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Mission Statement

State of Minnesota
Department of Administration
Risk Management Division

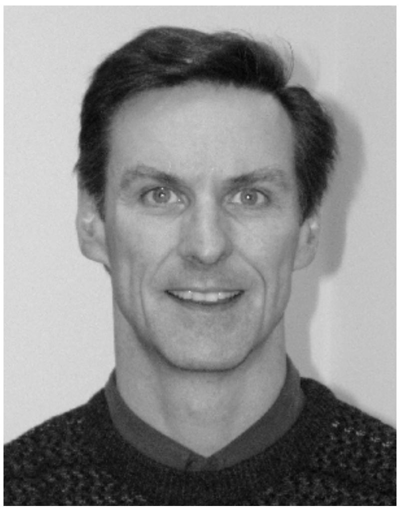
Promote
. . . proactive risk management techniques in state government;

Provide
. . . the mechanism to minimize the adverse impacts of risks and losses for state agencies;

Absorb
. . . risk while maintaining a stable financial profile; and

Ensure
. . . the long-term financial security of the State of Minnesota and its agencies.

COMMISSIONER'S STATEMENT



Since its founding in 1986, the State of Minnesota's Risk Management Division has delivered real and significant value to its customers and to citizens, protecting life, health, and safety by assuring that the state's many and varied operations face the least risk at the lowest cost. Events of the past year succinctly illustrate Risk Management's extraordinary level of talent, commitment to mission, and dedication to its customers.

When reinsurance providers announced a 193 percent increase in reinsurance rates, from $1.2 million to $3.3 million, Risk Management developed a two-pronged approach directed at ensuring rate stability for the State of Minnesota in the near-term and for the future. The division waived dividend payments to customers in FY03 and embarked on an aggressive campaign for procuring a more cost-effective reinsurance solution. Director Fred Johnson and his staff researched alternative markets for options that would result in better coverage at more favorable rates. In discussions with reinsurance providers, Risk Management successfully argued that a newly instituted loss prevention program, developed in response to a need identified following large losses the previous year, demonstrated the state's commitment to reducing risk. As a result, the state was able to procure a more favorable reinsurance program that, in addition to being more cost-effective, will ensure future rate stability. Furthermore, state agencies in FY04 received $1.7 million in insurance premium rebates.

Risk Management is also moving forward in other ways that will benefit its customers. In midyear, the division implemented *RiskSmart*, an electronic automation process that is increasing accuracy, reliability, and responsiveness in managing the state's insurance needs. This dynamic, web-based system is searchable and gives underwriters instant access to the information they need. Underwriters can automatically prorate premiums based on changes in property or coverage, and can more quickly identify potential problems for their customers.

From its modest beginning 17 years ago as the state's internal alternative for automobile liability insurance, through today as the insurance agent for nearly $7.5 billion in state property, Risk Management continually proves that talent, commitment, and dedication reap substantial rewards for Minnesota and its citizens.

Sincerely,

Brian J. Lamb
Commissioner

DIRECTOR'S MESSAGE

Most observers of the insurance industry are well aware of its' cyclical nature, as is evidenced by the last year. Twelve months ago, we had experienced sharp premium increases, substantially higher levels of assumption of risk, and much more restrictive terms and conditions for our property reinsurance. This was in the aftermath of the events of September 11, 2001 and our own adverse loss experience. Clearly, decisive action had to be taken to preserve the reinsurance coverage that is needed to permit the Risk Management Fund (RMF) to provide the high limits for catastrophic property losses and for the protection of the RMF against an aggregation of losses in any one year.

In fiscal year 2002, the Property Loss Conservation (PLC) program was implemented to enhance fire protection and related safety efforts. In the past fiscal year, we have expanded that program to include:

- Impairments to Protective Systems
- Pre-plant Fire Emergency Planning
- Monthly Churn Testing
- Windstorm Planning Guide
- Cold Weather Precautions

On-site inspections were carried out at 12 locations that represented Minnesota State Colleges and Universities (MnSCU), Department of Corrections, Department of Administration, Veteran's Homes, Perpich Center for Arts Education, State Fair Grounds, and the Iron Range Resources & Rehabilitation Board (IRRRB). To date, we have done 24 physical plant inspections that have property valued at $4.3 billion, or 58 percent of the total value of insured state physical plant. Additional facilities will be inspected each year.

The most common recommendations include: 1) exercise fire pumps monthly, i.e. churn testing; 2) implement an active hot work safety management program; 3) prohibit storage within 18 inches of sprinkler heads and 36 inches of electrical cabinets; 4) curtail propping open fire doors and test fire doors for correct operation; and 5) a low cost, but very important, recommendation – excellent housekeeping. All of these recommendations can be implemented at no or minimal cost. They not only reduce risks to the physical plant, but also reduce business interruption or extra expense losses, including loss of human life.

In fiscal year 2003, we deferred payment of dividends in order to preserve the financial integrity of the RMF and enable us to absorb the losses, if they should occur, that were imposed by the higher deductibles and retentions. We were pleased that we did not experience any significant property losses and that the renewal of our reinsurance program, consummated in June, had several significant improvements enabling us to declare and pay dividends in fiscal year 2004 totaling $1,668,215. The declaration of dividends was welcomed by state agencies at a period of time when all state government was experiencing budget difficulties because of the revenue shortfalls.

The true cost of losses from fires, auto accidents, slips and falls, and employee dishonesty cannot be measured by the premiums we pay compared to the losses we incur. The real measure is the indirect or hidden costs that are never fully measured. Relocation costs, programs that are curtailed, layoffs, human and emotional suffering all represent costs and loss of productivity that, in many cases, could have been eliminated or minimized through the application of sound risk management principles.

The success of the Property Loss Conservation Program, and its incorporation with the property insurance programs, is a good example of how insurance through the RMF can help agencies improve their risk and lower the chance of unexpected losses. There are other examples of the Risk Management Division's (RMD's) vision, such as the introduction of the daylight headlights program, which is now standard on many new vehicles. Another example is early awareness of the increased exposure of 15-passenger vans to accidents and rollover, which prompted the use of educational tools such as videos and training requirements for operators of these vehicles. The National Highway Traffic Safety Association recognized the rollover tendencies of the 15-passenger vans and has issued several warnings. The Risk Management Advisory Committee supported the Travel Management Division's decision to discontinue offering 15-passenger vans as an option for state agencies.

New opportunities and challenges continue to develop. Our increasing dependence on the internet and on-line services creates new exposures that must be identified and evaluated. To address the potential risks, new insurance products and services are being developed. The RMD can create solutions through effective communication of management information, and identification of issues and potential risk and insurance management solutions. We will continue to help state government by assisting with the elimination and minimization of risk and offering financial alternatives and solutions that respond to its needs.

I recently attended a conference at which the speaker stated, ***"Risk management may be the only departmental function of government capable of materially reducing cost without eliminating people or programs. . . ."*** The true value of risk management is savings for state agencies. For every dollar of premium, state agencies received $1.24 of benefit, based on dividend paying years. In addition, add the losses that have been minimized or eliminated, and risk management represents one of the greatest opportunities for cost/benefit risk alternatives in which any agency can invest.

This past year was a year of great achievement. Phillip Blue, Manager of Underwriting and Marketing, and Marlys Williamson, Senior Underwriter, received a Governor's Commendation in recognition of their work in challenging a proposed $2 million increase in reinsurance costs; however, they ultimately achieved a $1.7 million savings. Although Phil and Marlys received individual recognition for their efforts, the Division's entire staff responded to the challenges and contributed to the overall outstanding performance of the RMD. In the coming years, new challenges will arise that will have to be met with new and innovative solutions and will result in achieving even greater success.

As has been stated before and demonstrated in this past year, we will continue to meet the risk and insurance needs of all state agencies and political subdivisions. We remain committed to providing customer service with integrity to whomever we serve.

Frederick R. Johnson Jr.

Frederick R. Johnson, Jr., Director

Fiscal Year 2003 Annual Report Highlights

Fiscal year 2003 was a gratifying year, with the RMF enjoying excellent underwriting results, significant achievements, tremendous challenges, and continued growth. The RMF experienced increases in exposures underwritten, noteworthy claims handling, and continued the positive effort of building financial stability and integrity for the future.

- The RMF's total assets decreased by 38 percent from $28,962,230 in FY02 to $17,914,900 in FY03. The reasons for the $11 million decrease are: 1) the decision by the Department of Finance to eliminate from Risk Management financials the Securities Lending Collateral account ($2.9 million), 2) the reduction in reinsurance recoverable ($5.5 million), and 3) cash is down $2.6 million since, last year, the RMF received reinsurance funds on the last day of the fiscal year, thus inflating the prior year cash balance. These transactions have minimal impact on the overall solvency of the RMF.
- Policyholders' surplus (unrestricted net assets) decreased by three percent to $5,491,210, compared to $5,670,515 in FY02.
- Due to the uncertainty of the property line of business, the decision, approved by the Risk Management Advisory Committee (RMAC), was to not pay dividends in FY03. Dividends paid to date total $6,637,774. It is worth mentioning that the RMF will pay $1.7 million of dividends in FY04.
- The total insured property values increased by 19 percent from $6.2 billion in FY02 to $7.4 billion in FY03. The primary reason for the increase was the tremendous effort MnSCU put toward getting their buildings insured to value.

