

Program Evaluation

KENTUCKY ASSOCIATION OF COUNTIES SELF-INSURANCE AND LOAN PROGRAMS

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The Program Review and Investigations Committee is a 16-member bipartisan committee. According to KRS Chapter 6, the Committee has the power to review the operations of state agencies and programs, to determine whether funds are being spent for the purposes for which they were appropriated, to evaluate the efficiency of program operations and to evaluate the impact of state government reorganizations.

Under KRS Chapter 6, all state agencies are required to cooperate with the Committee by providing requested information and by permitting the opportunity to observe operations. The Committee also has the authority to subpoena witnesses and documents and to administer oaths. Agencies are obligated to correct operational problems identified by the Committee and must implement the Committee's recommended actions or propose suitable alternatives.

Requests for review may be made by any official of the executive, judicial or legislative branches of government. Final determination of research topics, scope, methodology and recommendations is made by majority vote of the Committee. Final reports, although based upon staff research and proposals, represent the official opinion of a majority of the Committee membership. Final reports are issued after public deliberations involving agency responses and public input.

FOREWORD

In April, 1993, the Program Review and Investigations Committee directed its staff to examine the seven different self-insurance and loan programs created and administered under the Kentucky Association of Counties (KACo). This report, with recommendations, was adopted by the Program Review and Investigations committee on December 8, 1993, for submission to the Legislative Research Commission.

This report is the result of dedicated time and effort by the Program Review staff. We appreciate additional research assistance received from other Legislative Research Staff, Bob Doris, Allan Alsip, Karen Hilborn, John Snyder, Virginia Wilson, and Jack Affeldt. Our appreciation is also expressed to the KACo program third-party administrators and their staff, trust board members, Kentucky Association of Counties staff and other persons interviewed for this study.

Vic Hellard, Jr.
Director

Frankfort, KY
July, 1994

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SUMMARY

In the 1970's and 1980's, a liability crisis in the insurance industry made it difficult for counties and other local government units to obtain insurance coverage. Insurance premiums charged local governments soared. In some instances, coverage was not available at all.

In response to this crisis, the Kentucky Association of Counties (KACo) began its first self-insurance program. In self-insurance programs, counties and other participants collectively share the risk of losses without transferring the risk to an insurance company.

The first KACo program provided workers' compensation insurance for county or local government employees. This program served as a model for the creation of other programs. Currently, KACo offers five insurance and two loan programs to counties and other local government entities. Services include workers' compensation, unemployment, medical, and comprehensive liability insurance, reinsurance and short-and long-term loan programs.

In time, some program participants and other private insurance industry members raised concerns about the lack of oversight of KACo programs by the Department of Insurance. These parties claimed that the programs were not adequately reserved, trusts were not sound, and management fees were too high. Moreover, they claimed that there were legal problems with these complicated programs and the related bond issues used to finance them. County liability was also questioned.

In April 1993, the Program Review and Investigations Committee directed staff to review all seven programs operated by KACo and KACo's relationship to

these programs. The study objectives were to determine the fiscal condition of the KACo programs, to determine the liability of the counties involved and to determine whether management and operations were sound. The Auditor of Public Accounts (APA) was asked to assist, because the APA was beginning its own audit of the KACo Trust at the request of KACo. The Department of Insurance was requested to comment on the soundness of the All Lines Fund (KALF) and the Attorney General was asked to comment on several legal questions.

CHAPTER II

DESCRIPTION OF THE KACO SELF-INSURANCE

AND LOAN POOL PROGRAMS

The Kentucky Association of Counties (KACo) is a nonprofit membership organization for counties and related county officials. Started originally as a lobbying organization for county government interests, in the late 1970s, it organized the first of several self-insurance and capital loan programs for the counties. Board members for the various trust funds are appointed by the KACo Board of Directors. Responsibility for the trusts and related programs is left to the trust boards, which tend to rely strongly on the advice of third party administrators (TPAs).

Third party administrators (TPAs) are responsible for all administrative aspects of the programs. Both KACo and the boards of the trusts rely heavily on these individuals for all decisions and accord them broad authority for independent decision making.

KACo's First Program Was Sponsored Jointly With KLC

In response to the liability crisis in government insurance, KACo and the Kentucky League of Cities (KLC) jointly sponsored the first self-insurance program. KACo and KLC operated that program, the Workers' Compensation Fund, jointly until July 1, 1993. At that time they split to form three separate programs, for counties, cities and a combined close out program.

Most KACo Programs Were Created Through the Interlocal Cooperation Act

KALF, KACoLT, KARP, KRT and KAMP were created through the Interlocal Cooperation Act (KRS 65.210 - 300), which allows local governments to cooperate in the provision of services and facilities. The interlocal cooperation act allows these programs to issue revenue bonds.

Each Program Has Its Own Board and Administrator

Each program has its own Board of Trustees which oversees the funds and directs the operations of the program. The Boards have three to seven members. The only qualification for serving as a Trustee is to be an elected official or designated representative of a public agency. All Trustees' appointments are made by the KACo Board of Directors.

Each program has a contract with a third party administrator (TPA). The TPA for four of the programs is the same company, Kentucky Related Insurance Services, Inc. (KRISI). The other TPAs are separate companies.

Programs are Controlled by Individuals Associated with KACo

The KACo self-insurance and trust programs were conceived and implemented by several staff and persons affiliated with KACo.

Financing for these Programs Involves \$330 Million in Borrowed Funds

Funding sources for the programs vary. Advanced premiums and investment income are the major source of revenue for the Workers' Compensation Fund and the Unemployment Insurance Fund. The other five programs (KALF, KACoLT, KRT, KARP and KAMP) include premiums, investment income and the proceeds from revenue bond issues by one or more counties.

CHAPTER III

LEGAL ISSUES

Many complex legal issues surround the KACo self-insurance and loan programs. Legal questions raised in this study about the KACo funds concerned liabilities incurred by counties participating in these KACo programs, liability for bonds issued to finance the programs and the actuarial soundness of the funds. Another set of legal questions involves the open record status of both the programs and the TPAs. A particular concern in the study request was the closed policy at the KACo trusts with regard to inspection of their records or disclosure of operational information.

The Licensing of KRT Has Been Constitutionally and Statutorily Questioned

More questions have been raised about the statutory and constitutional legalities of the Kentucky Reinsurance Trust KRT Insurance Company, Inc., than any of the other programs. KRT, an intergovernmental trust, issued revenue bonds and used the proceeds to establish a private insurance company. The legal question arises from a provision in the Kentucky Constitution, Section 179, that prohibits the General Assembly from authorizing a county to become a stockholder in a corporation.

County and State Have Practical Obligation for Bonds Issued

Another area of concern is the extent to which issuing counties are liable for the outstanding bonded indebtedness. Pendleton County has issued bonds for KALF, KACoLT and (jointly with Marshall County) for KRT.

On their face, the bond issues state that they are not general obligations of the issuing counties. These bonds are collateralized by letters of credit obtained from banking institutions which provide protection for the bond holders in the event of a default. Practically, default on these bonds would impact the credit ratings of the issuing counties and perhaps affect the ratings of other counties.

Although the state is not legally responsible, many believe that the state has a moral and practical obligation to prevent the default of any local bond. State bond ratings are affected by the governmental bond issues within the state.

Attorney General States Joint and Several Liability Is Not Unconstitutional

At least three provisions of the Kentucky Constitution restrict the amount and length of debt that counties can incur. These constitutional provisions have been used by critics to challenge the joint and several liability clause in agreements signed by participating counties. Joint and several liability means that counties will be sharing the debt of other counties. Yet the whole concept of self-insurance pools is the sharing of liability.

In OAG 93-54, dated July 16, 1993, the Attorney General stated that the Kentucky Constitution does not generally ban joint and several liability.

Trusts and Some TPAs Are Subject to Open Records Laws

From the beginning of these funds, KACo has taken the posture that they will not release information regarding the financing and membership of the funds to private parties, participating or potential members, or other state agencies, because the information is proprietary. Their concern is that because of the competitive nature of their insurance activities, the release of this information would put them at competitive disadvantage.

In OAG 93-ORD 96, 92-ORD-1232, and 92-ORD-1245, the AG ruled that KACo and five of the trusts (KAMP, KALF, KRT, KACoLT, KARP) are public agencies for purposes of the Open Records Act.

CHAPTER IV

FISCAL ISSUES

The first major hurdle in creating the counties self-insurance pools was to develop a way to finance them. The Workers' Compensation and Unemployment Insurance Fund programs were based on the anticipation that advanced premiums would be able to cover claims until a sufficient surplus could be built up to cover higher than average claims periods. The rates charged by the industry between 1978 and 1980 were high enough to sustain the program through the initial phase.

Debt became the financial backbone of the next group of programs, beginning with a \$25 million bond issue for KALF and adding on bonded indebtedness of \$205 million for KACoLT, \$50 million for KRT, and \$43 million in certificates of participation for KARP. Although the programs' financial stability has been widely questioned, the programs are solvent, and have sufficient reserves to cover normal claim levels. For these programs to continue to provide service for the counties, however, they will have to weather the occasional high claim years, and unforeseen cost, including litigation.

