety Rate Section of the Bureau of Insurance in making an estimate of expected fire loss. Few insurance companies can boast of having more qualified rate men, and men of general insurance knowledge than are housed in the Virginia Bureau of Insurance. The rate section of the Bureau approves the rates, evidence of coverage, and the basis of the rates before they may be used by insurance companies.[7] Certainly, these men could aid in establishing a sound estimate of probable loss over the next ten to twenty years.

In fact, the prediction could in a way take care of itself. Incorporated in any argument against self-insurance by a state is always reference to the inability of the administering officials to predict losses accurately, which is agreed a theoretical necessity. But in practice would this really be so important, for the Virginia Insurance Rating Book is in actuality a mass prediction of losses. The ratings are based upon the loss predictions of the various insurance companies amended by the

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[6]Self-Insurance: State and Municipal (Chicago, Insurance Information Institute, 1960) p. 1.

[7]The Eastern Underwriter 12 December, 1958, p. 20

Bureau of Insurance to reflect more accurately the conditions present in Virginia. So if Virginia were to charge the institutions and agencies the same premium as the commercial companies, would this not be a reasonably accurate method of arriving at a chargeable premium which would be commensurate with established insurance principles?

Allowance should also be taken of the fact that with competitive costs removed, the premium dollar charged by the State would be relatively higher. This would in a way provide recompense for the acceptance of more concentrated risks, both by geographic and value motifs, which enhances the long-run success of the program and goes a long way in overcoming some major obstacles.

North Carolina is reported to charge sixty-eight percent of the commercial rate and it appears on the way to the establishment of a comprehensive and successful self-insurance program. If Virginia were to charge 100% of the commercial rate, the chances that the program would get on its feet would be even better. When the fund or funds are at the proposed limit, the premium charged should be reduced.

Over the years, the ratings have been constantly dropping and there is a reason for this aside from the competitive aspects of the insurance industry. New buildings are usually built to be highly fire resistant, resulting with better loss records; this allows an eventual overall reduction in rates. Now, if Virginia would use the presently published ratings of the Bureau of Insurance over the next ten years in its calculation of the premiums to be charged, it would, in effect, be penalizing itself; but using this method of a cut-off year, to be revised every ten years or so, would be giving even more leeway to concentrative obstacles and objections.

TABLE VII

CLASSIFICATION OF VIRGINIA PUBLIC PROPERTIES
AS TO USAGE AND RELATIVE VALUE 1961

USAGE OF BUILDINGS & STRUCTURES	VALUE OF BUILDINGS	VALUE OF CONTENTS	TOTAL	PERCENTAGE
Highway & Construction	12,179,233	1,303,241	13,482,474	.0368637
Schools & School Administration	154,875,130	23,200,663	178,075,793	.4880464
Welfare & Corrective Institutions	26,092,709	5,479,792	31,572,491	.0965829
Hospitals & Sanitoriums	81,427,520	9,974,397	91,401,917	.2506562
Conservation & Economic Development	4,300,413	528,924	4,829,337	.0130438
State Office	15,898,200	783,169	16,681,369	.0457462
Museums & Parks	4,477,000	6,458,219	10,935,219	.0296882
A B C	1,713,000	15,494,902	17,207,902	.0470901
Military Affairs	453,000	11,000	464,000	.0012725
TOTALS	$301,416,205	$63,234,297	$364,650,502	1.0101900

Although there are a veriety of uses to which the buildings and structures are put, the ample majority of these, both by number and values, are used for three purposes: (a) schools, (b) welfare and corrective, and (c) hospital and sanitorium. Value-wise approximately eighty-four percent of the buildings and strucutres are used for three purposes. The remaining sixteen percent is distributed more or less equally among the remaining six uses, with the exception of military affairs. Certainly this is indicative of the State's properties meeting the third condition or our criterion.

4 GEOGRAPHICAL CONCENTRATION

The next consideration, the degree of concentration of the State's buildings and strucutres, is the main criticism of the proposed program as voiced by the insurance interests.[8]

The State universities are supposed to represent the prime example of concentrated risks, but are they? Most of the buildings are dispersed in such a manner that nothing short of an earthquake, or some other act of God, could destroy them wholesale. And this type loss is excluded under all commercial policies.

The fire loss record of the State properties refutes this contention also. Although there have been several fires above or near the $100,000.00 range (which might well be considered major), they have not spread rampant through other buildings. The latest fire of such proportion occurred at

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[8]Testimony of Richard E. Smith, executive secretary and general counsel for the Virginia Association of Insurance Agents, before the VALC Committee, July 25, 1961.