In addition, the RMD has seen noteworthy continued growth and achievements in the following areas:

- Continued, for the second year, a comprehensive statewide PLC program for our insured property.
- Successfully assisted in creating a new statewide worker's compensation cost allocation fund that kicked off in October 2002.
- Developed a new policy information system, *RiskSmart*, in time to electronically renew fiscal year 2004 policies.
- New staff member assumed the important Webmaster duties for the RMD. This strategy has resulted in the RMD website being a resource for our customers with current claims, underwriting, loss control, and publications materials always available.
- Renewed the FY04 property reinsurance program for lower retention ($2.5 million to $2 million), lower rates ($.052 rate per hundred to $.0385 rate per hundred), and better terms and conditions. For example, the total property limit increased from $300 million to $750 million.
- Developed new and current insurance requirements contract language for the state of Minnesota's construction and professional/technical contracts.
- Explored cost savings potential of an Owner-Controlled Insurance Program (OCIP) for the $180 million Capitol Complex building project.

Property Loss Control Program

A property loss control (PLC) program was initiated for the RMD's insured agencies in the first quarter of FY02. The program includes site inspections of insured properties and the introduction of safety management programs. The objectives of the PLC program are to:

- Protect personnel from physical harm and loss of life,
- Protect state property from physical harm, and
- Reduce or eliminate property losses that disrupt the state's operations and impact the state's ability to carry on the business of state government.

Site inspections were conducted by a loss-control engineer who represented our property reinsurer. RMD personnel, along with interested agency staff, also participated. Recommendations made by the loss-control engineer have been responded to by the state agencies in a positive manner. There were 15 site inspections completed in FY03, for a total of 26 since the start of the program. The properties inspected to date represent 58 percent of the total value that is insured. The initial focus of the inspections has been to visit sites with the highest insured values. Inspections were done at MnSCU campuses, Minneapolis Veterans' Home, Perpich Center for Arts Education, Stillwater Prison, I.R.R.R.B. properties, and the Minnesota State Fair. There are 12 inspections planned for FY04.

Seven **safety management programs** are currently being used in conjunction with the property loss control program. Further details of each safety management program are available on our web site at http://www.mainserver.state.mn.us/risk/. The first four safety management programs listed below were formally introduced statewide during FY03:

1. ***Hot work*** outlines the proper safety procedures to follow when engaged in any activity that produces a spark.
2. ***Impairment*** outlines the actions to be taken when fire detection and protection equipment are inoperable.
3. ***Inspection and testing*** outlines the systematic testing and maintenance of fire protection and detection equipment. The monthly fire pump churn test is an example.
4. ***Emergency response*** outlines the items to discuss with local fire officials regarding the lay of the land so all are well prepared in case of a catastrophic event.
5. ***Plan review*** – blueprint review of the sprinkler density to occupancy relations, as well as any other loss control particulars relating to a construction project.
6. ***Audits*** – include loss control inspections to check local conditions and compliance with implemented programs.
7. ***Loss investigation and analysis*** – used to determine cause of loss so that changes can be made statewide for weaknesses found in the system.

This program is now an integral part of Risk Management's overall mission. The success of the PLC effort can spell the difference between a viable, competitive, dividend paying, property program and a program having a less desirable result. Success is the only option.

Division Summary of Operations

In FY03, the RMD continued to provide four major areas of service to state departments, boards, bureaus, commissions, and component units of the State of Minnesota, as well as political subdivisions. Those services include:

- Managing the RMF, which operates as the state's internal insurance company. The RMF provides property and casualty insurance coverages that are tailored to meet clients' needs.
- Purchasing commercial insurance to meet agencies' needs when the placement of insurance coverage in the RMF may not be appropriate or cost effective.
- Providing risk and insurance management consulting and training services on a wide variety of issues.
- Property Loss Control, or Conservation, efforts were continued in earnest in FY03.

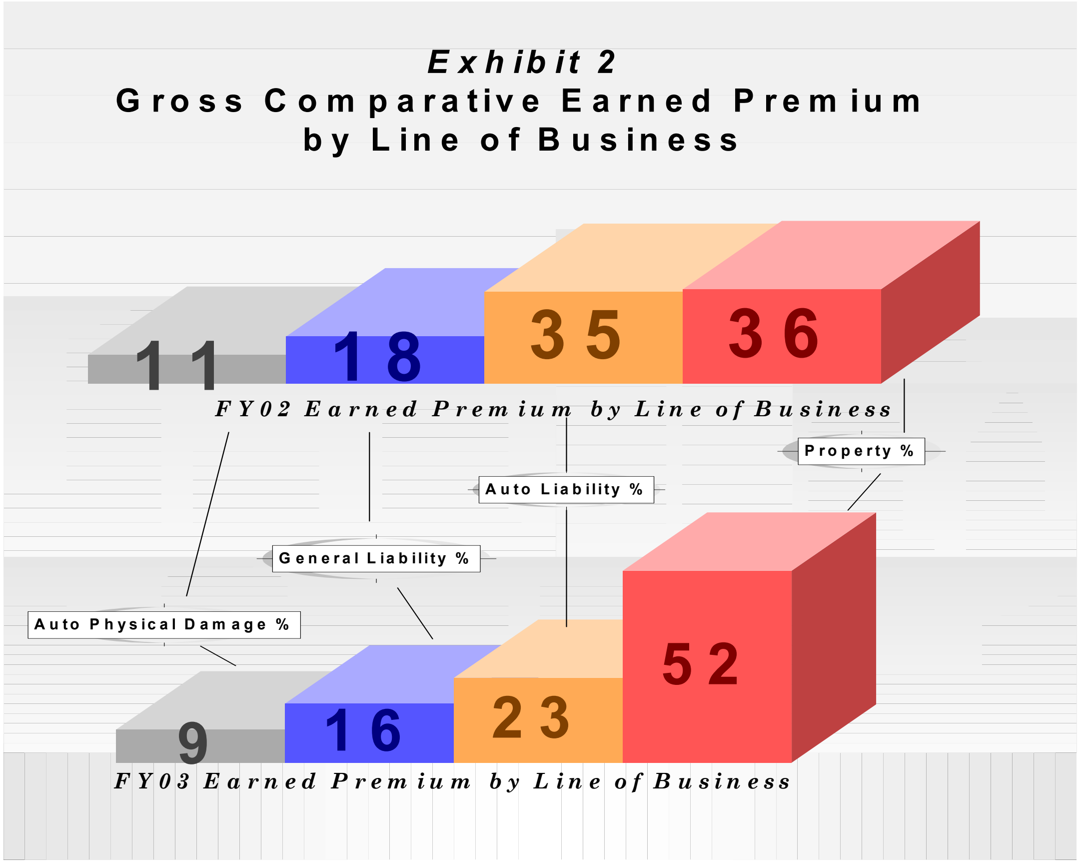
The RMD develops, for the Department of Finance, a business plan for each line of insurance underwritten by the RMF. Each line of insurance is evaluated for the development of losses, adjusting expenses, reinsurance expenses, administrative expenses, and, where appropriate, legal expenses.

An objective of the RMD is to maintain operating expenses well below the industry average for comparable insurance companies, as reported by AM Best in its annual publication *Aggregates and Averages*. The five-year performance of the RMF, compared to industry averages, as demonstrated in Exhibit 1, indicates that we have met our objective in each of the past five years, with all five years better than 40 percent lower than the industry.

For the last four years, the RMF has experienced a very stable expense ratio, varying only six-tenths of a percentage point over that period.

Exhibit 1

	FY99	FY00	FY01	FY02	FY03
Net Premium Written	$4,590,939	$4,658,498	$5,419,278	$5,585,401	$5,911,569
Industry average operation expense ratio	30.5%	30.6%	28.6%	30.5%	30.2%
Projected industry average operation expense based on RMD's actual premium	$1,400,196	$1,425,500	$1,549,914	$1,703,547	$1,785,294
Actual RMD operating expenses	$ 583,454	$ 780,405	$ 910,691	$ 950,542	$1,029,334
RMD operating expense ratio	12.7%	16.8%	16.8%	17.0%	17.4%



FY03 Line of Insurance	Premium
Auto Liability	$2,075,124
Auto Physical Damage	842,814
General Liability	1,412,839
Property/Boiler	4,340,004
Crime	68,359
Other	343,719
Total	$9,082,859

FY02 Line of Insurance	Premium
Auto Liability	$2,473,245
Auto Physical Damage	789,014
General Liability	1,259,829
Property/Boiler	1,969,545
Crime	57,393
Other	349,677
Total	$6,898,703

On July 1, 1995, the RMF changed from a primarily mono-line automobile liability insurance fund to a full-line property and casualty insurance fund offering a wide variety of insurance coverages tailored to meet the clients' needs.