Interlocal Agreement Bonds Are Not Regulated As County Bonds

The \$425 million bonds issued by the counties to finance the KACo sponsored programs were not subject to the same oversight as other county bond issues. Therefore, the Board of Directors and the TPA of each trust have total discretion in obligating the debt of the issuing counties.

RECOMMENDATION 1: AUTHORIZE OFMEA TO REVIEW BONDS

The General Assembly should amend KRS 42.420 to authorize the Office of Financial Management and Economic Analysis to review and approve all bonds issued by all entities created through the Interlocal Cooperation Act.

**RECOMMENDATION: 2 STANDARDS FOR COOPERATIVE BOND
ISSUES**

The General Assembly should amend appropriate statutes to require all bonds issued by or on behalf of any entities created by counties through the Interlocal Cooperation Act to comply with all standards or statutes as applicable to county bond issues. The Office of Financial Management and Economic Analysis and the Legislative Capital Projects and Bond Oversight Committee should review and make a determination on such bond issues.

KACo Programs Rely on Bonds for Their Reserves

KACo's current strategy is to use the investments from bonds and funds to pay for administrative costs and to reduce membership premiums. Although this strategy minimizes the premium cost for the counties, it fails to develop a significant reserve capital to reduce the bond debt or offset program losses. Only the UI Fund has non-borrowed reserves in excess of existing claims. The Workers' Compensation Fund and KALF have reserves equal to existing claims.

RECOMMENDATION 3: DEBT LIQUIDATION FUND

All KACo Trusts associated with the self-insurance and loan programs should develop a debt liquidation fund which sets aside a percentage of increased premiums or loan payments to retire bonds or other debts when they mature.

Unbid TPA Contracts Do Not Ensure Lowest Operating Expense

Payments to KACo-associated TPAs are set fees, based on either a percentage of premiums or a percentage of bonds. These contracts range from \$25,000 to \$766,000. Moreover, these contracts require no competitive bidding, negotiation, or justification of expenditures, and contain no performance standards. TPAs contracts are open ended and are renewed without requiring action by the program board of trustees.

RECOMMENDATION 4: POLICIES AND PROCEDURES FOR KACO TRUSTS

KACo's self-insurance, loan and re-insurance Trusts should follow the administrative policies and procedures required by state law to be followed by counties which created or join these programs. This should include the bidding of service contracts.

RECOMMENDATION 5: CONTRACTING AND PURCHASING REQUIREMENTS

All entities created under the Interlocal Cooperation Act, including all local government self-insurance pools, trusts, and loan programs, should comply with the same policies and procedures for contracting and purchasing required of individual local governments, as provided in applicable state laws. In the event a Model Procurement Code exists in Kentucky statutes for that unit of government, this Model Procurement Code should govern the operation of the created entity. In addition, all

such entities should operate according to commonly accepted accounting and reporting procedures applicable to that type of entity.

Program Funds Are Being Used for Activities Unrelated to the Programs

Another area of concern that raises questions about the use of KACo program funds is the interrelated party transactions and the non-program-related uses. Several transfers of money among the KACo entities include interest free personal loans and loans made to other programs to cover shortfalls. In addition to these loans to other KACo-related entities, funds are also being used for the acquisition of property.

CHAPTER V

PROGRAM ASSESSMENT

Counties' present levels of participation indicate a need for the insurance and loan programs offered by the KACo Trusts. The KACo programs represent over \$330 million in borrowed and revenue funds, for which the participating counties could be held liable. Currently, state agency oversight and monitoring by the Department of Insurance, Department of Local Governments, and other state financial agencies is severely limited. In addition, the boards who should be the representatives of the public in insuring the proper operation of these funds depend heavily on hired administrators to make program decisions.

KACo Programs Are Serving Many County Needs

Counties must insure against unanticipated losses arriving from disasters, accidents, and lawsuits, as well as provide for employee medical, workers' compensation and unemployment insurance. Utilization of the programs and interviews with some county fiscal court officials seem to support a continuing desire to use these programs.

KACo Programs Have Limited Oversight

Normally, an insurance company must conform with all the requirements of the insurance code. Self-insurance liability groups are not regulated as insurance companies. These groups are exempted from the insurance code under KRS 304.1-120 (6). Rather than licensing them as insurance companies, the Department of Insurance issues a Certificate of Filing that allows self-insurance groups to operate within the state with only limited oversight and regulation.

RECOMMENDATION 6: REGULATE SELF-INSURANCE

The General Assembly should amend KRS 304 (The Insurance Code) to remove the exemption and to place self-insured liability groups under Department of Insurance regulation and oversight.

The Department of Local Government (DLG) has limited review of loans made to counties and the amount of bonding they undertake. DLG has no authority over any entity created through an interlocal agreement, such as the two loan programs offered by KACo, (KARP and KACoLT).

RECOMMENDATION 7: OVERSIGHT OF KACO LOAN PROGRAMS

The General Assembly should amend KRS 147A to authorize the Department of Local Government to review and oversee all county loan programs created through the Interlocal Cooperation Act.

The KACo Trust Boards Exercise Little Control Over the Trust Programs

The TPAs, not respective boards, are the ones who really make all the important financial and programmatic decisions. The Boards of Trustees are responsible for the programs they oversee and should take an active role in their

Research Report: Kentucky Association of Counties Self-Insurance Program

administrative affairs. The Boards are accountable to the participating counties and therefore should control the financial and programmatic aspects of the trusts.

Additional Committee Recommendations

RECOMMENDATION 8: BOARD MEMBERSHIP

KRS 65.210-300 should be amended to require that the boards of directors or trustees for entities created by interlocal agreements should have a majority membership representative of and appointed from participating units of government.

RECOMMENDATION 9: REVIEW KRT CERTIFICATE OF AUTHORITY

The Department of Insurance should review its issuance of the Certificate of Authority for KRT Insurance Corporation in the light of the Attorney General's Opinion 94-1, which indicates that the KRT Trust is not authorized to own a corporation or to use Bond proceeds to purchase a corporation.

Committee Action

The report, along with recommendations, was adopted by the Program Review and Investigations Committee at its January 10, 1994 meeting.

Legislative Action

Recommendation 6 was addressed in SB 361 (BR1615) - An act relating to liability self-insurance groups. SB 361 was referred to the Banking and Insurance Committee, passed the Senate 37-0, passed the House 85-2, and was signed by the Governor on April 8, 1994.

Recommendations 1, 2, 4, 5, 7, and 8 were addressed in SB 350 (BR 2091) - An act relating to local government. SB 350 was referred to the Senate State Government Committee, but were not acted upon.

CHAPTER VI

AUDITOR OF PUBLIC ACCOUNTS REPORT

The Kentucky Auditor of Public Accounts (APA) conducted its own audit of the KACo Trusts at the request of KACo. The APA presented this report to the Committee at its November 8, 1993 meeting and generated similar recommendations concerning the self-insurance and loan programs operated by KACo. The report generally agreed with the Committee's findings on the financial soundness of the KACo programs. However, APA recommendations were directed more specifically toward internal operations and controls.

CHAPTER I

INTRODUCTION

In the 1970's and 1980's, a liability crisis in the insurance industry made it difficult for counties and other local government units to obtain insurance coverage. Insurance premiums charged local governments soared. In some instances, coverage was not available at all.

In response to this crisis, the Kentucky Association of Counties (KACo) began its first self-insurance program. In self-insurance programs, counties and other participants collectively share the risk of losses without transferring the risk to an insurance company.

The first KACo program provided workers' compensation insurance for county or local government employees. This program served as a model for the creation of other programs. Currently, KACo offers five insurance and two loan programs to counties and other local government entities. Services include workers' compensation, unemployment, medical, and comprehensive liability insurance, reinsurance and short - and long-term loan programs.

In time, some program participants and other private insurance industry members raised concerns about the lack of oversight of KACo programs by the Department of Insurance. These parties claimed that the programs were not adequately reserved, trusts were not sound, and management fees were too high. Moreover, they claimed that there were legal problems with these complicated programs and the related bond issues used to finance them. County liability was also questioned.

KACo claims that its programs are sound and that the concerns are unfounded. KACo asserts that its programs are insured and have saved the counties money at times when private insurance companies did not want to cover them at all or charged extremely high premiums. The representatives of KACo state that complaints against their programs are just "sour grapes" from the competition.

Senator Richard Roeding formally requested the Program Review and Investigations Committee to conduct a study of KACo and its self-insurance and loan programs. In his study request, Senator Roeding indicated his desire to resolve these contradicting claims. The Committee approved undertaking a study of KACo at its April 1993 meeting.

Scope of the Study

The Program Review and Investigations Committee directed staff to review all seven programs operated by KACo and KACo's relationship to these programs. The study objectives were to determine the fiscal condition of the KACo programs, to determine the liability of the counties involved and to determine whether management and operations were sound. The Auditor of Public Accounts (APA) was asked to assist, because the APA was beginning its own audit of the KACo Trust at the request of KACo. The Department of Insurance was requested to comment on the soundness of the All Lines Fund (KALF) and the Attorney General was asked to comment on several legal questions.