Longwood College, causing damages of an estimated $150,000.00. This was contained before spreading to other buildings. In most cases, damage to other buildings would be caused by water emanating from that sprayed upon the burning structure.

The insurance industry spokesmen still point to the great fires of San Francisco and Chicago to give emphasis to their arguments. Of course, the fact that most of the buildings were of wood construction and highly inflammable is seldom mentioned; also, fire fighting equipment was not so efficient as it is today; the danger of a similar fire today is negligible.

Let us examine some of the business practices of those who would throw stones. Let us take for example one of Virginia's respected school for girls, Hollins College, which is not State owned. The buildings of the main body are very close together, almost inviting a catastrophic loss. For the most part, these buildings are very old and anything but fire resistant. These structures are insured by several companies, through one large general agent, in line with the idea of spreading the risk, but does this practice actually reduce the hazard of concentrated risk?

The several companies each stand to lose less than if one company insured the entire college, but does this actually make the risk safer? The answer is obviously no. The risk of fire is the same and it is the amount of accepted money risk that is reduced. Insurance companies cannot alter the concentration of buildings; but they do make allowance for this condition by higher ratings. Ratings derived from predictions have been previously discussed: suffice it to say that a sufficient premium charged on the risk goes a long way to defeat the scientific basis of the concentration-of-risks criticism.

As new buildings are added to the State universities, there is a theoretical increase in concentration, but these new buildings are constructed in such a fire-resistant manner that the added actual increase in danger is almost negligible. As an example, the new buildings of Virginia Polytechnic Institute are almost fire proof; a person would find it difficult to start a sustained fire in them. The commercial companies are just as eager to renew their policies there, even if the concentration is increased. In fact, they have increased their total dollarwise coverages indicating that the catastrophic loss hazard could not be too severe.

These same statements could be made about the other buildings of the State. It is obvious that the use to which they are put determines their concentration. Most of the criticism is pointed at the State schools; however, because they comprise the bulk part of the total insurable value. It might be pointed out that these concentrated buildings suffered 56% of the losses over the past twelve years, but then, they represent 50% of the total value also. So, the concentration of these buildings did not affect their overall loss record.

Furthermore, an examination of the type properties which are exposed to the catastrophic loss is important. A fire is less likely to spread to adjoining buildings if the contents of these buildings are not highly flammable. Certainly, school buildings usually house no highly volatile contents; neither do the welfare and corrective institutions, and together they account for sixty percent of the total value of the buildings.

The industrially used buildings of Virginia are certainly few, and it is this type of building which is most subject to a spreading fire loss. Heat alone could cause explosions or similar losses to this type of

structure in many cases. Yet, the insurance industry offers coverage for large industrial concerns having many adjoining buildings. Most of these plants have sprinkler systems and are highly fire resistant, but a small fire could trigger the sprinkler system and cause great water damage--a consideration not to be overlooked.[9]

In fact, as a whole, the State properties are used in safer pursuits than most private properties which are eagerly vied for by the various insurance companies. A typical dwelling is often a more hazardous risk, for there, meals are cooked, highly volatile liquids are stored, and evenings are spent by a cozy fireside. The list is too exhaustive to list even for comparative purposes. The typical dwelling is not considered subject to a catastrophic loss if in a residential district, but these houses are usually closer than many of the buildings accused of being concentrated risks.

How close must buildings be to be considered concentrated? This is a question that is difficult to answer and depends upon your criterion of concentration for a value judgment. Generally, this criterion has become more liberal as the years since the great fires of bygone eras pass.

After general examination of the use of Virginia's buildings, their construction, and their actual degree of concentration, the threat of catastrophe hazard is shrunk to its rightful size. This is not to say that there is no threat of such loss altogether, but that the danger is not so great as critics would have the general public to believe. The

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[9]In February of 1961, a small fire at the Bassett Chair Plant of the J. D. Bassett Furniture Industries triggered the sprinkler system and caused a loss in excess of $41,000, borne by commercial insurance companies.

probability that one building of significant size and value would burn and cause loss in excess of the self-insurance fund is much greater than the chance that a fire would spread throughout the various structures of an institution or agency.