Exhibit 2 reflects the changes of FY03, compared to FY02. The changes that occurred include the reduction in Auto Liability rates, and increased business in Auto Physical Damage and General Liability. The biggest change was a doubling of premiums in the Property lines due to a $1.9 million increase in property reinsurance costs and a quintupling of the self-insured retention. This was a positive rate change when compared to the heavy reinsurance cost increase and the large jump from $500,000 to $2.5 million in the amount retained by the RMF on each and every loss. The most significant accomplishment in FY03 was holding the property rate increase to the level that it was. To put it in perspective, premiums increased $2.4 million and reinsurance costs increased $1.9 million, leaving only an additional $500,000 for property losses. The commercial market would have responded much differently with dramatic rate increases.

The RMF continues its real growth in all lines as additional customers seek coverage. With the difficult insurance market, including much higher prices and reduced amounts of coverage, the RMD's goal is to continue to provide affordable coverage.

Dividends

The FY03 dividend of $1,668,215 was calculated in FY03, but declared and paid in FY04. This brings the total dividends paid since inception to $8,305,989. FY03 dividends, by line of insurance and total dividends paid from the inception of the program, are as follows:

	Calculated in FY03	Total Dividends Declared
Auto Liability	$ 743,691	$4,841,161
General Liability	579,211	1,773,584
Property	345,313	1,691,244
	$1,668,215	**$8,305,989**

The following outlines the dividend strategy exercised by the RMF:

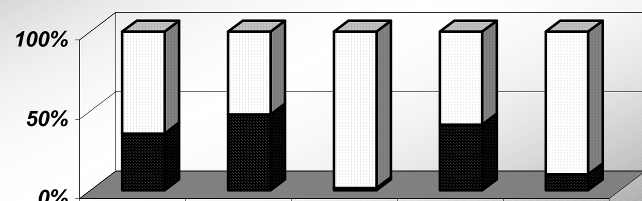
- Dividend declarations vary by the line of insurance and the maturity or conclusion of claims. Property losses have the shortest maturity and payment payout, so dividends are generated more quickly with a 25 percent dividend declaration 24 months after the close of the policy year, and the remaining amount paid 36 months after the close of the policy year.
- Automobile liability losses take longer than property losses to mature and be paid; therefore, dividends are declared 36 months after the close of the policy year, based on the experience of that year, and are paid out over a four-year time period (35 percent, 25 percent, 25 percent, and 15 percent respectively). General liability takes the longest time to mature, resulting in a 48-month period before the first dividend declaration. However, the pay out pattern is the same as automobile liability (35 percent, 25 percent, 25 percent, and 15 percent respectively).
- Dividends represent the return of premium for superior loss and expense experience. From premiums collected, excess funds are invested by the state's Board of Investment. The difference between premium and investment income, less deductions for losses paid, administrative expenses, loss adjustment expenses, reinsurance costs, and legal fees paid to defend claims, equals the amount of funds that are eligible for dividend declaration. The evaluation process to determine how much, if any, dividends will be paid involves the analysis of each line of insurance. This is done as part of the annual business plan. This analysis takes into account the RMF's performance for each line of business for each policy year. If there is a positive balance and sufficient development time has elapsed, a dividend is determined for that year and line of business.
- In the event of unsatisfactory experience, it is possible that no dividend will be declared or a favorable year's dividend will be used to offset the poor experience. This approach creates a more level dividend over time, and also minimizes the possibility of dividend recapture, which can be very disruptive to an agency's budget planning. Due to the huge price

increases in the reinsurance markets, the RMD obtained approval from the RMAC to use dividend proceeds to help finance the reinsurance premium increase, thereby minimizing the premium increase to our customers.

A decision was made in FY02 to add, at least temporarily, one year to the payment payout before the first payment is made. In FY03, this decision was reviewed and continued due to substantial increases in property retentions, aggregate loss coverages, and premiums. The net result was to postpone payment of the dividend normally calculated in FY02 by one year. The FY03 dividend of $1,668,215 is the postponed FY02 dividend recalculated using premium, loss, and investment income values as of June 30, 2003. The dividend calculated in FY03 would have been approximately $1,471,000 higher if one year had not been temporarily added to the payout matrix.

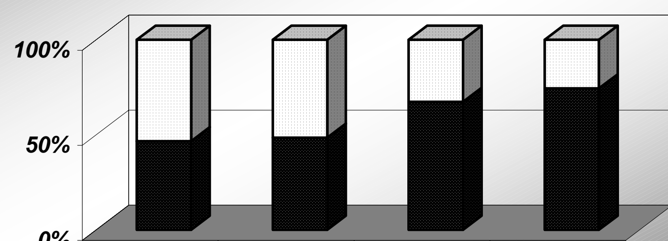
Exhibits 3A and 3B document the dividend payout amounts and percents versus expense (claim, reinsurance, and administrative) by underwriting year for the auto liability and property lines of business. The underwriting years displayed include the most recent dividend closed years where the dividend payout has reached 100 percent.

Exhibit 3A
Auto Liability Dividend Payout - Closed Years
FY1993-1997



	1993	1994	1995	1996	1997
□ Paid Loss&Exp	$830,548	$1,200,50	$2,194,38	$1,373,71	$2,184,85
■ Dividend	$462,859	$1,098,02	$31,177	$972,863	$245,360

Exhibit 3B
Property Dividend Payout - Closed Years
FY1996-1999



	1996	1997	1998	1999
□ Paid Loss&Exp	$617,128	$502,693	$515,733	$524,914
■ Dividend	$539,370	$473,096	$1,061,744	$1,521,185

Exhibit 4

Self-Insurance Property and Casualty Underwriting Results

Premiums Earned by Line

	FY00	FY01	FY02	FY03
Auto Insurance				
Auto Liability	$1,993,664	$2,303,193	$2,473,245	$2,075,124
Auto Physical Damage	467,228	599,021	789,014	842,814
Garagekeeper's Legal Liability	31,220	33,611	35,147	34,456
Standard Commercial Insurance				
Property	$1,448,908	$1,592,633	$1,753,658	$4,187,342
Boiler & Machinery	146,691	174,578	215,887	152,662
General Liability	998,853	1,096,637	1,259,829	1,412,839
Crime	42,330	52,352	57,393	68,359
Other	182,339	257,209	314,530	309,263
Total Premiums Earned	$5,311,233	$6,109,234	$6,898,703	$9,082,859
Less Reinsurance Ceded	$ 677,145	$ 714,372	$1,336,742	$3,206,085
Total Net Premiums Earned	4,634,088	5,394,862	5,561,961	5,876,774
Plus Unearned Premium	24,410	24,416	23,440	34,795
Total Net Premiums Written	$4,658,498	$5,419,278	$5,585,401	$5,911,569

Combined Loss and Expense Ratio (Before Dividends and IBNR)	FY00	FY01	FY02	FY03
Auto Insurance				
Auto Liability	87%	81%	64%	64%
Auto Physical Damage	100%	89%	77%	74%
Garagekeeper's Legal Liability	19%	18%	20%	56%
Standard Commercial Insurance				
Property	40%	78%	1,398%	9%
General Liability	28%	50%	43%	47%
Boiler & Machinery	73%	66%	70%	73%
Crime	21%	17%	29%	65%
Other	116%	104%	57%	63%
Combined Loss Ratio **Before** Reinsurance	63%	81%	399%	36%
Combined Loss Ratio **After** Reinsurance	72%	84%	80%	55%

Financial Position Discussion

Exhibit 4 illustrates a four-year comparison of the RMF's gross premiums earned and combined loss and expense results, by line of business, before IBNR and Dividends.

In FY03, the RMF experienced total premiums earned of $9,082,859. This was an increase of 32 percent over FY02. The increase in premiums was primarily due to a tremendous increase in the cost of reinsurance for the property lines. The overall increase was softened by a 16 percent decrease in auto liability rates.

- The total increase in net premiums written was 6 percent, or only $326,168, over last year despite the substantive increase in the cost of property reinsurance and the five-fold increase in self-insured retention from $500,000 to $2.5 million.
- Reinsurance ceded increased by 238 percent, or $1,869,343, from FY02. The FY03 increase in reinsurance follows an 87 percent increase last year.

The double-barrel impact of the reinsurance cost increases, and quintupling of the property retentions, resulted in the doubling of property rates. The RMD felt that doubling the property rates was a necessary step but, in the overall scheme of the FY03 renewal, this was a very modest price increase when it is compared to the potential cost to the RMF. The overall net premium increase was only 32 percent, which is a positive when considering the potential financial impact of a large property loss. The program was fortunate to not suffer a large property loss in FY03. Risk Management's emphasis on PLC, along with the superb cooperation of the insured state agencies, played an important role in the favorable FY03 property loss results.

The RMD will continue to closely monitor the increase in reinsurance costs and take measures to lessen the impact to policyholders, while continuing to responsibly manage risk.