Methodology

In pursuing these objectives, Program Review staff interviewed KACo executives, third party administrators (TPAs) for the programs, KACo's counsel, representatives of the Kentucky League of Cities (KLC), insurance agents, county officials, private insurers and other concerned individuals. Staff reviewed state and federal laws and regulations, audit and actuarial reports, contracts, and numerous financial and operations documents related to the KACo programs.

Research Report: Kentucky Association of Counties Self-Insurance Program

Finally, staff interviewed 17 county officials to determine their attitudes and concerns about the programs. This paper provides general background information on the KACo programs, and identifies legal issues, financial analyses, and program problems.

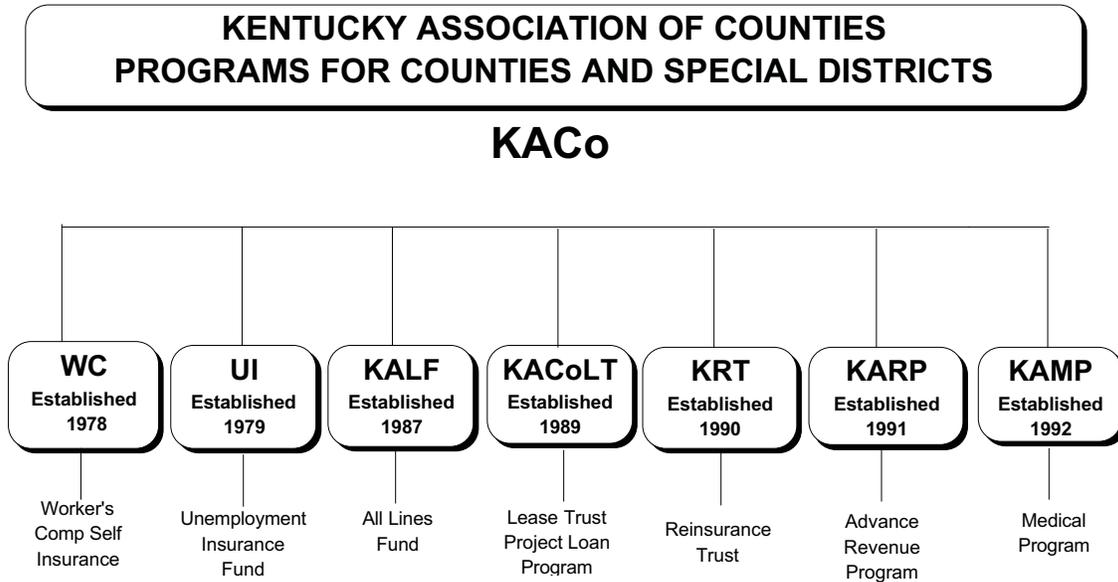
CHAPTER II

DESCRIPTION OF THE KACO SELF-INSURANCE AND LOAN POOL PROGRAMS

The Kentucky Association of Counties (KACo) is a nonprofit membership organization for counties and related county officials. Started originally as a lobbying organization for county government interests, in the late 1970s, it organized the first of several self-insurance and capital loan programs for the counties (see Figure 2.1). In some cases, bonds were issued by one or more counties to create capital for establishing the programs. In most cases, premium assessments are used for funding. Board members for the various trust funds are appointed by the KACo Board of Directors. Responsibility for the trusts and related programs is left to the trust boards, which tend to rely strongly on the advice of third party administrators (TPAs).

Third party administrators (TPAs) are responsible for all administrative aspects of the programs. All but one of the major TPAs were created by former members or employees of KACo. These TPAs were created as, and operate as, private businesses even though, in most cases, their sole source of income and business is the KACo programs. In the case of KRISI, trust monies were used to create the organization. Although the trust funds are created with boards of trustees, the programs are primarily controlled by those KACo-associated individuals who helped to organize these programs and own the major TPAs. Both KACo and the boards of the trusts rely heavily on these individuals for all decisions and accord them broad authority for independent decision making.

Figure 2.1{XE "Figure 2.1"}



SOURCE: LRC Office of Program Review and Investigations.

KACo Is a Nonprofit Corporation Created in 1974 to Serve County Governments

The KACo organization includes counties, elected county officials, associate members, honorary members and adjunct members. According to its articles of incorporation, KACo was established to assist with cooperative efforts among the counties, disseminate information and provide technical assistance, and promote legislation favorable to the counties.

An elected board of thirty-four members makes policy decisions for KACo and the Executive Director carries out the policy established by the Board. Each county pays dues based on its population. KACo also receives funds from administrative fees for services provided to county self-insurance and loan trust pools, dues from associate and adjunct members, and income generated by its annual conference (see Figure 2.2).

Figure 2.2{XE "Figure 2.2"}

KACo SOURCES OF INCOME	1992 INCOME
Members dues	\$109,000
Administrative fees from loan and insurance programs	\$314,000
Annual Convention	\$16,000
Interest	\$12,000
Rental Income	\$19,000
Advertising	\$16,000
TOTAL	\$486,000

Source: Compiled by Program staff from KACo Annual Audit Report, Charles T. Mitchell Accountants.

KACo's First Program Was Sponsored Jointly With KLC

In response to the liability crisis in government insurance, KACo and the Kentucky League of Cities (KLC) jointly sponsored the first self-insurance program. KACo and KLC operated that program, the Workers' Compensation Fund, jointly until July 1, 1993. At that time they split to form three separate programs for counties, cities and a combined close out program. This first workers' compensation program served as a model for the creation of the other programs. Currently, both KLC and KACo operate seven separate insurance or loan programs. Figure 2.4 shows the five insurance and two loan programs that KACo has created since 1978. Each program serves a unique purpose for the counties. KLC runs programs for cities and KACo provides programs for counties, special districts and other local government groups.

Most KACo Programs Were Created Through the Interlocal Cooperation Act

KALF, KACoLT, KARP, KRT and KAMP were created through the Interlocal Cooperation Act (KRS 65.210 - 300), which allows local governments to cooperate in the provision of services and facilities. The program is created through an interlocal agreement that includes a trust instrument and by-laws for the programs. The interlocal cooperation act also allows these programs to issue

revenue bonds. These interlocal agreements are the basic frameworks for the KACo programs.

Each interlocal agreement must provide the following information:

Figure 2.3{XE "Figure 2.3"}

Statutory Requirement of the Interlocal Cooperation Act	KACo Provisions
Duration of the Agreement	Perpetual
Organization, composition, powers and nature of any separate legal or administrative body	All include the authority for an administrator. Two agreements specify corporations as administrators.
Purpose	Each program has a specific purpose.
Financing of the programs	Revenue bond proceeds, premiums from participants, investment income, leasing payments
Termination of the program	A certain number of the participants, generally 2/3, must agree to the termination and then the proceeds after the payment of expenses are returned to the participants on a pro rata basis.
Withdrawal from the program	The participant must give 60 days written notice prior to the beginning of the fiscal year for the program. The participant forfeits the right to all future payments of dividends, surplus or credits from KALF. The Trust must still service any pending claims.

Note: The KACo provisions represent a generalization about the five separate programs. Variations exist in the different programs.