For example, if the ABC Board warehouse in Richmond were to burn, the loss would be tremendous. The reason for this lies not in the structure itself, but the contents housed therein. Any time that the contents are far in excess of the value of the building itself, this risk should be considered as concentrated. The various libraries at the State universities fall into this category. If commercial insurance connections or an additional reinsurance fund were established for these contents, the concentrated risk would be removed, relative to other buildings. At this moment, if the contents of the University of Virginia Library were to burn, the State would be faced with a loss far in excess of the insurance carried.[10] This would also mean a loss with no fund from which to draw the difference. This same statement is true for the total contents of every institution or agency, for the State carries risk without provision for the over-and-above loss, at present. Therefore, a total loss to a building and its contents of concentrated value would mean an appropriation to be forthcoming before replacement could be made.

Thus, the State is at present facing peril should a concentrated risk of large value burn, and it would not greatly increase this peril if it were to provide a fund that would pay for the major portion of a large loss.

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[10]Unpublished Data--Bureau of Property Records and Insurance.

Still, if the State wanted to be on the safe side of the theoretical considerations of intensified risk acceptance, it would do well to follow the example of South Carolina and establish a reinsurance fund. This "double fund" goes a long way to diminish criticism and insure success of the program. For although Virginia's loss record is favorable, that, in itself does not guarantee that a single large loss would not occur.

5 STABILITY OF LOSSES

From the information gathered by the Bureau of Property Records and Insurance, it would seem that Virginia properties have suffered an unstable loss experience over the past twelve years.[11] Even if this were not so, the average annual loss would still be approximately the same. The emphasis on this condition and the reason for its inclusion is that it effects the management of the program after its inception.

To review a loss record, you must do so for its entirety. The loss record for a single year indicates little as it is the average which is important. But if Virginia were to suffer an annual fire loss of approximately $50,000 every year, then the fund could be managed more in the manner of a sinking fund or some other such corporate reserve fund. As it is, the amount of premium over losses seems excessive in some years and too little in others. The fund will grow rapidly in good years and little in lean years. There cannot be any set amount of investments scheduled each year as might be the case under a stable loss experience.

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[11]Personal interview with Stewart R. Moore, Chief of Bureau, Bureau of Property Records and Insurance, September, 1961.

It should be noted, however, that the mechanics of the fund would be unaffected. The management of the fund would be the same whether the surplus were large or small. The present average annual loss is $76,363, a figure which has declined from the $80,195 amount in June, 1960. Several good loss years can cause a small statistical drop in the amount of this average, but if the loss record extends over the years, the figure tends toward stability--as would be the case with any average. A year that was relatively bad, such as the annum of the Longwood College fire, would tend to raise this average slightly.

Of course, no State with a vast hazard pool of dis-similar properties could expect a very stable loss experience. Based on the past twelve years, Virginia can only point with some pride to a loss record on its public buildings that is below the national average.[12] A proponent of self-insurance might point out that it is the majority of good years, in which losses were very low in relation to both the commercially charged premiums and the value of the buildings, that causes the uneven loss experience. If Virginia had suffered fire loss in the amount supposedly anticipated by the commercial companies, its loss record would indeed be stable.

This condition fully met would enable a prospective self-insurer to operate with less apprehension, but it does not effect the actual theoretical soundness of such a venture. The economical soundness of the Program depends upon many factors viewed over a length of time.

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[12]This statement is based on the contention by insurance companies that fifty-six cents of the premium dollar is paid in losses.

6 AVAILABILITY OF DATA

Because of legislative interest in the possibilities of Virginia's becoming a self-insurer, there has been compiled a considerable amount of data about the State's properties. The fire loss record extending over a twelve year period and more is available for examination and planning. The Bureau of Property Records and Insurance has been collecting information about Virginia's structures and buildings since its inception in September of 1958. This Bureau could be called upon in an advisory capacity by legislators to aid in the establishment of a plan. The Bureau of Insurance is certainly in a position to give advice and counsel since its knowledge of the insurance industry is vast.

Also, the State has had experience in the management of a reserve fund of the type required of a self-insurance fund. The State Literary Fund has provided the experience and education necessary to enhance the successful handling of the proposed fund.

7 FINANCIAL POSITION OF THE STATE

The last condition stated that a state should be in a strong financial condition before setting up a self-insurance program. Certainly, Virginia should be rated as one of the true financially strong states. How many others can boast of a surplus; most are operating in the red. Virginia has been engaged in large and steady building programs since the early 1950's and while this program has not been as rapid as some political liberals might wish, it has been undertaken in a prudent manner. This condition would certainly prove no hinderance to the establishment of the program.