From FY02 to FY03, the policyholder surplus (total net assets) decreased by 3 percent, or $179,305. The excellent underwriting results that occurred in FY03 allowed for an increase in the incurred but not reported reserve. The RMF was also able to weather the elimination of a worker's compensation net asset balance of $572,160, which was paid back to participants or was set up as a liability for Department of Administration divisions that were in the previous worker's compensation administration fund maintained by the RMD. This fund became extraneous when the statewide worker's compensation cost allocation fund was implemented in October 2002.

The dividend policy of the RMF is to return all underwriting profit and investment income to its policyholders whenever economically feasible so the results inure to the benefit of the state agencies the RMF insures. The ultimate costs to the state are losses, administrative expenses, adjusting expenses, and reinsurance costs, less investment income. To guarantee the soundness of the RMF, a healthy policyholder's surplus, and continued management of the increasing costs associated with reinsurance, the RMAC decided to not issue a dividend for FY02, payable in FY03.

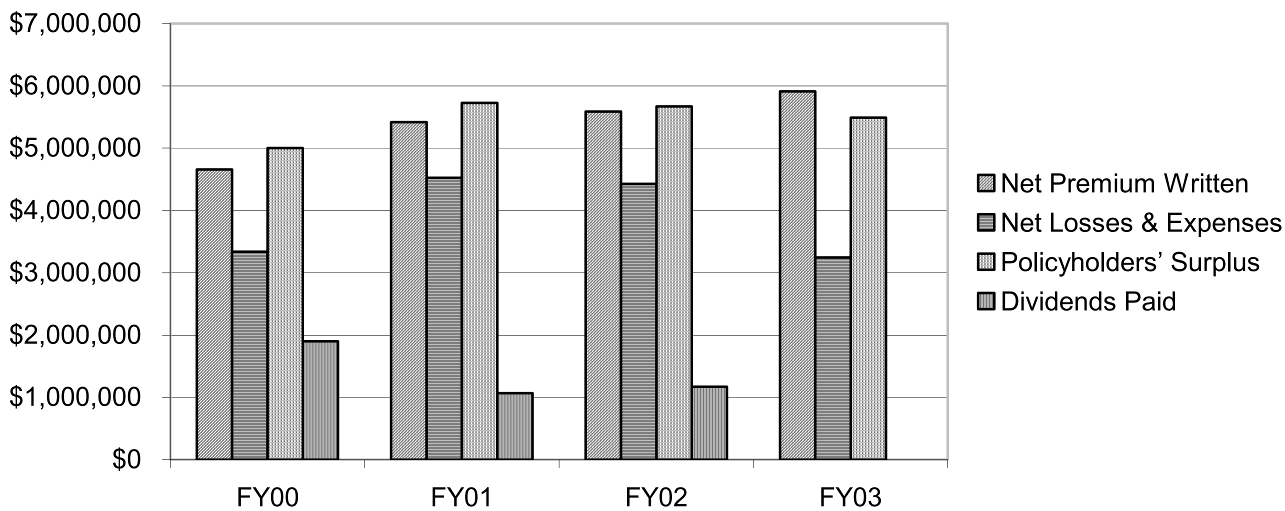
It is important to maintain a favorable financial position for the following reasons: 1) access to quality reinsurance, 2) adequate funding to assure liquidity in the event of unexpected adverse loss experience, and 3) a reasonable premium written to policyholders' surplus ratio. The current industry average of net premium written to policyholders' surplus is 1.29 to 1. The RMF's ratio is 1.08 to 1. A ratio of 1 to 1 or better provides the greatest financial security. A ratio in excess of

3 to 1 is considered a high premium to surplus ratio. The RMF's ratio is better than that of the industry. This is a positive factor that contributes to a stronger fund. In addition to the RMF's strong net premium to surplus ratio, the RMF utilizes reinsurance to guard against catastrophic losses, as well as the aggregation of losses.

Exhibit 5 identifies the past four years' performance of the RMF, detailed for those four major items representing the financial integrity of the RMF – net premium written, combined losses and expenses before incurred but not reported losses, policyholders' surplus, and dividends paid.

Exhibit 5

RMF Performance by Fiscal Year



	FY00	FY01	FY02	FY03
Net Premium Written	$4,658,498	$5,419,278	$5,585,401	$5,911,569
Net Losses & Expenses	3,340,179	4,525,257	4,428,791	3,244,851
Policyholders' Surplus	5,002,628	5,726,279	5,670,515	5,491,210
Dividends Paid	1,899,812	1,068,999	1,169,226	0

Lines of Insurance Discussion

Automobile Liability and Automobile Physical Damage

Exhibit 6

Automobile Liability Exhibit

Year	Number of Accidents	Number of Vehicles	Frequency per 100 Vehicles	Average Cost per Vehicle Accident	Combined Loss & Expense Ratio after One Year	Cumulative Loss & Expense Ratio
2003	713	14,086	5.1%	$1,868	79%	64%
2002	777	13,860	5.6%	$2,102	78%	67%
2001	640	12,828	5.0%	$2,138	78%	82%
2000	507	11,263	4.5%	$2,804	83%	87%
1999	695	11,232	6.2%	$2,251	85%	57%
1998	680	10,738	6.3%	$3,068	84%	108%
Avg.	669	12,335	5.0%	$2,372	81%	78%

For the first time since the beginning of the RMF, automobile liability insurance was no longer the largest line of insurance. This was primarily due to volatile changes in the property line.

There was still growth in the automobile line with an increase in the number of vehicles insured. Fortunately, the number of accidents decreased by 9 percent compared to FY02, and the average cost of repairs decreased by 13 percent. It is likely that a mild winter contributed to these favorable results.

Exhibit 6 demonstrates a desired level of stability in the combined loss and expense ratio.

MnDOT paint striper

Exhibit 7

Automobile Physical Damage Exhibit

Year	Number of Accidents	Number of Vehicles	Frequency per 100 Vehicles	Average Cost per Claim	Combined Loss and Expense Ratio at 12 Months	Subrogation Recovery
2003	390	8,200	4.8%	$1,594	74%	$ 77,344
2002	457	6,857	6.7%	$1,361	78%	$ 75,932
2001	410	6,244	6.6%	$1,185	81%	$109,451
2000	361	5,472	6.6%	$1,230	115%	$ 98,575
1999	287	5,478	5.2%	$1,996	121%	$ 71,968
Avg.	381	6,450	6.9%	$1,473	94%	$ 86,654

Automobile physical damage premium decreased from 11 percent to 9 percent of total gross earned premium from FY02 to FY03. As was the case in the other lines of insurance, the decrease is relative to the dramatic increase in the property line. Nevertheless, there was growth in this line. The number of vehicles insured grew by almost 20 percent. Although the average cost per claim increased, due to higher levels of severity, the number of accidents decreased to a six-year low, resulting in a decrease of the combined loss and expense ratio.

The five-year Automobile Physical Damage experience is shown in Exhibit 7. Losses are valued at the end of 12 months for each of the years identified.

Property, Boiler & Machinery, and Crime

FY03 was the first fiscal year that the property line surpassed the automobile liability line as the largest category of insurance written by RMF. FY03 gross earned property premium represented 52 percent of the total RMF earned premium for all lines of business. This increase is a result of higher rates and larger insured values.

After four consecutive years of rising combined loss and expense ratios, the FY03 ratio dropped to a respectable 80 percent. Upon maturity, loss ratios initially below 100 percent will climb to 100 percent since any unallocated premiums – those not earmarked for loss payments and expenses – are returned to insureds in the form of a dividend, resulting in a combined loss and expense ratio of 100 percent. Conversely, loss ratios exceeding 100 percent indicate a declining trend and an inadequate premium base.

Although the number of claims rose from 114 in FY02 to 124 in FY03, the RMF experienced no catastrophic property losses in FY03.

The five-year property experience is shown in Exhibit 8. Losses are valued at the end of 12 months for each of the years identified.

FY96 was the first year of the expanded property insurance program, which included MnSCU, the State Fair, the Veterans' Homes Board, and those agencies previously covered through commercial insurance programs. During FY96 and FY97, the RMD's program was a combination of funded self-insurance and excess property coverage with the St. Paul Companies.

Under this program, the RMF insured losses below $100,000. Losses that exceeded the $100,000 limit were insured by excess coverage. In addition, had the aggregate losses in the RMF reached $1 million, all subsequent losses would have been insured by excess coverage, subject to a $10,000 deductible.