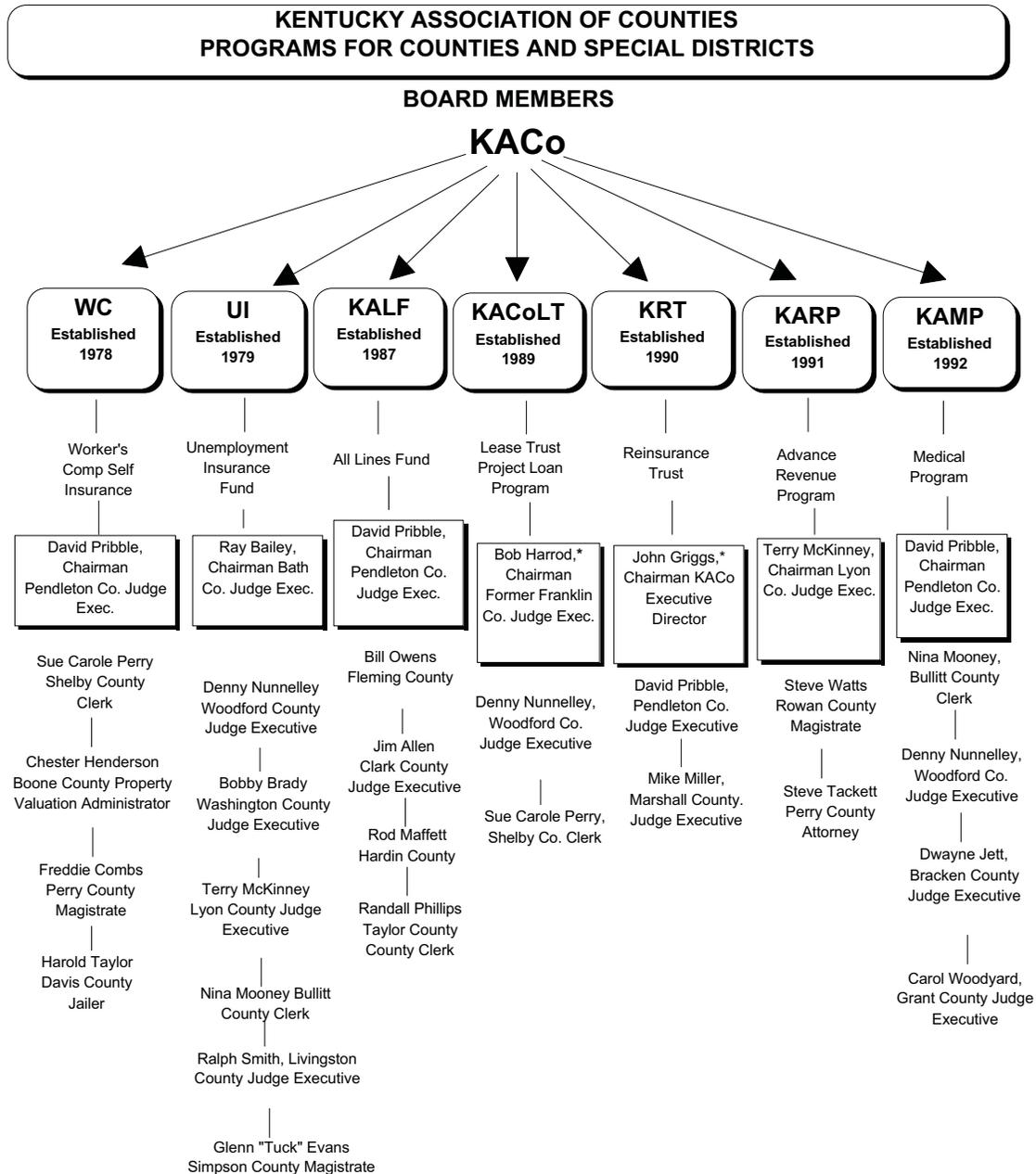
Each Program Has Its Own Board and Administrator

All of the programs are structured similarly. Therefore, an explanation of one program's structure will serve as a model for the others. Each program has its own Board of Trustees (see Figure 2.4), which oversees the funds and directs the operations of the program. The Boards have three to seven members. The only qualification for serving as a Trustee is to be an elected official or designated representative of a public agency. Two Boards (KACoLT and KRT) allow a KACo representative to serve as a Trustee. All Trustees' appointments are made by the KACo Board of Directors. Figure 2.4 identifies the membership for each Board.

Research Report: Kentucky Association of Counties Self-Insurance Program

Appendix A and B provide information regarding provisions for the Board of Trustees.

Figure 2.4{XE "Figure 2.4"}



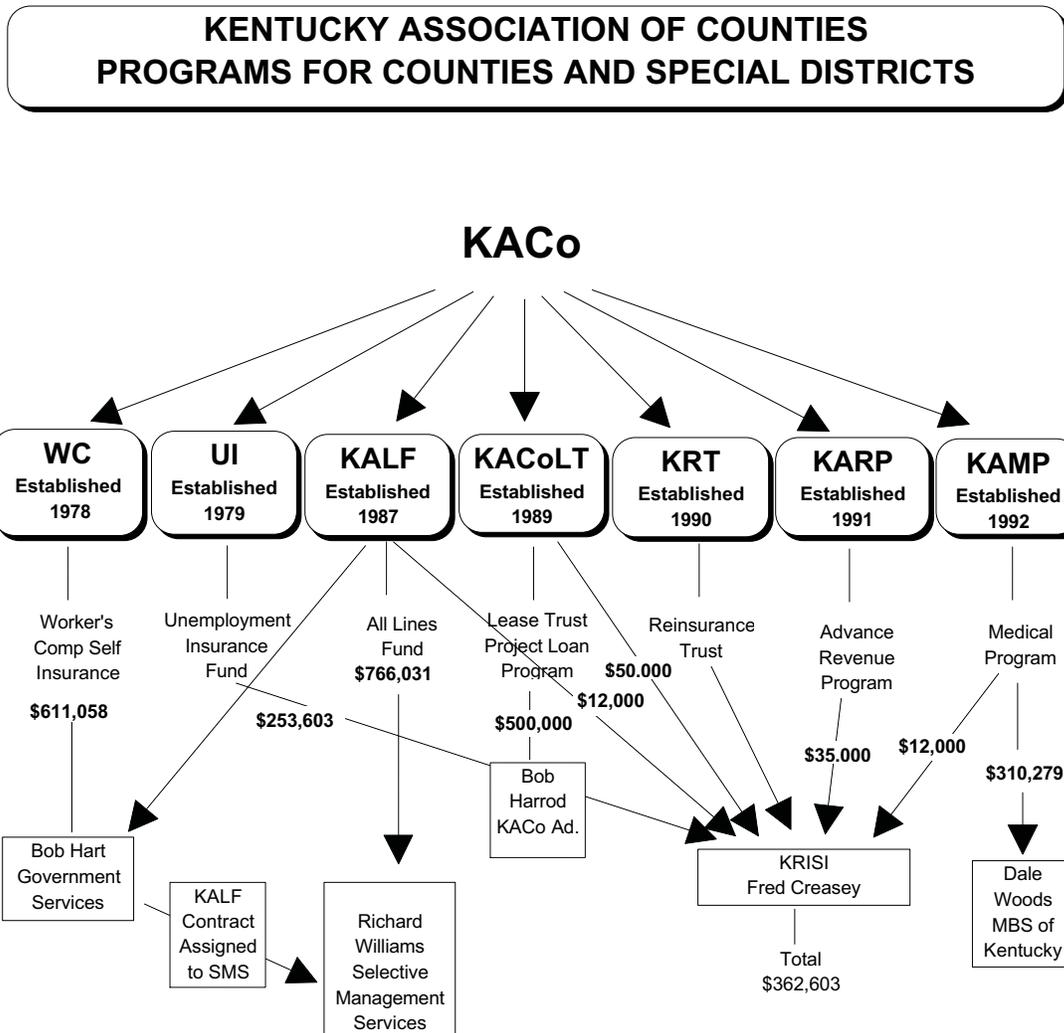
SOURCE: Compiled by LRC staff from information received from KACo.

* All Board Members are elected officials except Bob Harrod, former Franklin Co. Judge Exec., and John Griggs.

Each program has a contract with a third party administrator (TPA). The TPA for four of the programs is the same company, Kentucky Related Insurance

Services, Inc. (KRISI). The other TPAs are separate companies. The TPA companies, the Executive Director, and the contract amount for TPA services, by program are shown in Figure 2.5.