CONCLUSIONS

In summary, after an examination of the established criterion, there is no one major obstacle which would condemn the economic soundness of an insurance type undertaking. Most criticism directed at the proposal concerns other than violation of basic insurance practices.

Not all conditions are present which would make for an ideal program or strict adherence to ideal underwriting science. But it has been pointed out that insurance companies cannot and do not adhere either; for although the principles of insurance are definite in theory, they are abstract in practice. Few insurance companies fail because of a bad loss record. One of the main purposes of this paper is to examine the proposed program for validity of criticism. The representatives of the insurance industry voiced at the 1961 Public Hearing one real and valid criticism: a concentration of value will be assumed by the State in its program. Of the conditions listed in the criterion, this is the one giving cause for concern. This condition was discussed at length, but there was no mention of its actual effect on the proposed program.

Being cognizant of the risk in insuring concentrated value buildings is important, for realization of a problem is necessary before a solution can be forthcoming. The bills introduced in the 1960 legislature proposed that one million dollars be set aside to cope with a large unexpected loss until the fund could build to three million dollars. Then, the one million would be repaid to the General Fund of the State. As long as the fund remained at three million dollars, all interest income would also be paid into the General Fund.

While three million dollars is a substantial amount, four million is even a safer level for the fund. By the time the fund could build to a level from which one million could be safely repaid, it would not be missed from the vast amount of appropriations of the State. In addition, the fund should be handled as two-one insurance fund and one reinsurance fund. There is no reason for the excess of interest income over losses to be paid into the General Fund. The amount that will be saved from eliminated premiums would be substantial and will prove the worth of the fund.

With the large funds, the State could safely assume large value risks and overcome the one obstacle which has theoretical validity.

Of course, the present plan as recommended by the VALC calls for the fund to be created and fed by the savings of a centralized insurance program. But regardless of the technique of creation, there should be two funds of substantial amount that would grow with the increase in assumed risk and in direct relation to the value of new buildings. The total value of these funds should equal approximately the value of the most expensive building.[13] This would mean that the proposed limit of the Virginia fund, should be raised to six million dollars, which would be 75-80% of the most expensive risk, including contents, to be assumed by the State. This is using the value of the ABC Board warehouse in Richmond as the basis of calculation.

With the funds at this level, the economic feasibility of Virginia's plan could not be challenged on violation of basic insurance principles.

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[13]Chester A. Kline, "Purchasing School Insurance," Journal of American Insurance (Vol. 21, No. 5, May, 1944), p. 6.

CHAPTER V

ADVANTAGES OF A SELF-INSURANCE PLAN

SELF-INSURANCE OVER ALTERNATIVE PLANS

Since 1961 most of the eligible state properties have been insured under the Public and Institutional Property form. This plan supposedly reduced the ratings of the buildings twenty-five percent. But because of required higher minimum coverages and increases in total insurable value, the average annual premium paid by the State has increased $8,870. With the insurance industry reporting that no more favorable coverage can be offered, the total cost of insurance will, of course, rise with each new public building or structure and with each new rise in the cost of similar coverage.

A study was made for the VALC committee on self-insurance through the cooperation of the Bureau of Insurance and the Bureau of Property Records and Insurance, comparing the costs of various possible coverages on selected high value State properties. The four possibilities examined were as follows:[1]

(1) Plan 1.
Use of a $50,000 deductible
(a) per building basis
(b) per occurrence basis

(2) Plan 2.
Under the Public and Institutional Property Plan

(3) By insuring uniformly at 30% co-insurance on Triple-A construction, 80% on sprinklered risks and 50% on all other buildings.

(4) Carrying no insurance on buildings and contents valued at $25,000 or under.

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[1]Joint Report to Virginia Advisory Legislative Council, Division of the Budget, L. M. Kuhn, director, (Richmond, 1961).

TABLE VIII[2]