Exhibit 8

Property, Boiler & Machinery, and Crime

Year	Number of Claims	Insurable Values	Frequency per $1 Million of Insurable Values	Average Cost per Claim	Combined Loss & Expense Ratio at 12 Months
2003	124	$7,360,890,716	1.7%	$30,917	80%
2002	114	$6,225,662,878	1.9%	$27,330	129%
2001	161	$5,397,569,866	3.0%	$14,863	112%
2000	158	$5,009,281,119	3.2%	$ 8,878	74%
1999	63	$4,648,483,354	1.4%	$19,031	68%
1998	39	$3,855,913,116	1.0%	$27,341	109%
1997	26	$3,736,138,327	0.7%	$31,703	100%

In FY98, the RMD reorganized the property program, modifying it from a self-insurance/excess program to a self-insurance/reinsurance agreement. The property insurance limits were increased from $300 million to $400 million to reflect the concentration of values in the capitol complex, which the RMF began insuring the prior year. In addition, the retention level within the RMF was increased from $100,000 to $500,000. The aggregate stop loss remained at $1 million, the boiler and machinery insurance deductible continued at $25,000, and the crime coverage remained at a $25,000 limit with a $1,000 deductible.

In FY99, the RMF leveraged a combined property and casualty aggregate stop loss limit of $3.5 million.

In FY01, the property limits were increased from $400 million to $500 million to allow for inflationary increases in insurable values, and to prepare for acceptance of political subdivisions as clients. (The RMD received approval to insure political subdivisions from the 2001 legislature.) Due to the lack of availability of a combined property and casualty aggregate stop loss limit, a property (only) aggregate stop loss limit of $1 million was introduced. All other aspects of the property program remained the same.

In FY02, the business income and extra expense sublimit was reduced from a $100 million blanket to $2.5 million per location. The aggregate stop loss increased from $1 million to $2 million.

FY03 saw another year of significant restrictions in reinsurance terms and conditions. The business income and extra expense sublimit was reduced from $2.5 million per location to $50,000 per location. Property limits were reduced from $500 million to $300 million and the aggregate stop loss escalated from $2 million to $7.5 million, with a $25,000 maintenance deductible. In addition, the RMF retention level increased from $500,000 to $2.5 million, and the boiler and machinery insurance deductible increased from $25,000 to $100,000.

Property lines of insurance represented 23 percent of premiums in FY96 and grew to 52 percent in FY03. Insured property values increased by 113 percent, or $4 billion, from FY96 to FY03.

General Liability

Exhibit 9

General Liability Exhibit

Year	Number of Claims	Average Cost per Claim	Combined Loss & Expense Ratio at 12 Months
2003	140	$4,740	46%
2002	141	$3,615	40%
2001	170	$2,134	33%
2000	124	$3,781	45%
1999	116	$3,333	40%

Approximately 16 percent of the total gross earned premium for FY03 was generated from the general liability line. This is 2 percent lower than FY02 as a proportion of all four major lines. However, the overall premium amount increased due to additional customers coming into the RMF, as well as expansion of coverage from existing customers.

The combined loss ratio for FY03 was 46 percent, compared to 40 percent for FY02. The average cost per claim is significantly higher as well. One catastrophic loss accounted for the large increases in both the percentage and the average cost per claim. If that loss is factored out, the combined ratio would be 25 percent and the average cost per claim would be $2,597. This large loss is the first general liability loss that is impacted by the change in the tort cap that went into effect January 1, 1998. At that time, the cap increased from $200,000 per person, $600,000 per accident, to $300,000 per person, $750,000 per accident.

The tort cap that went into effect January 1, 2000, limiting payment to $300,000 per person, $1 million per accident remained in effect through FY03.

The five-year general liability experience is shown in Exhibit 9. Losses are valued at the end of 12 months for each of the years identified. At 46 percent, the general liability loss experience is still favorable. As the RMF has grown, the ability to absorb catastrophic losses has grown.

Optional general liability coverages include public officials' liability, broadcasters' liability, and police officers' professional liability.

Other Lines

Other lines of commercial insurance offered by the RMD include inland marine, garagekeepers' legal liability, and homeowners' warranty. Inland marine policies are designed to provide specialized coverage, or lower deductible options, on computers, fine arts, musical instruments, signs, TV and radio towers, as well as many other items. Garagekeepers' legal liability provides coverage for an agency that has automobiles in their "care, custody, or control." Examples include valet parking, garage operations, and MnSCU automotive programs. Homeowners' warranty coverage is designed to provide coverage for defects caused by faulty workmanship or defective materials. MnSCU campuses offering construction career programs have an interest in homeowners' warranty coverage.

Inland marine, garagekeepers' legal liability, and homeowners' warranty are included in the property line for premium and loss reporting purposes.

Property Reinsurance

Definition of *Reinsurance*: A reinsurer indemnifies another insurance company against all or part of a loss that the latter may sustain under policies it has issued. By reinsuring its policies, an insurance company is able to reduce its risk from loss, while meeting clients' demands for coverages and limits of liability.

Reinsurance has been obtained to protect the RMF from catastrophic events and aggregation of losses in any given year.

Due to the RMF's growing financial strength and favorable loss experience, as well as increased risk retention, reinsurance premiums decreased by 37 percent, or $414,296, from FY96 to FY01. In addition to reduced reinsurance costs, added value was derived from coverage enhancements.

Coupled with adverse changes in the reinsurance marketplace and unfavorable RMF loss experience, reinsurance costs have since escalated. We experienced an 87 percent increase in reinsurance costs in FY02 and a staggering 238 percent increase in FY03.

The cost of reinsurance, as well as the corresponding terms and conditions, will continue to be a major concern for the RMF going forward, particularly in light of the impending crisis in the commercial property/casualty reinsurance market.

Managing future reinsurance costs, while at the same time maintaining the appropriate coverages and limits of liability, are ongoing challenges.

Risk Management Fund Advisory Committee

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Fiscal & Administrative Services

Sieglinde Bier
MnSCU

Assistant Commissioner
Department of Administration

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Department of Commerce
Registration & Insurance

Bill Hoyt
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3M Insurance Department (Retired)

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Merrill King
Department of Finance

Terry Lahti
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Attorney General's Office

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Client State Agencies and Political Subdivisions

Administrative Hearings, Office of
Agriculture, Department of
Amateur Sports Commission
Attorney General
Building Codes & Standards
Building Construction
Center for Criminal Justice & Law
  Enforcement
Central Stores
Chicano Latino Affairs Council
Chiropractic Examiners, Board of
Communications Media
  DocuComm
  MailComm
  ReComm
Corrections, Department of
Dakota County
Deaf/Blind Learning Academies
Dentistry, Board of
Developmental Disabilities Council
Economic Security, Department of
Education, Department of
Electricity, Board of
Emergency Medical Services Regulatory Board
Environmental Assistance, Office of
Financial Management & Reporting
Gambling Control Board
Governor's Office
Health, Department of
Higher Education Facilities Authority
Higher Education Services Office
Housing Finance Agency
Human Rights, Department of
Human Services, Department of
Indian Affairs Council
InterTechnologies Group
Investment Board
IRRRB
Judicial Standards, Board of
Labor & Industry, Department of
Lawyers Professional Responsibility Board
Management Analysis
Medical Practice, Board of
Metropolitan Airports Commission
Metropolitan Council
Metropolitan Radio Board
Military Affairs, Department of
MN State Lottery
MN Technology
MnSCU – all facilities
National Sports Center
Natural Resources, Department of
Nursing, Board of
Nursing Home Examiners BENHA, Board of
Ombudsman for Corrections
Ombudsman for Mental Health & Mental
  Retardation
Perpich Center for Arts Education
Pharmacy (ASU), Board of
Physical Therapy, Board of
Plant Management
Podiatric Medicine, Board of
Pollution Control Agency
Public Defense, Board of
Public Employees Retirement Association
Public Safety, Department of
Public Service, Weights & Measures
Revenue, Department of
Risk Management
Secretary of State
Social Work, Board of
STAR Program
State Agricultural Society (State Fair)
State Armory Building Commission
State Arts Board
State Auditor
State Energy Office
State Services for the Blind
State Treasurer, Office of
Supreme Court – Board of Law Examiners
Surplus Services
Teachers Retirement Association
Technology, Office of
Trade & Economic Development, Department of
Transportation, Department of
Travel Management
Veterans Affairs
Veterans Homes Board – all locations
Veterinary Medicine, Board of
World Trade Conference Center
Zoological Board