Figure 2.5{XE "Figure 2.5"}

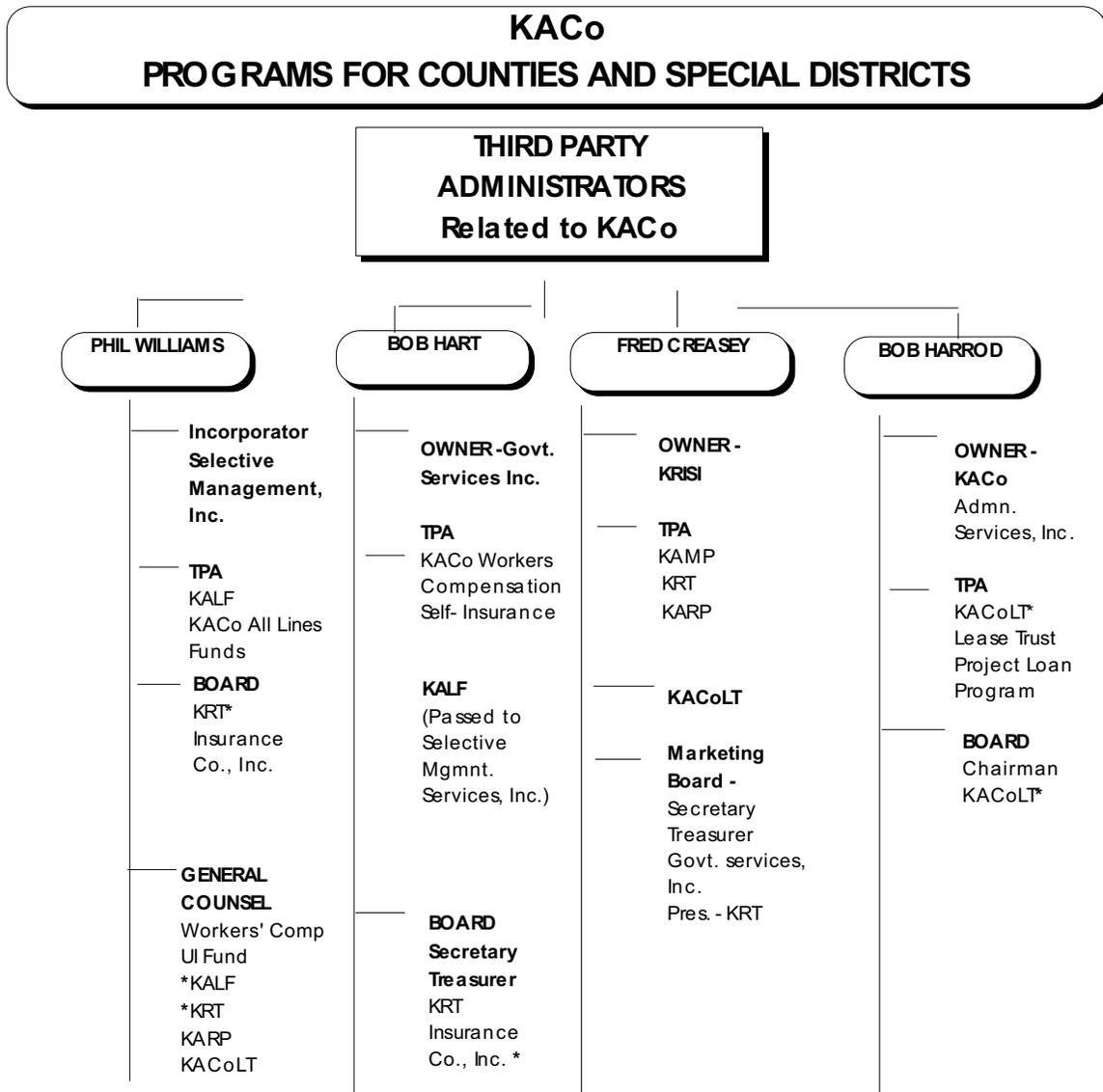


SOURCE: LRC Office of Program Review and Investigations.

Programs Are Controlled By Individuals Associated With KACo

The KACo self-insurance and loan programs were conceived and implemented by several staff and persons affiliated with KACo, including its executive director at the time, as shown in Figure 2.6. These individuals, Fred Creasey, Phil Williams, (legal counsel), Robert Hart (board member), and Robert Harrod (board member) now own (or are legal counsel for) the major TPAs and serve as board members or officers in other TPAs or programs. Based upon interviews with these individuals, they appear to be making the major decisions for the programs in relation to all aspects, including refinancing bond issues.

Figure 2.6{XE "Figure 2.6"}



SOURCE: Compiled by LRC staff from information obtained from KACo.

Financing for These Programs Involves \$330 Million in Borrowed Funds

Funding sources for the programs vary (see Figure 2.8). Advanced premiums and investment income are the major source of revenue for the Workers' Compensation Fund and the Unemployment Insurance Fund. The other

five programs (KALF, KACoLT, KRT, KARP and KAMP) include premiums and investment income and the proceeds from revenue bond issues by one or more counties. These revenue bonds are collateralized by letters of credit from banks. Figure 2.7 shows the date, the counties, the amount and sources of the revenue, including originally issued revenue bonds or loans, and the banks for bonds issued or major loans.

Figure 2.7{XE "Figure 2.7"}

DEBT SOURCES FOR KACO SELF-INSURANCE AND LOAN POOLS

Date	KACo Program	Issuing Counties	Revenue Source	Loaning Institutions
1987 (Remarketed annually)	KALF	Pendleton	\$25 million Bonds	Citizens Fidelity Bank and Trust Co.
1989	KACoLT	Pendleton	\$200 million Bonds	Commonwealth Bank of Australia
1990	KRT	Pendleton Marshall	\$50 million Bonds	Marine Midland Bank Hong Kong and Shanghai Banking Corporation, Limited
1991	KARP		\$42,965,000 Bonds redeemed	Mitsue Taiyo Kobe Bank Tokyo Japan
1992	KAMP		\$300,000 \$1,250,000 Letter of Credit	KACoLT Loan PNC Bank Louisville
1993	KACoLT	Pendleton	\$100,000,000 Bonds <\$95,000,000 redeemed>	PNC Bank of Kentucky Louisville, Kentucky

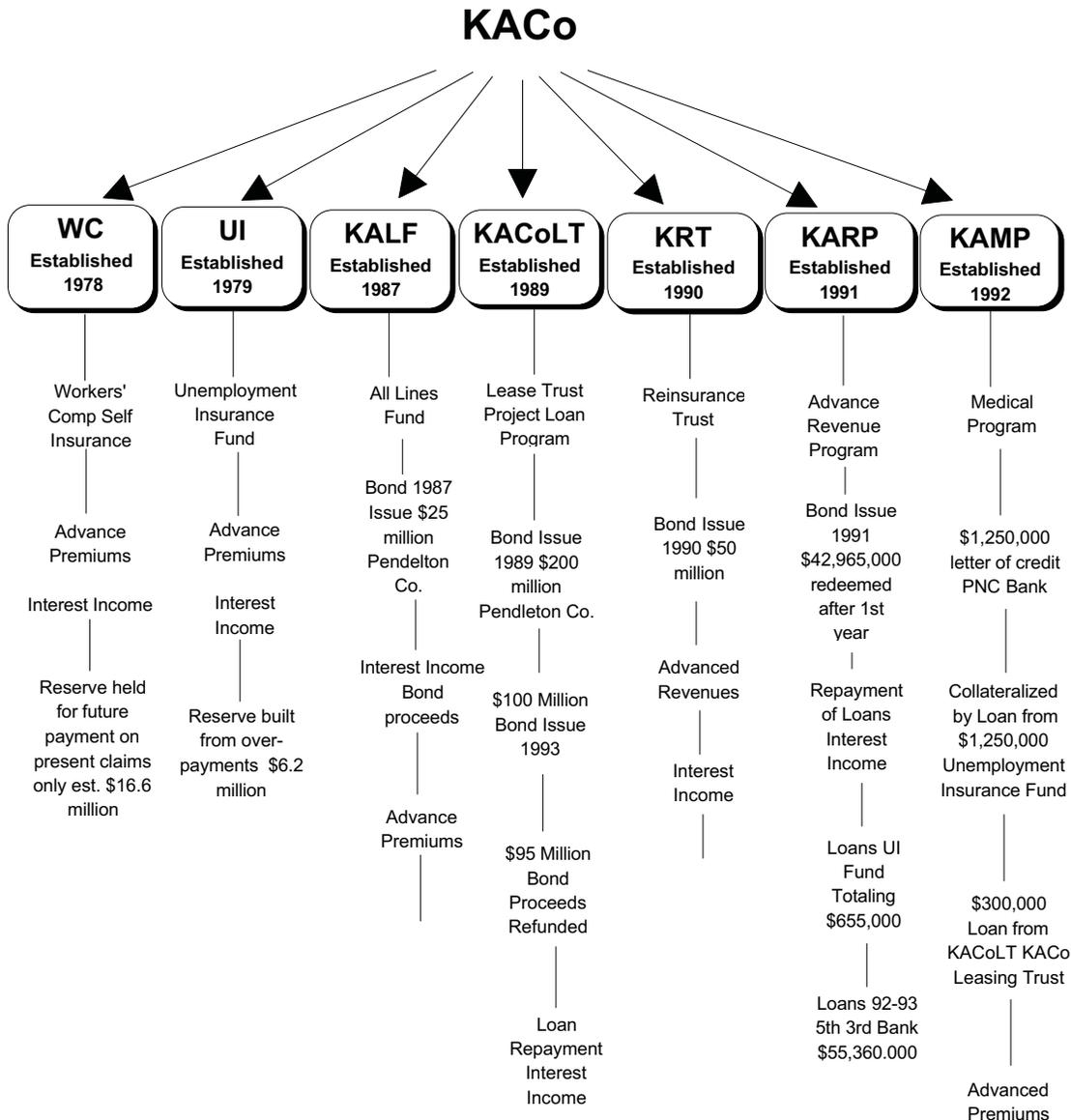
SOURCE: Compiled by Program Review

As shown in Figure 2.7, the debt involved in these bond issues and loans has been as high as \$425 million over the last six years and is presently at \$330 million. In contrast, the KAMP program borrowed funds from the Unemployment Insurance Fund or KACo Leasing Trust.

Figure 2.8{XE "Figure 2.8"}

**KENTUCKY ASSOCIATION OF COUNTIES
PROGRAMS FOR COUNTIES AND SPECIAL DISTRICTS**

FUNDING SOURCES AND RESERVES



SOURCE: Compiled by LRC staff from information received from KACo.

CHAPTER III

LEGAL ISSUES

Many complex legal issues surround the KACo self-insurance and loan programs. The statutory authority for these programs is shown in Figure 3.1. Five of these programs (KALF, KAMP, KRT, KARP and KACoLT) were established by interlocal agreements under the Interlocal Cooperation Act (KRS 65.210 - 300). This statute allows counties to associate for purposes of providing governmental services. The other two programs, the Workers' Compensation Program and the Unemployment Fund, have their statutory basis in the law governing their specific subject areas.

Legal questions raised in this study about the KACo funds concerned liabilities incurred by counties participating in these KACo programs, liability for bonds issued to finance the programs, and the actuarial soundness of the funds. Another set of legal questions involves the open record status of both the programs and the TPAs. A particular concern in the study request was the closed policy at the KACo trusts prohibiting inspection of their records or disclosure of operational information. This posture regarding use of disclosure of information was one of the reasons for the breakup of the KACo-KLC Workers' Compensation Fund in June, 1993.