Alternative Plans Summary

Institution or Agency	Form of Insurance	Present Coverage	Present Annual Premium	Annual Saving Under Plan				
				1(a)	1(b)	2	3	4
DIVISION OF BUDGET								
Bldgs. & Grounds	PIP	FIRE	$ 4685	$ 531	None	On PIP	$ 775	$ 37
DEPT. OF EDUCATION								
Longwood College	PIP	Fire	5887	1293	$ 274	On PIP	200	360
Madison College	PIP	Fire	8552	1340	None	On PIP	1422	327
Va. Sch. D & B	PIP	F&EC	2140 ✓	423	None	On PIP	None	53
Va. State Coll.								
Norfolk	PIP	F&EC	3723	313	20	On PIP	743	99
Petersburg	PIP	F&EC	9153 ✓	3503	None	On PIP	369	6777
Va. State Schl.	PIP	F&EC	1706	796	16	On PIP	None	465
W.W. Rehab.Cen.	SCHED	Fire	1670	*	None	None	None	1350
DEPT. OF HEALTH								
Blue Ridge Sana.	SCHED	Fire	2383	1330	519	$ 401	941	711
Catawba Sana.	PIP	Fire	3041	1380	134	On PIP	709	580
Piedmont Sana.	**	Fire	1962	1545	602	552	762	497
MEDICAL COLLEGE OF VIRGINIA								
College	PIP	F&EC	4017	487	None	On PIP	257	67
Hospital	PIP	F&EC	9882	32	None	On PIP	1472	87
DEPT. MENTAL HYGIENE & HOSP.								
Central St. Hosp.	PIP	Fire	5880	1520	None	On PIP	545	570
Eastern St. Hosp.	PIP	Fire	4104	1327	None	On PIP	793	206
Lyn.Trn.Sc.&Hosp.	PIP	Fire	4610	1407	103	On PIP	943	428
Petrsbg.Trn.Sch.	PIP	Fire	1325	271	None	On PIP	315	34
S.W. State Hosp.	PIP	Fire	4078	1730	163	On PIP	758	550
W.St.&DeJarnette	PIP	Fire	6999	1364	20	On PIP	426	1009
UNIVERSITY OF VA.								
Clinch Val.Coll.	***	Fire	1742	1142	372	643	512	22
Univ.& Hospital	SCHED	Fire	19364	2894	None	None	62	1530
Mary.Wash.Coll.	PIP	Fire	5626	2959	None	On PIP	1168	124
V. M. I.	****	Fire	6020	2350	1075	505	2185	470
V. P. I.								
Institute	*****	F&EC	21884	11202	4616	4186	3324	2570
Radford College	PIP	F&EC	4515	555	None	On PIP	578	264
DEPT. WELFARE & INSTITUTIONS								
Beaumont School	BLANK.	Fire	5089	2903	1399	******	2295	1112
Bland Corr.Farm	"	Fire	3692	2912	1072	"	1782	1275
Bon Air School	"	Fire	1456	966	419	"	505	300

TABLE VIII (Continued)[2]

Institution or Agency	Form of Insurance	Present Coverage	Present Annual Premium	Annual Saving Under Plan				
				1(a)	1(b)	2	3	4
DEPT. WELFARE & INSTITUTIONS (Continued)								
Hanover School	BLANK.	Fire	$ 1801	$ 1543	$ 521	******	$ 811	$1081
Janie P. Barrett	"	Fire	1212	1045	315	"	545	372
Peni.& Ind.Dept.	"	Fire	8271	2841	2401	"	1401	4[illegible]
Southampton Farm	"	Fire	6940	5347	2210	"	3406	2207
St.Farm for Men	"	Fire	13466	8303	3922	"	5766	3492
St.Ind.Frm.Women	"	Fire	4657	2503	1343	"	2119	59[illegible]
Study Home/Boys	"	Fire	261	None	*	"	161	147
COLLEGES OF WILLIAM & MARY								
Norfolk College	PIP	F&EC	3220	1215	None	On PIP	420	117
R. P. I.	PIP	F&EC	2526	884	None	On PIP	None	48
Williamsburg	PIP	F&EC	10253	2985	42	On PIP	1197	1328
TOTALS			$207800	$75155	$21550	$6287	$44667	$31412

* Below $500 Minimum
** Blanket and Specific
*** Schedule and Specific
**** Schedule and Blanket
***** Blanket and Reporting
****** Not Eligible for PIP Plan

[2]Insurance on State-owned Buildings, House Document 17, (Richmond, Department of Purchases and Supply, 1962), p.24.

The results were presented in table form and showed that, even if all the buildings, including those proven ineligible, were insured under the PIP plan, only small relative savings would result. The other plans mean the assumption of large risk without a fund to provide for losses; they might better be termed patial no-insurance plans. The indication here would be that the State might be better off self-insuring totally with a fund from which to pay losses than attempting the use of large deductibles without provisions for the amount of the deductible.