Policies Offered by the Risk Management Fund

- **Auto Liability** – Provides liability coverage for injuries to others and/or damage to their property (“bodily injury and property damage liability”) arising out of an agency’s ownership or use of motor vehicles, as specified in Minnesota Statute § 65B.
- **Auto Physical Damage** – Provides coverage for damage to owned vehicles. Two basic types of physical damage coverage are generally provided for owned vehicles: collision and comprehensive. Collision coverage insures against damage from collision with another vehicle or object, as well as from overturning. Comprehensive coverage provides protection against damage from other perils such as hail, fire, vandalism, and flood.
- **Garagekeeper’s Legal Liability** – Automobile dealers and garage operators can be held legally liable for loss or damage to customers’ vehicles should they fail to exercise the degree of care required of them. The care, custody, and control exclusion in the general liability policy creates the need for garagekeeper’s insurance.
- **Property** – Property insurance is first-party coverage, as opposed to liability insurance, which is described as third-party coverage. The RMF provides coverage for damage to the insured’s (first-party) property caused by an insured peril. The RMF provides coverage for “all risk” of direct physical loss – coverage for all perils not specifically excluded by the policy. Examples of covered perils include, but are not limited to, damage caused by fire, windstorm, hail, collapse, theft, vandalism, flood, earthquake, business interruption, and other unforeseen causes of loss. The RMF property program also provides builders’ risk coverage.
- **Boiler and Machinery** – Provides coverage for loss arising from the operation of boilers and machinery. Coverage includes loss sustained by the boilers or the machinery itself, damage to other property, and business interruption (use and occupancy) losses.
- **General Liability** – General liability protects the insured against a claim alleging bodily injury or property damage, as specified in Minnesota Statutes §§ 3.732 and 3.736. The coverage includes defense costs, awards, or settlements associated with lawsuits brought by third parties who are injured or sustain property damage as a result of the insured’s operations, or while on the insured’s premises.
- **Inland Marine** – Provides coverage for any goods in transit, except trans-ocean, as well as insurance for certain types of personal property that are transportable. For example, floater policies covering equipment, laptop computers, tools, musical instruments, cameras, etc., are considered inland marine policies.
- **Crime** – Governmental entities face substantial crime exposures, particularly with respect to employee dishonesty. The RMF provides coverage for both employee dishonesty and money and securities. Employee dishonesty coverage insures against loss to the agency as a result of employee dishonesty or fraud. Money and securities coverage provides protection for losses occurring inside the insured's premises, or while outside the insured's premises, if the money and securities are in the care and custody of an employee or partner. In addition, coverage applies over and above the limits purchased by an armored car service for loss in transporting the insured’s money or securities. Coverage does not extend to any property other than money and securities.

- **Others** – In addition to the policies mentioned above, the RMF offers other coverages such as public officials' errors and omissions, police officers' professional liability, broadcasters' liability, and homeowners' warranty.

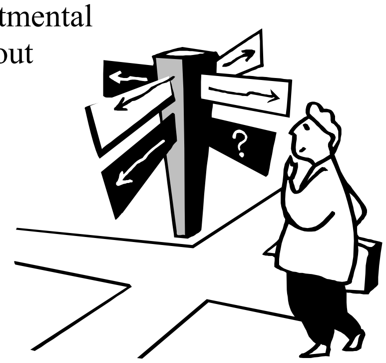
  Also, the RMF offers specialized insurance programs with unique coverages that are designed to meet the diverse needs of its customers.

- **Purchased Insurance** – In some instances, it is more expedient to utilize the conventional insurance market, rather than the RMF. In such cases, the RMD works with clients to determine the appropriate insurance coverages and to obtain the necessary policies.

Frequently Asked Questions

Why has the RMD's focus turned to loss control?

It has been said that risk management may be one of the few departmental functions of government capable of materially reducing costs without eliminating people or programs. We agree! Specifically, risk management techniques designed to control losses can achieve significant savings:



- Reinsurance costs are directly impacted by claims experience. Hence, the implementation of loss control measures that help mitigate losses serve to control reinsurance costs. The savings get passed on to our clients in the form of reduced premiums and/or dividends.
- Loss control initiatives also preserve property and protect individuals from injury, thereby reducing costs associated with reconstruction and relocation, the loss of employee services, and the loss of use of state owned and or operated facilities. These costs would otherwise be borne by the State and its taxpayers. Since the Division rolled out the statewide loss control initiative just two years ago, we have had the opportunity to work with countless agencies and, together, implement loss control measures that meet common objectives.

When did the RMF begin, and why was it formed?

The RMF was formed in 1986 for the purpose of writing automobile liability coverage. Prior to this time, automobile liability coverage was obtained through the conventional insurance market. The state made the decision to self-insure its fleet of approximately 8,000 vehicles in the mid-1980s when conventional insurance market rates escalated. The state's fleet has grown to over 14,000 vehicles since 1986, and is still insured through the RMF.

Since its inception, the RMF has offered many additional property and casualty lines of insurance, including automobile physical damage.

What does the RMF do with any surplus funds, and how does it handle unsatisfactory loss experience?

The RMF returns surplus funds to its clients in the form of dividends. Dividends were declared annually for five consecutive years, from 1996 - 2001. The dividend declared in 2002, payable in FY03, was retained due to escalating expenses driven by changes in the RMF's reinsurance program. (Note: The retained FY02 dividend will be payed out in FY04.) Dividend declarations vary by the line of insurance and the maturity or conclusion of claims. In the event of unsatisfactory experience, it is possible that no dividend will be declared, or a favorable year's dividend will be used to offset the poor experience.

Each year, the RMF promulgates rates that are based, in part, on the loss experience of prior years. Unfavorable loss experience can result in increased rates in those instances where the loss experience indicates a declining trend and an inadequate premium base.

Why are some agencies insured through the RMF and others are not?

Actually, all agencies are insured through the RMF for automobile liability. All other lines of insurance are obtained on a voluntary basis. Although there are a variety of reasons why some agencies have not purchased the voluntary insurance coverages, we will focus on the most common motives.

MN State University Moorhead is estimating a fall 2004 completion date for their new science building (Hagen Hall)

- Some agencies are not aware that insurance coverage is available. As staff changes occur, and information fails to get disseminated to new associates, awareness is impacted. We attempt to overcome this obstacle through marketing efforts.
- Many agencies have the false assumption that they are self-insured through the state, when, in reality, they are uninsured for all lines except automobile liability. Self-insurance requires that there be a funding mechanism in place for loss settlements. Since agencies do not project future losses using generally accepted insurance principles and earmark funds for those losses, they are not self-insured. To the contrary, they are uninsured. The state's only insurance funding mechanism is through the RMD.
- Budgetary issues are a factor. Agencies report that they have no surplus funds for insurance. However, what is frequently overlooked is the fact that a known insurance premium is much easier to fund than a future loss of unknown magnitude.

What prompted your clients to obtain voluntary insurance coverages from the RMF?

Since it is human nature to realize the value of insurance *after* a loss, it is not surprising that many clients have come to us after they incurred loss or damage to their property, or when a third party sustained an injury on their premises.

The state's Business Continuation Management unit has also boosted state agencies' awareness of the RMF. Those responsible for this initiative realize that insurance is a necessary part of disaster preparedness in minimizing their exposure to financial loss, and in providing the most economical funding alternatives.

State of Minnesota
Risk Management Fund
Statement of Net Assets
June 30, 2003

ASSETS	FY03	FY02
CURRENT ASSETS		
Cash	$13,493,240.01	$16,105,383.93
Accounts Receivable	24,275.62	73,949.00
Prepaid Expenses	0.00	0.00
Prepaid Reinsurance	0.00	0.00
Prepaid Billback Insurance	263,132.74	289,617.95
Reinsurance Recoverable	4,134,252.00	9,558,803.00
Securities Lending Collateral (Note 5)	0.00	2,934,475.81
Total Current Assets	**17,914,900.37**	**28,962,229.69**
NON-CURRENT ASSETS		
Capital Assets	0.00	0.00
Less: Accumulated Depreciation	0.00	0.00
Total Non-Current Assets	0.00	0.00
TOTAL ASSETS	**17,914,900.37**	**28,962,229.69**
LIABILITIES		
CURRENT LIABILITIES		
Accounts Payable	46,066.20	246,949.76
Salaries Payable	25,439.38	18,128.73
Claims Payable	7,114,517.00	12,161,320.00
Claims Payable – IBNR (Note 1)	4,599,322.00	3,185,352.00
Claims Payable – Reinsurance Due to Insureds	0.00	4,364,434.00
Due to Other Funds (Note 4)	256,795.00	0.00
Dividend Payable	0.00	0.00
Unearned Premium – Self Insurance	34,795.00	23,440.00
Unearned Premium – Worker's Comp.	0.00	0.00
Unearned Premium – Billback	276,073.00	296,498.00
Compensated Absences Payable (Note 3)	3,358.01	28,301.95
Securities Lending Collateral (Note 5)	0.00	2,934,475.81
Total Current Liabilities	**12,356,365.59**	**23,258,900.25**
NONCURRENT LIABILITIES		
Compensated Absences Payable (Note 3)	67,324.69	32,814.27
Total Long-Term Liabilities	**67,324.69**	**32,814.27**
TOTAL LIABILITIES	**12,423,690.28**	**23,291,714.52**
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	0.00	0.00
Unrestricted Net Assets (Note 6)	5,491,210.09	5,670,515.17
TOTAL NET ASSETS	**5,491,210.09**	**5,670,515.17**

State of Minnesota
Risk Management Fund
Statement of Revenues, Expenses, and Changes in Net Assets
June 30, 2003