The following points summarize the major areas of contention regarding the legality of these programs.

Figure 3.1{XE "Figure 3.1"}

**STATUTORY AND REGULATORY AUTHORITY
FOR KACO PROGRAMS**

KACO PROGRAMS	STATUTORY AUTHORITY AND REGULATORY
KACo-KLC Workers' Comp Self-Insurance Fund	KRS 342.340 - 350(4) Workers' Compensation Regulations 803 KAR 25:025 Joint self-insurers
KACo Unemployment Insurance Fund	KRS 341.275 - 281
KACo All Lines Fund (KALF)	KRS 65.150 Interlocal Cooperation Act KRS 65.210 - 300 806 KAR 1.010 Liability Self-Insurance group regulations
KACo Counties Leasing Trust (CoLT)	Interlocal Cooperation Act KRS 65.210 - 65-300 KRS 58.010 - 190 (Public Projects) Tax reform act of 1986 26 U.S.C. 103 (See note 44 on bond pools)
KACo Advance Revenue Program (KARP)	KRS 65.7703 - 65.7721 Short Term Borrowing Act Interlocal Cooperation Act KRS 65.210 - 65-300
KACo Reinsurance Trust (KRT)	Interlocal Cooperation Act KRS 65.210 - 65-300 KRS Chapter 304
KACo Medical Program (KAMP)	Interlocal Cooperation Act KRS 65.210 - 65-300

Source: Compiled by Program Review staff.

The Licensing of KRT Has Been Constitutionally and Statutorily Questioned

More questions have been raised about the statutory and constitutional legalities of the KRT Insurance Company, Inc. than any of the other programs. KRT was formed by Pendleton and Marshall Counties through an interlocal agreement. KRT, an intergovernmental trust, issued revenue bonds and used the proceeds to establish a private insurance company. The legal question arises from a provision in the Kentucky Constitution, Section 179, that prohibits the General Assembly from authorizing a county to become a stockholder in a corporation. Initially, the Department of Insurance rejected the KRT interlocal agreement, stating that it violated a statute in the Insurance Code against governmental ownership of an insurance company. The Department subsequently reversed its position and allowed the agreement, under three conditions: that the agreement include only two counties; that the trustees of the company serve in their individual capacities and not as county officers and KACo individuals; and that the trust not be administered by an elected public official, an employee of a political subdivision or KACo.

The Department of Insurance did not address this constitutional question, so the Program Review and Investigations Committee requested an Attorney General's opinion about it.

In OAG 94-1, dated Jan. 7, 1994, the Attorney General found that the interlocal cooperation act does not give governmental units any greater authority than they possess separately. Therefore, the trust's authority is no greater than that of either county, and, since the counties cannot own stock in a corporation, neither can the trust.

Concerning whether it is constitutional for counties to join together and form a trust under the interlocal cooperation act, which in turn forms a corporation that issues revenue bonds, the AG found that under KRS 65.150(4), an association of governmental units can issue revenue bonds to provide insurance to its participating members. The statute does not authorize the actions by the trust, however, for two reasons: (1) In our view the statute plainly contemplates the purchase of insurance, not the purchase of an insurance company. (2) The

statute specifies that the insurance obtained by revenue bonds must be for the participating members; because the bonds in question were sold for the purpose of providing insurance to entities other than the two participating members (Pendleton and Marshall Counties), the bond issue is not authorized by KRS 65.150(4).

In OAG 94-2, dated Jan. 7, 1994, concerning whether KRT Insurance Company, Inc., is in violation of KRS 304.3-080(1) because it was formed as a result of an interlocal agreement between Marshall County and Pendleton County and the funding was derived from the issuance of revenue bonds from these counties, the Attorney General says:

As stated in OAG 94-1, the invocation of the interlocal cooperation act does not permit Pendleton and Marshall counties to create a trust which in turn owns stock in a corporation. However, the statute merely prohibits the insurance commissioner from issuing a certificate of authority to such a company; it does not prohibit the conduct of business by the company if it has been licensed by the Department of Insurance. Therefore it is not a violation for the company to conduct insurance business within the scope of its license. That license could be subject to revocation, however, under KRS 304.3-190 if the Department of Insurance determines that the license should not have been issued in the first place.

County and State Have Practical Obligation for Bonds Issued

Another area of concern is the extent to which issuing counties are liable for the outstanding bonded indebtedness. Pendleton County has issued bonds for KALF, KACoLT and, jointly with Marshall County, for KRT.

On their face, the bond issues state that they are not general obligations of the issuing counties. This statement is backed by the opinions of bond counsel. These bonds are collateralized by letters of credit obtained from banking institutions which provide protection for the bondholders in the event of a default. The agreements signed by the participants state that the bond issues are not a debt of the participating counties. The debt of the issuing counties is limited to the revenues generated by the programs and other legally available funds.

Practically, however, default on these bonds would impact the credit ratings of the issuing counties and perhaps affect the ratings of other counties.

Although the state is not legally responsible, many believe that the state has a moral and practical obligation to prevent the default of any local bond. State bond ratings are affected by the governmental bond issues within the state. Therefore, to protect its rating, the state may choose to act in the event of potential default.

Attorney General States That Joint and Several Liability is Not Unconstitutional

At least three provisions of the Kentucky Constitution restrict the amount and length of debt that counties may incur. These constitutional provisions have been used by critics to challenge the joint and several liability clause in agreements signed by participating counties. Joint and several liability refers to counties sharing the debt of other counties. Yet the whole concept of self-insurance pools is the sharing of liability.

In OAG 93-54, dated July 16, 1993, the Attorney General stated that the Kentucky Constitution does not generally ban joint and several liability. According to the Attorney General, there would only be a constitutional problem with Sections 157 and 158 if the liability would be so great as to contravene these sections. If a county's potential liability cannot be reasonably ascertained or is unlimited, there would be constitutional problems. The Attorney General found that the KALF agreement is limited to funds available. That is, the general funds of the county are available to the extent determined by the participant and that they are not pledged for any other obligations. Since the KALF agreement has these limitations, it is not unconstitutional under Sections 157 and 158.

Concerning the question of whether the Management Review conducted by the Auditor of Public Accounts on KACo and related programs, alluded to fact that contrary to the data furnished by KACo, the counties that issued the bonds to finance KALF and KRT may be liable for their repayment, the Attorney General stated in OAG 94-2 that:

It is our understanding that all the KACo bonds were issued as revenue bonds. The classification of these bonds as revenue bonds is significant because the issuing agency is protected from general liability on the bonds. Thus, even if a court were to construe the KRT bonds as having been issued by Pendleton and Marshall Counties rather than by the trust, the counties still would not be liable on the bonds except to the limited extent of the funds available from sources specified in the bond statement. We do not foresee any substantial likelihood that the counties will be held liable on the bonds.

Trusts and Some TPAs Are Subject to Open Records Laws

From the beginning of these funds, KACo has taken the posture that they will not release information regarding the financing and membership of the funds to private parties, participating or potential members and other state agencies because the information is proprietary. Their concern is that because of the competitive nature of their insurance activities, the release of this information would put them at competitive disadvantage. This particular problem over the public nature of this business led to a split-up of the KACo and KLC UI Fund. The KLC believes that their information is public and releases it to all requesting parties.

In OAG 93-ORD 96, 92-ORD-1232, 92-ORD-1245, the AG ruled that KACo and five of the trusts (KAMP, KALF, KRT, KACoLT, KARP) are public agencies for purposes of the Open Records Act. Furthermore, in response to a request from Program Review and Investigations Committee, the Attorney General has advised that the KRT and Unemployment Insurance fund (OAG 93-65 dated Sept. 29, 1993) as well as three of the TPAs (KRISI, GSI, KAS) (OAG 93-78 dated Nov. 8, 1993) are public. The remaining TPAs (Selective Management Services and MBS) were not declared public because they receive less than 25% of their funding from public agencies. The Attorney General expressed the view that a private entity that administers a public agency should not ignore the requirements of the Open Records Act. If a private entity administering a public agency ignores these requirements, this practice could open the door to widespread abuse.

CHAPTER IV

FISCAL ISSUES

The first major hurdle in creating the counties self-insurance pools was to develop a way to finance them. The Worker's Compensation and Unemployment Insurance Fund programs were based on the anticipation that advanced premiums would be able to cover claims until a sufficient surplus could be built up to cover higher than average claims periods. The rates charged by the industry between 1978 and 1980 were high enough to sustain the program through the initial phase.

Debt became the financial backbone of the next group of programs beginning with a \$25 million bond issue for KALF and adding on bonded indebtedness of \$205 million for KACoLT, \$50 million for KRT, and \$43 million in certificates of participation for KARP. Although the program's financial stability has been questioned generally, the programs are solvent, and have sufficient reserves to cover normal claim levels. For these programs to continue to provide service for the counties, they will have to weather the occasional high claim years, and unforeseen cost including litigation.