Another interesting observation is that at present most of the buildings are insured for fire protection only. Extended coverage and replacement cost coverage would add a substantial amount to the total average annual premium if it were purchased. As it is, most buildings are now subject to uncovered wind, water, and smoke damage. A loss to an older building would also require of the State a large sum upon its replacement because of depreciated value. At the present time, the State is not fully protected against large risks and any sum that would be called for by an uncovered loss would come from the General Fund or be charged against the institution of agency's appropriation. The public buildings are not now so safe from loss under purchased coverage as insurance industry spokesmen alledge, and a self-insurance fund would actually provide increased coverage in many instances.

ACTUAL SAVINGS

Of course, the most apparent advantage is that of eventual reduced cost of insurance. One of the methods that might be used to evaluate the

present return on the premium dollar is by the loss-cost ratio. The total average annual premium over the past twelve years has been $295,427; while average fire loss has been $76,363.[3] This gives a loss-cost ratio per year of 25.8, which means that 74.2 cents of every premium dollar has been the gross profit of the insurance companies.

The "concentrated risk" educational buildings got back thirty-five cents on the dollar in paid losses. This is not an unusually fine loss record either, as the loss-cost ratio of educational institutions all over the United States is 37.2.[4] Thus when the buildings and structures that comprise better than fifty percent of the total value suffer a combined loss which is in line with the national average, the loss record cannot be termed "excessively low or lucky." This is especially so when we see that, as was pointed out earlier, these educational buildings suffered 56% of the total loss.

The spokesmen of the Insurance industry at the public hearing before the VALC committee reported that the Virginia Bureau of Insurance allowed only a small margin of profit. It would seem that the insurance companies might be "taking a beating" from some of those private buildings insured in accordance with sound insurance practices; that is if they, as reported, have made no underwriting profit in Virginia over the last several years.

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[3]All statistical data quoted in this chapter, unless otherwise indicated, was drawn from the 1961 Reports of the Bureau of Property Records and Insurance.

[4]Gaylord D. Morrison, Insurance of Colorado School Property (Abstract), (Colorado, 1958), p. 2.

The Virginia Bureau of Insurance tries to establish rates that will follow the formula established by the Virginia Supreme Court in 1928. The case from which this precedent arose was the American Druggist versus the Commonwealth. Of each premium dollar, the insurance company is supposed to pay out 52.5 cents in losses, to have 42.5 cents of administrative cost and to make a small profit of 5 cents. Included in the administrative cost is an approximate 15 cents allowance for the Agent's commission. This formula was established before advent of fire resistive building construction and many other incorporated general safety features. In fact the catastrophic loss theory was still prevalent. The loss record of Virginia and other states were much poorer at the time, and actual administrative costs should have been a greater percentage of the premium dollar if we are to believe the companies' contention of present lower administrative costs. Today, this formula is still used to guide and defend the rates charged; if this is valid, the highly touted efforts of the National Board of Fire Underwriters in fire prevention have gone for naught.

For the last twelve years, Virginia has paid the companies an average net profit of 34.2 cents on each premium dollar; that is if we use the 40% administrative expense figure reported to be the present average.[5] Administrative cost is comprised of varied expenses: Agent's commission, competitive and selling expenses, salaries, loss adjustment, maintenance

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[5]O. A. Kulp, Casualty Insurance, (New York, Ronald Press, 1940), p. 470.

of bureau and organizational memberships, office machinery, and inspection are all included in the 40% figure.

Howard M. Teaf of the Federal Department of Labor and Industry in a special bulletin reports that the administrative costs of self-insurance is approximately 10%, which is at least a thirty cents saving on the dollar.[6] This 10% figure is further substantiated by the fee of approximately 10% of gross premium charged by outside self-insurance management services.[7]

If the State had been self-insured over the past nine to ten years, there would be a fund created by the surplus of premiums over losses of $2,000,000. The investment of this surplus as it materialized could have meant another $200,000 or more in interest income. There is certainly nothing to refute the contention that this would also be the outcome of a self-insurance venture over the next decade.

One industry spokesman reported at the public hearing that insurance coverage on public buildings and structures costs the citizens of Virginia only about ten cents per capita. Of course not all "per capitas" pay taxes; thus, each taxpayer pays about thirty-five to forty cents each year on insurance for his public buildings. Approaching this situation from the above standpoint, anyone could justify any expenditure. The "farm surplus" problem costs the taxpayer only a dollar or so a year; thus, this might be considered unimportant by this criterion.

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[6]Howard M. Teaf, Insurance and Administrative Costs, (Washington, Department of Labor and Industry, Bulletin No. 40, Part II), p. 2.

[7]O. A. Kulp, Casualty Insurance, (New York, Ronald Press, 1940), p. 472.