	FY03 YTD	FY02 YTD
OPERATING REVENUES		
Insurance Premiums – Self Insurance	9,082,859.00	6,898,703.00
Insurance Premiums – Worker's Compensation	119,559.00	591,240.00
Insurance Premiums – Billback	1,154,740.00	961,909.00
Consulting Services	2,012.00	20,785.00
Total Operating Revenue	**10,359,170.00**	**8,462,637.00**
OPERATING EXPENSES (Note 1)		
Claims – Self Insurance	3,139,226.27	3,390,914.53
Claims – Worker's Compensation	195,336.17	610,280.32
Claims – Billback	0.00	0.00
Claims – IBNR	1,413,970.00	183,661.00
Salaries & Benefits	707,292.48	597,218.75
Rent	43,952.11	43,443.06
Advertising	600.05	0.00
Repairs	436.33	2,106.30
Insurance	417.00	418.00
Insurance Premium – Billback	1,154,740.00	961,909.00
Insurance Premium – Self Insurance	3,206,085.00	1,336,741.70
Printing	15,767.72	21,101.68
Professional Services – Adjuster	196,979.50	203,173.12
Professional Services – Broker	63,250.00	87,000.00
Professional Services – Legal and Other	51,068.15	189,894.18
Computer Services	13,005.72	1,752.60
Communications	10,742.70	11,591.56
Travel	6,711.39	5,870.39
Other Operating Costs	4,392.31	37,845.73
Memberships & Employee Development	1,268.00	1,942.00
Supplies	37,241.44	38,030.58
Depreciation	0.00	0.00
Indirect Costs	73,190.00	79,986.00
Total Operating Expenses	**10,335,672.34**	**7,804,880.50**
OPERATING INCOME (LOSS)	**3,497.66**	**657,756.50**
NON-OPERATING REVENUE (EXPENSES)		
Interest Earnings	277,409.14	453,450.59
Policyholder Dividend Expense	0.00	(1,169,226.00)
Securities Lending – Gross	0.00	61,236.23
Securities Lending – Fees	0.00	(58,980.78)
Total Non-Operating Revenue (Expenses)	**277,409.14**	**(713,519.96)**
CHANGE IN NET ASSETS	300,906.80	(55,763.46)
NET ASSETS, BEGINNING	5,670,515.17	5,726,278.63
Adjustment to Net Assets (Note 7)	(480,211.88)	0.00
NET ASSETS, ENDING	**5,491,210.09**	**5,670,515.17**

State of Minnesota
Risk Management Fund
Statement of Cash Flows
Quarter Ended June 30, 2003

	FY03
CASH FLOW FROM OPERATING ACTIVITIES	
Receipts from Customers	$10,154,744.50
Receipts from Other Revenue	2,012.00
Payments to Employees	(690,415.35)
Payments to Suppliers for Goods and Services	(5,061,130.98)
Payments for Insurance Claims	(7,294,763.23)
Net Cash Provided by (Used for) Operating Activities	(2,889,553.06)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES	
Policyholder Dividend Payments	0.00
Net Cash Provided by (Used for) Non-capital Financing Activities	0.00
CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Purchase of Fixed Assets	0.00
Proceeds from Sale of Fixed Assets	0.00
Payments of Interest	0.00
Capital Contributions	0.00
Net Cash Provided by (Used for) Capital and Related Financing Activities	0.00
CASH FLOW FROM INVESTING ACTIVITIES	
Investment Earnings	277,409.14
Securities Lending Collateral	0.00
Net Cash Provided by (Used for) Investing Activities	277,409.14
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,612,143.92)
Cash and Cash Equivalents, Beginning	16,105,383.93
Cash and Cash Equivalents, Ending	13,493,240.01
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities	
Operating Income	23,497.66
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities	
Depreciation Expense	0.00
Amortization Expense	0.00
(Increase) Decrease in Accounts Receivable	(450,138.50)
(Increase) Decrease in Inventories	0.00
(Increase) Decrease in Prepaid Expenses	26,485.21
(Increase) Decrease in Other Current Assets	5,424,551.00
Increase (Decrease) in Accounts Payable	(181,283.56)
Increase (Decrease) in Salaries Payable	7,310.65
Increase (Decrease) in Due to Other Fund	256,795.00
Increase (Decrease) in Sales Tax Payable	0.00
Increase (Decrease) in Compensated Absences	9,566.48
Increase (Decrease) in Deferred Revenue	(9,070.00)
Increase (Decrease) in Claims Payable	(7,997,267.00)
Total Adjustments	(2,913,050.72)
Net Cash Provided by (Used for) Operating Activities	(2,889,553.06)
Non-cash Investing, Capital, and Financing Activities	
None	

State of Minnesota
Risk Management Fund
Footnotes to Financial Statements
Quarter Ended June 30, 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Risk Management Internal Service Fund utilizes full accrual accounting, pursuant to M.S. § 16A.055.

The RMF provides automobile liability, general liability, automobile physical damage, property, boiler and machinery insurance on real and personal property, business interruption, and other insurance coverage to state agencies. Insurance coverage generally coincides with the fiscal year, and revenue is recognized over the period of coverage. Coverage was first issued beginning January 1, 1987. The RMF also purchases reinsurance from reinsurance companies to protect itself from catastrophic losses and the aggregation of losses. The RMF also purchases commercial insurance at the request of state agencies and bills those agencies at cost. These revenues and expenses are referred to as "Billback" and are pro-rated over the lives of the various policies. Billback revenues and expenses are identified separately.

Expenses are based on data received from the MAPS accounting system, and from subsidiary records.

An estimated liability has been included for claims incurred but not reported (IBNR).

This financial statement includes claims information known as of June 30, 2003 for claims incurred prior to July 1, 2003.

2. LEGISLATION AND AUTHORITY

The Risk Management Internal Services Fund was created by Minnesota Laws 1986, Chapter 455, Section 3.

3. COMPENSATED ABSENCES

State employees accrue vacation leave, sick leave, and compensatory leave at various rates within limits specified in the collective bargaining agreements. Such leave is liquidated in cash only at the time of separation from state employment. The accumulated leave is shown as a liability. In FY03, the Department of Finance made a change in calculating the short-term liability portion of compensated absences. The short-term liability is based on the assumption that what is earned in the next year will be used first, and only a small portion of the balances will be used in the next year.

4. DUE TO OTHER FUNDS

In FY03, the Department of Administration became a participant in a new Worker's Compensation plan. The previous Worker's Compensation plan for the Department of Administration, administered by Risk Management, had a surplus balance. Funds are returned to the appropriate division based on the status of outstanding claims.

5. SECURITIES LENDING COLLATERAL

In March 2000, the state began lending securities of the state's cash investment pool (invested Treasurer's Cash or ITC) to derive extra income. Securities lending is an investment procedure used by managers of large investment pools that places large volumes of securities in someone else's custody for a fee. The securities lender receives a large amount of collateral (cash or securities) from the borrower that is invested for short-term gain. The securities are returned to the lender and the collateral returned to the borrower at the end of the loan term. The valuation of the asset, and offsetting liability, are provided by the Department of Finance. The income and expense figures are also provided by the Department of Finance. In FY03, the Department of Finance made the decision to not allocate an amount for securities lending collateral to the Risk Management Fund due to the immaterial amount.

6. NET ASSETS

During FY02, the State of Minnesota implemented new accounting standards, as prescribed by the Governmental Accounting Standards Board (GASB). The standards include revised statement formats that resulted in the change from retained earnings to net asset reporting. For historical cost comparison, the total net assets and the retained earnings have been reconciled as shown below.

Invested in Capital Assets, Net of Related Debt	0.00
Unrestricted Net Assets	5,491,210.09
Total Net Assets	5,491,210.09

Schedule of Retained Earnings:

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
Beginning Retained Earnings	5,670,515.17	5,393,688.74	5,417,510.80	5,157,037.55
Prior Period Adjustment	0.00	0.00	(572,160.00)	91,948.12
Quarterly Net Income (Loss)	(276,826.43)	23,822.06	311,686.75	242,224.42
Ending Retained Earnings	5,393,688.74	5,417,510.80	5,157,037.55	5,491,210.09
Add: Capital Contributions	0.00	0.00	0.00	0.00
Reconciliation to Total Net Assets	5,393,688.74	5,417,510.80	5,157,037.55	5,491,210.09

7. ADJUSTMENT TO NET ASSETS

In FY03, the adjustments to net assets are the summation of the following:

** Risk Management Fund disbursed surplus funds related to the agency's Worker's Compensation plan. The total funds that will be returned equal $572,160, of which $315,365 has already been released.

** Paid $511.88 for a returned Billback premium from FY2002.

** Adjusted Accounts Payable for a FY02 overstatement of $19,600.

** Adjusted Accounts Receivable for a FY02 understatement of $72,860

STATEMENT OF ACTUARIAL OPINION
REGARDING THE STATE OF MINNESOTA
ASSUMED AUTOMOBLE AND LIABILITY OTHER THAN AUTO RETAINED LIABILITIES
AS OF MARCH 31, 2003

My name is Todd A. Gruenhagen and I am the Consultant and Managing Director of RTAG Consulting and Software, Inc., a Minnesota Corporation. RTAG Consulting and Software, Inc. is a worldwide actuarial & risk management consulting firm specializing in software solutions to actuarial analyses. I am an Associate of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. I meet the qualification standards of the American Academy of Actuaries for rendering an actuarial opinion on property and casualty loss and loss adjustment expense reserves.