Reducing debt, building reserves and controlling excessive expenditures could improve the fiscal conditioning of these programs. This could include a critical look at the expenditures of program funds for unrelated purposes such as mortgaging property and buildings or making loans to other programs. Presently contract program administrators are not required to meet performance standards or otherwise expected to meet standards for purchasing, contracting or disclosure.

Interlocal Agreement Bonds Are Not Regulated As County Bonds

The \$425 million bonds issued by the counties to finance the KACo sponsored programs were not subject to the same oversight as other county bond issues. Therefore, the Board of Trustees and the TPA of each trust, have total discretion in obligating the debt of the issuing counties.

Dr. James R. Ramsey issued a report to the Auditor's Office in June, 1993 entitled, Review of Kentucky Association of County Debt Issues. Dr. Ramsey concluded in the report that the KACo debt management program can be described as aggressive and complex (see Appendix G for a summary of Dr. Ramsey's report).

This bonded indebtedness impacts not only the financial profile of the issuing counties or participating counties, but also impacts the state as a whole. Although these bonds have been declared, the potential legal and fiscal implications on state and local governments is such that more oversight and standards for issuance seem appropriate. Given that the Department of Local Government (DLG) and Office for Financial Management and Economic Analysis (OFMEA) already have the responsibilities for other public bonded indebtedness, it is recommended that their authority be extended to bonds by intergovernmental trusts.

RECOMMENDATION 1: AUTHORIZE OFMEA TO REVIEW BONDS

The General Assembly should amend KRS 42.420 to authorize the Office of Financial Management and Economic Analysis to review and approve all bonds issued by all entities created through the Interlocal Cooperation Act.

**RECOMMENDATION: 2 STANDARDS FOR COOPERATIVE BOND
ISSUES**

The General Assembly should amend appropriate statutes to require all bonds issued by or on behalf of any entities created by counties through the Interlocal Cooperation Act to comply with all standards or statutes as applicable to county bond issues. The Office of Financial Management and Economic Analysis and the Legislative Capital Projects and Bond Oversight Committee should review and make a determination on the above referenced bond issues.

KACo Programs Are Operating on Limited Reserves

The financial statements prepared by private auditors for these KACo funds reflect that their expenditures are in line with revenues. Furthermore, actuarial reports suggest that the premiums are in line with the claims history of these funds.

The annual financial statements and actuarial reports for the various funds show reserves. In the case of the KRT, KACoLT, and KALF the proceeds are from bonds issued by certain counties. The KAMP reserve is in the form of a letter of credit collateralized by a loan from the UI Fund. The KACo Workers' Compensation program has a reserve fund of \$16 million which is adequate to cover existing filed and unfiled claims. In addition to the bonds KALF has reserves of \$720,000 which is adequate to meet existing identified but unreported claims. Only the UI Fund has a reserve (\$6.8 million), which is estimated to be equivalent to five years of average claims.

KACo Programs Rely on Bonds for Their Reserves

KACo's current strategy is to use the investments from bonds and funds to pay for administrative costs and to reduce membership premiums. Although this strategy minimizes the premium cost for the counties, it fails to develop a significant reserve capital to reduce the bond debt or offset program losses. Only the UI Fund has non-borrowed reserves in excess of existing claims. The Worker's Compensation Fund and KALF have reserves equal to existing claims.

Part of KACo's strategy is to level an assessment on the county members if there is a fund loss. Given the instability of interest rates, continued reliance on this strategy seems risky. Using interest income to pay current expenses without generating a contingency reserve does not seem fiscally prudent.

RECOMMENDATION 3: DEBT LIQUIDATION FUND

All KACo Trusts associated with the self-insurance and loan programs should develop a debt liquidation fund which sets aside a percentage of increased premiums or loan payments to retire bonds or other debts when they mature.

Unbid TPA Contracts Do Not Ensure Lowest Operating Expense

The major expenses of the KACo trusts involve contract payments to TPAs and membership dues to KACo. A review of expenditures indicates potentially large profits, perquisites not normally considered appropriate for public agencies and a lack of competition. Payment from the trusts to KACo for membership dues or administrative services total \$293,722 annually, (See Figure 2.2). This total represents 65% of KACo's annual budget.

Research Report: Kentucky Association of Counties Self-Insurance Program

Payment to KACo associated TPAs are set fees, based on either a percentage of premiums or a percentage of bonds. These contracts range from \$25,000 to \$766,000. Moreover, these contracts require no competitive bidding, negotiation, justification of expenditures, and contain no performance standards. TPAs contracts are open ended and are renewed without requiring action by the program board of trustees.

The TPA expenses include leases for luxury cars, and entertainment and travel accounts including direct payments for country club billings.

In the absence of competitive bidding it is hard to determine whether services provided by current TPAs could be obtained at a lower cost to members. According to KACo's Executive Director and TPA administrators, TPA fees are not out of line with the industry and may in a few cases be slightly lower. However, a comparison of the KLC administrative costs for their Unemployment Insurance Fund, to KACo's, the KLC is paying \$73,535 while KACo's UI Fund administrative cost is \$410,620. This amount is five times greater than what the KLC is paying for similar services, however, it should be noted that KACo's UI Fund administers twice the dollar amount of claims. The KLC UI Funds administration fees are based on the number of claims processed; KACo's UI Fund administrative fees are based on a percentage of premiums.

The Boards should treat TPAs as either staff for Trusts or private corporations. If they are staff for Trusts then they are subject to open records and open meetings laws as they apply to public entities and county governments and should be held to the same standards of public employees. If they are private corporations then public purchasing procedures should be used to obtain their services. Under the current system, TPAs who claim to be private businesses, are given preferential treatment in obtaining public agency business. Furthermore, they do so without having to publicly account for the services provided or the cost of these services.

Standards for purchasing and contracting by counties and special districts are generally provided for in KRS 68.005 (the county administrators code). These KACo self-insurance and loan programs are special county cooperative creations

that amount to quasi local government agencies and therefore should comply with policies and procedures found under KRS 68.005 for local governments.

RECOMMENDATION 4: POLICIES AND PROCEDURES FOR KACO TRUSTS

KACo's self-insurance, loan and re-insurance Trusts should follow the administrative policies and procedures required by state law to be followed by counties which created or join these programs. This should include the bidding of service contracts.

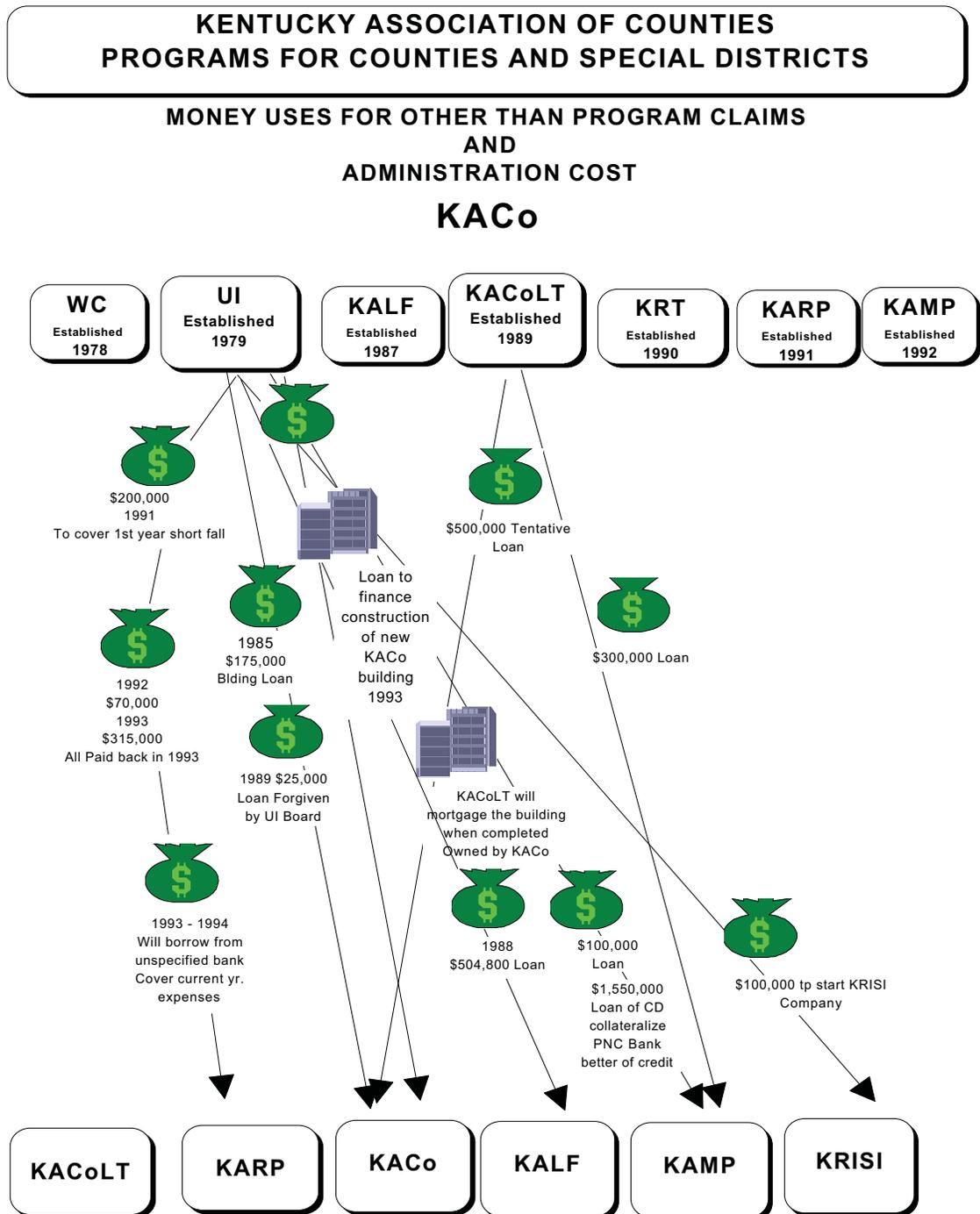
RECOMMENDATION 5: CONTRACTING AND PURCHASING REQUIREMENTS

All entities created under the Interlocal Cooperation Act including all local government self-insurance pools, trust, and loan programs should comply with the same policies and procedures for contracting and purchasing required of individual local governments as provided in applicable state laws. In the event a Model Procurement Code exists in Kentucky statutes for that unit of government, this Model Procurement Code should govern the operation of the created entity. In addition, all such entities should operate according to commonly accepted accounting and reporting procedures applicable to that type of entity.