MORE COVERAGE FOR OLDER BUILDINGS

At present the State pays a very high premium to insure, even partially, some of its older buildings. Some are unable to qualify for coverage. While it is true that some of the buildings of this class could not safely be insured for full book value, even by a self-insurance fund, they could be given greater coverage for relatively the same amount of premium. And should one of these buildings be lost by fire, replacement and payment from the fund could be made at a time most suitable to the State--a replacement which could be made to comply with the overall building schedule and a more economical allocation of available resources.

ADDED INCENTIVE FOR SAFETY

Even insurance merit plans, such as the FIP form, do not fully reflect individual experience.[8] If the State's loss record were even one-half the total of what it is, the rate charged would still be approximately the same. This is because the same policy is offered for purchase on other than public properties, which may or may not have as favorable a loss record. This would seem to refute the contention that a self-insurance fund removes all safety incentives; in fact, it should increase the drive for safety. The loss record would more fully reflect upon the institution oragency and would bring to light any losses caused by neglect or carelessness in providing an adequate safety program. There would be no sharing of

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[8]Robert I. Mehr and Emerson Cammack, Principles of Insurance, (Homewood, Richard D. Irwin, Inc., 1957), p. 623.

a good loss experience with stockholders.[9] A company's administrative or fixed costs in insuring each property is a block to the full reflection of a favorable loss record in charged rates.

A CORPS OF ADVISORS

One of the main arguments against self-insurance voiced by the Virginia Association of Insurance Agents is that the State would be losing the valuable services of the many local agents, which include inspection and advice on safety features. The agent is really supposed to earn his commission and then some, by his service of the risks. Prior to the public hearing by the VALC committee, the head men of many institutions and agencies testified about their agent's "valuable services" at a closed committee hearing. The majority reported that the only time they saw the agent was when he came to write a new policy at the expiration of the old policy term, to increase the coverage upon completion of a new building, or to explain the necessity for higher premiums.[10]

The inspection service on most public buildings is already done by an arm of the State Corporation Commission, the Fire Marshal Division. This division is located in the Bureau of Insurance and is headed by the Chief Fire Marshal. The division's responsibility is the enforcement of Virginia fire safety regulations and investigation of fires of suspicious origin.

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[9] C. A. Kulp, Casualty Insurance, (New York, Ronald Press, 1940), p. 470.

[10] Testimony of the VALC Committee members at the self-insurance public hearing, Richmond, July 25, 1961.

It advises the Commission on appropriate regulations, testifies for the Commission at public hearings on the regulations, keeps the Commission abreast of changes in the field requiring amendments to the regulations, and investigates alleged violations of regulations.[11]

A district engineer is in charge of each of the five State territories. In the case of existing public buildings the district engineer, with/or his assistants, makes inspections thereof on his own initiative or upon request, and writes technical reports of the inspection citing the requirements of the law that are not being met. He also recommends additional fire safety measures where applicable and follows up all such inspection to insure compliance with the State code.

The engineer also approves architectural plans and designs prior to the construction of new public buildings in his district. In this way, any violations are corrected before expenditures are made, saving unnecessary embarrassment.[12]

So, with the majority of the inspection chore presently resting with State officials, little additional expenditure nor a newly created agency would be required in the establishment of a self-insurance program. An enlargement of an engineer's duties to include assessment for insurance purposes could be worked smoothly into the overall mechanics of the program.

There appears to be no paucity of available public officials and experience which might deter the self-insurance movement. A long range

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[11] The Eastern Underwriter, 12 December, 1958, p. 20.

[12] Ibid., p. 110.

advantage is that the State would develop a corps of public officials experienced in the overall aspects of insurance principles and practices. This experience would prove invaluable in many aspects of governmental operations, not to be confined to insuring public buildings. The advisory capacity of such men could induce savings in other types of required insurance on various governmentally controlled ventures.

PLACEMENT ABOVE FAVORITISM

A self-insurance fund would also relieve the institutional or agency employee of the often embarrassing task of selecting the agent or agents who will receive the insurance business. Some of our colleges seem to be trying to place their business in a manner which will award as many of their alumni in the insurance business as possible, rather than in the manner which would give comprehensive coverage at least cost and involvement.[13] The agents could no longer lobby for business, and reliance upon adequate placement would be removed from those who have a vested interest in the very matter upon which they are advising.

It should be noted here that this paper is not intended to answer the socio-political controversy about whether by self-insuring, a governmental unit is actually entering into the insurance business. Suffice it to say that a self-insurance program is not intended to compete with commercial insurance, and its effect does not extend beyond the State's own properties.