RTAG Consulting and Software, Inc. has been retained by the State of Minnesota as their consulting actuary. One of the services we provide to the State of Minnesota is the evaluation of liabilities assumed under Minnesota Statutes, Chapter 3, Section 376, Subdivision 4, for automobile liability and liability other than auto exposures.

All loss data utilized in this analysis was provided to me via the State of Minnesota, Risk Management Division. I relied on the accuracy and completeness of the loss data without audit or independent verification. Exposure information was provided via the State of Minnesota, Risk Management Division. If the data is inaccurate or incomplete, these estimates may need to be revised.

The State of Minnesota's retained automobile liability for accident periods July 1, 1994 through March 31, 2003, listed by accident period as of March 31, 2003 are as follows:

		(1)	(2)	(3)	(4) =(3)-(2)	(5) =(1)-(3)	(6) =(4)+(5)
Accident Period Beginning:	Ending:	Ultimates @3/31/2003	Paid Losses @3/31/2003	Incurred Losses @3/31/2003	Case O/S Reserves @3/31/2003	IBNR Reserves @3/31/2003	Total Reserves @3/31/2003
7/1/1994	6/30/1995	1,888,556	1,863,553	1,888,556	25,003	-	25,003
7/1/1995	6/30/1996	926,300	914,218	914,218	-	12,082	12,082
7/1/1996	6/30/1997	1,701,200	1,655,410	1,700,001	44,590	1,199	45,790
7/1/1997	6/30/1998	1,769,500	1,674,318	1,722,862	48,544	46,638	95,182
7/1/1998	6/30/1999	1,013,300	888,688	888,688	-	124,612	124,612
7/1/1999	6/30/2000	1,331,200	1,099,568	1,253,915	154,347	77,285	231,632
7/1/2000	6/30/2001	1,535,300	1,039,909	1,300,342	260,433	234,958	495,391
7/1/2001	6/30/2002	1,751,700	602,553	1,017,900	415,347	733,800	1,149,147
7/1/2002	3/31/2003	1,562,625	234,426	608,876	374,450	953,749	1,328,199
Totals:		13,479,681	9,972,643	11,295,358	1,322,715	2,184,323	3,507,038

The State of Minnesota's retained liability, other than auto liability for accident periods July 1, 1994 through March 31, 2003, listed by accident period as of March 31, 2003, are as follows:

		(1)	(2)	(3)	(4) =(3)-(2)	(5) =(1)-(3)	(6) =(4)+(5)
Accident Period Beginning:	Ending:	Ultimates @3/31/2003	Paid Losses @3/31/2003	Incurred Losses @3/31/2003	Case O/S Reserves @3/31/2003	IBNR Reserves @3/31/2003	Total Reserves @3/31/2003
7/1/1994	6/30/1995	57,000	56,902	56,902	-	98	98
7/1/1995	6/30/1996	152,900	149,971	152,679	2,708	221	2,929
7/1/1996	6/30/1997	255,400	242,426	255,288	12,862	112	12,974
7/1/1997	6/30/1998	217,200	210,722	210,722	-	6,478	6,478
7/1/1998	6/30/1999	159,200	130,411	157,324	26,914	1,876	28,789
7/1/1999	6/30/2000	139,000	59,505	127,849	68,343	11,151	79,495
7/1/2000	6/30/2001	331,800	152,455	268,780	116,325	63,020	179,345
7/1/2001	6/30/2002	455,500	138,756	221,316	82,560	234,184	316,744
7/1/2002	3/31/2003	481,800	12,154	381,882	369,728	99,918	469,646
Totals:		2,249,800	1,153,302	1,832,741	679,439	417,059	1,096,498

It is my opinion that the above estimated liabilities:

1. Are computed in accordance with commonly accepted actuarial loss reserving standards and methods and are fairly stated in accordance with sound actuarial principles.

2. Make a reasonable provision for all unpaid loss and allocated loss adjustment expense liabilities that the State of Minnesota assumes under Minnesota Statute 3.736, Subdivision 4 for automobile and liability other than auto exposures.

3. Are based on factors and data relevant to the State of Minnesota.

I believe that these reserves make a good and sufficient provision, in the aggregate, for all unpaid loss and allocated loss adjustment expense obligations of the State of Minnesota with respect to its retained liability exposures for the accident period July 1, 1994 through March 31, 2003. This opinion is based upon my best estimate of the ultimate loss and allocated loss adjustment expenses to be paid by the State of Minnesota and is based upon data available as of March 31, 2003.

Note that this estimate is based upon actuarial assumptions as to future contingencies deemed to be reasonable and appropriate under the circumstances. The reader of this Statement must realize that these projections involve estimates of future events and, as such, are subject to economic and statistical variations from the expected values. For these reasons, no absolute assurance can be given that the emergence of actual losses will correspond to the projections reflected in this report. However, I have not anticipated any extraordinary changes to the legal, social, or economic environment that might affect the reserve values.

This opinion is provided to the State of Minnesota solely for the purpose of meeting its internal reporting obligations. Any other use is prohibited.

11 April, 2003 | /s/ Todd A. Gruenhagen
Date | Todd A. Gruenhagen, ACAS MAAA

RTAG Consulting & Software, Inc. **F4**

Glossary of Insurance Terms

Accident – An incident resulting in injury or damage to a person or property which has or will become a loss.

Aggregate Limit – A limit in an insurance policy stipulating the most it will pay for all covered losses sustained during a specified period of time, usually one year. Aggregate limits are commonly included in liability policies.

Business Income Insurance – Coverage designed to provide protection against losses resulting from a temporary shutdown because of fire or other insured peril. The insurance provides reimbursement for lost net profits and necessary continuing expenses.

Claim – Demand or obligation for payment as a result of a loss.

Combined Loss & Expense Ratio – Basically, a measure of the relationship between dollars spent for claims and expenses and premium dollars taken in. A ratio above 100 means that, for every premium dollar taken in, more than a dollar went for losses and expenses.

Coverage – 1) The scope of protection provided under a contract of insurance; 2) Any of several risks covered by a policy.

Deductible – An amount that a policyholder agrees to pay, per claim or per accident, toward the total amount of an insured loss.

Direct Premiums Written – Property and casualty insurance premiums written (less return premiums), without any allowance for premiums for ceded reinsurance.

Dividend – A return of part of the premium on participating insurance to reflect the difference between the premium charged and the combination of expense and investment experience.

Earned Premium – The portion of a premium that is the property of an insurer, based on the expired portion of the policy period. For example, an insurer is considered to have earned 75 percent of an annual premium after a period of nine months of an annual policy has elapsed.

Exclusions – Specific conditions or circumstances listed in the policy for which the policy will not provide benefit payments.

Exposure – A situation, practice, or condition that might lead to loss.

First Party Claim: A demand for payment under an insurance policy made by a policyholder reporting an insured event directly to the insurer.

Frequency and Severity – Frequency is the number of times an incident occurs; severity is the monetary impact of a loss.

Incurred-but-not-Reported (IBNR) Reserves – Liability account on an insurer's balance sheet reflecting claims that are expected, based upon statistical projections, but which have not yet been reported to the insurer.

Insurance – An arrangement under which individuals, businesses, and other organizations or entities, in exchange for payment of a premium, are guaranteed compensation for losses resulting from certain perils under specified conditions.

Loss Control – Any conscious action (or decision not to act) intended to reduce the frequency, severity, or unpredictability of accidental losses.

Loss – A reduction in value.

Net Premium – The portion of the premium rate that is designed to cover benefits of the policy, but not expenses.

Net Written Premiums – Premium income retained by insurer, directly or through reinsurance, after payments made for reinsurance.

Occurrence – An accident, including continuous or repeated exposure to substantially the same general, harmful conditions, that results in bodily injury or property damage during the period of an insurance policy.

Peril – A "cause" of loss (e.g., fire, vandalism, terrorism).

Policyholders' Surplus – Sum left after liabilities are deducted from assets. This surplus is an additional financial protection to policyholders in the event the insurer suffers unexpected or catastrophic losses.

Premium – The sum paid by a policyholder to keep an insurance policy in force.

Reinsurance – The acceptance by one or more insurers, called reinsurers, of a portion of the risk accepted by another insurer who has contracted for the entire coverage.

Retention – The net amount of risk retained by an insurer for its own account or that of specified others, and not reinsured.

Risk Management – The practice of protecting an organization from financial harm by identifying, analyzing, and controlling risk at the lowest possible cost.

Risk – 1) The chance of loss; 2) The insured or property covered by a policy or application

Third Party – The claimant under a liability policy. So called because the person making the claim is not one of the two parties, insured and insurer, to the insurance contract.

Tort – A civil wrong, other than a breach of contract, for which a court of law will afford legal relief (e.g., harming another by an act of negligence in driving an auto).