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[13]Personal Interview, Charles Lunsford of Charles Lunsford Sons & Izard, July, 1961.

The real concern of this paper has been entirely with the economic feasibility of Virginia's becoming a self-insurer, with an attempt to point out some of the more obvious pitfalls as encountered by other States and the fallacies in most criticisms voiced by the insurance interests.

INTEREST INCOME

Various mention of underwriting profit has been made throughout this paper, but not to be overlooked is another avenue of added profit open to the insurance companies--that of interest income. Of course, the fire insurance industry is not as dependant upon this income as is the life insurance industry, but nonetheless, it does play an important role. After administrative expenses, if the $180,000 of premiums left of the $300,000 premiums charged were to be invested prudently at four percent, the interest income would be $7,200. This is a "goodly" amount to add to an approximate $222,600 of profit which has already been grossed by the insurance companies.[14]

This interest income would be even greater for the State with less administrative expense, about $11,600. In fact, when the self-insurance fund accumulates to $3,000,000 as proposed, all losses should be payable solely out of interest income.

THE "JONESES"

One of the better arguments for self-insuring might be the use of the Fund record of North Carolina, one of the South's most progressive states. This might be a "keeping up with the Joneses" type argument, but North

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[14]Based on the 74.2% gross profit figure over the past twelve years.

Carolina is close enough geographically to share many of the climatic and geographical conditions prevalent in Virginia. It should also be pointed out that since participation in the fund is voluntary for many institutions and that it is in reality an emergency reserve fund, a properly managed self-insurance fund may well show a better record.

OPERATING RECORD 1949-1960[15]
STATE OF NORTH CAROLINA
INSURANCE FUND

Direct Premiums Earned	$ 4,409,072		
Less Cost of Reinsurance	$ 84,341		
New Premiums Earned		$ 4,324,731	
Direct Losses Paid	$ 2,514,517		
Reinsurance Recovery	$ 130,000		
Net Losses Paid	$ 2,384,517		
Administrative Expense	$ 296,070		55.1
Total Expenses		$ 2,680,587	6.8
Underwriting Profit		$ 1,644,144	61.9
Investment Income		$ 703,170	
Earned Surplus		$ 2,347,314	

[15] State School Fund Competition, (Charlotte, North Carolina Association of Insurance Agents, 1961), p. 3.

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VITA

My full name is Jerry Thomas Ferguson. I was born May 8, 1938 at Roanoke, Virginia. I received my elementary education in the public schools of Roanoke, Virginia. I was graduated from William Fleming High School in Roanoke, Virginia in 1956.

In September of 1956, I entered Virginia Polytechnic Institute, Blacksburg, Virginia. There I studied Business Administration and completed the requirements for the Bachelor of Science degree in June, 1960. The following September I enrolled at Virginia Polytechnic Institute as a candidate for the Degree of Master of Science in Business Administration.

From September of 1961 until June of 1962, I was with the General Adjustment Bureau in Martinsville, Virginia

Jerry T. Ferguson

A SELF-INSURANCE PLAN
FOR THE STATE PROPERTIES OF
VIRGINIA

by

Jerry T. Ferguson

AN ABSTRACT

The object of this study was to determine: (1) the economic feasibility of a self-insurance plan for the State properties of Virginia, (2) the present status of the State insurance program, and (3) the possible advantages to be had by instituting a self-insurance plan. The procedures used to arrive at a solution to the problems were:

1. To investigate the insurance plans and practices of other states,

2. To examine basic insurance principles and practices as stated by writers on the subject,

3. To examine reports of special legislature studies dealing with the possibilities of self-insuring,

4. To investigate the validity of various criticisms of self-insurance programs.

Data was gathered through personal interviews and correspondence with the State Bureau of Insurance, State Bureau of Property Records and Insurance, and various officials and representatives of the insurance industry. The data were then analyzed and interpreted. The conclusions and findings reached as the result of the interpretations were stated.

The study showed that a self-insurance plan could be instituted for the State properties without violating basic insurance principles and practices. By evaluating the present status of the Virginia insurance

program, it was found that self-insuring would not call for a vast reorganization of State administration or organization. It was shown that if the State had been self-insured over the past twelve years, well over two million dollars would have been saved and accumulated in a fund. On each dollar paid for commercial insurance protection, the State received twenty-six cents in paid losses. Also, there were found a number of advantages to be had in self-insuring other than the obvious savings in cost.