Program Funds Are Being Used for Activities Unrelated to the Programs

Another area of concern that raises questions about the use of KACo program funds are the interrelated party transactions and the non program related uses. Figure 4.1 reflects several transfers of money among the KACo entities including interest free personal loans of up to \$100,000 to start the KRISI TPA and a \$25,000 loan to KACo which was forgiven. Other loans have been made to the KARP program to cover shortfalls. The loans are coming from two programs, the UI Fund reserve account and the KACo bond issue fund.

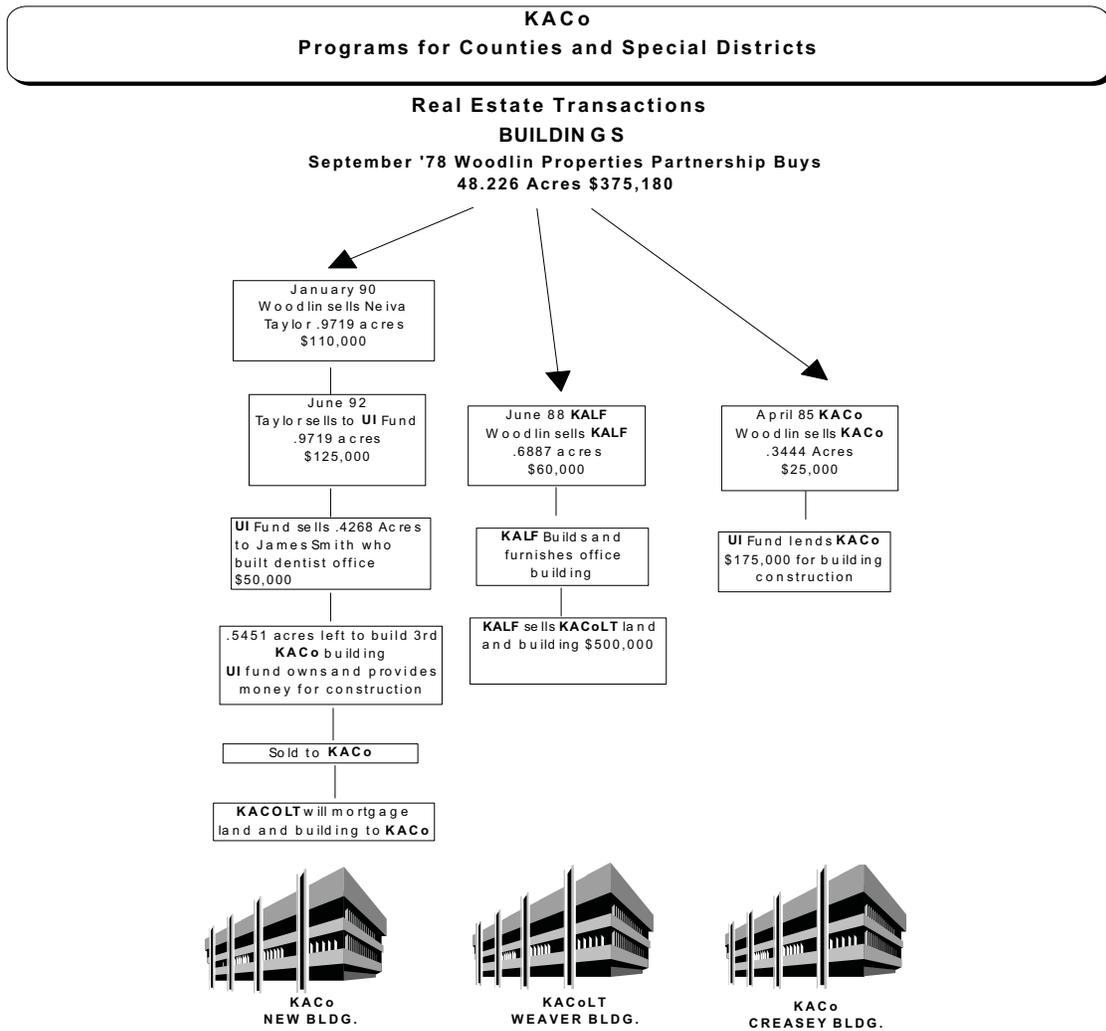
Figure 4.1{XE "Figure 4.1"}



SOURCE: Compiled by Program Review staff from information provided by the various KACo trusts.

In addition to these loans to other KACo related entities, funds are also being used for the acquisition of property as shown in Figure 4.2. Two buildings have been constructed using funds from UI, KACoLT and KALF. One additional building is being constructed from funds coming from the UI Fund and will be later mortgaged by KACoLT.

Figure 4.2{XE "Figure 4.2"}



SOURCE: Compiled by Program Review staff from information provided by the various KACo trusts.

CHAPTER V

PROGRAM ASSESSMENT

Counties have a legitimate need for the insurance and loan programs offered by the KACo Trusts. Their present levels of participation indicate a need for these programs. The KACo programs represent over \$330 million in borrowed and revenue funds, for which the participating counties could be held liable. Given the large amount of funds involved, it is incumbent to have adequate oversight. Currently, state agency oversight and monitoring by the Department of Insurance, Department of Local Governments, and other state financial agencies is severely limited. In addition, the boards who should be the representatives of the public in insuring the proper operation of these funds depend heavily on hired administrators to make program decisions.

KACo Programs Are Serving Many County Needs

Counties must insure against unanticipated losses arriving from disasters, accidents, law suits, as well as provide for employee medical, workers' compensation and unemployment insurance. According to KACo officials, KACo programs have been designed to provide this insurance at the lowest cost. Utilization of the programs and interviews with some county fiscal court officials seem to support a continuing desire to use these programs.

Program Review staff surveyed 17 county fiscal court officials to gauge their needs, attitudes and concerns about the KACo programs. This judgmental sample was drawn from counties that participate in the fund. With the exception of KARP and KRT (which is not a county participatory program), the survey responses were generally positive.

With the exception of the programs recently created, utilization of KACo programs has been generally high. Figure 5.1 below reflects the participation levels in KACo programs.

Figure 5.1{XE "Figure 5.1"}

KACO TRUST PROGRAM PARTICIPANTS

FUND	TOTAL PARTICIPANTS	COUNTIES	POLITICAL SUBDIVISIONS
KACo Workers Comp	535	117	418
KACoLT	61	54	7
KALF	569	76	493
KACo Unemployment Comp	458 ¹		
KARP	66	64	2
KAMP	50 ¹		
KRT	0 ²		

SOURCE: Compiled by Program Review staff.

KACo Programs Have Limited Oversight

Normally, an insurance company must conform with all the requirements of the insurance code. Self-insurance liability groups are not regulated as insurance companies. These groups are exempted from the insurance code under KRS 304.1-120 (6). Rather than licensing them as insurance companies, the Department of Insurance issues a Certificate of Filing that allows self-insurance groups to operate within the state with only limited oversight and regulation.

Several agencies have some degree of regulatory authority over self-insurance groups. The Department of Insurance approves and regulates KRT in a manner similar to other insurance companies. However, KALF is classified as a

¹Participants status not provided.

²There are no participants at this time.

county self-insurance fund. Under KRS 304.1-120 (6) KALF is exempted from Department of Insurance regulation and is required only to provide adequate coverage for claims made against participants, establish a comprehensive loss prevention and risk management program and file with the Department a Certificate of Filing which simply acknowledges their compliance with this section.

Due to disputes between KACo and the Department of Insurance about what information should be provided, the Attorney General determined in OAG 92-124 that the Commissioner of Insurance has the authority to determine if this trust fund is adequate. The commissioner can also investigate if insurance violations have occurred. Subsequently, the Department of Insurance has strengthened their regulations related to self-insurance pools to require more extensive information and documentation regarding actuarial soundness and other features pertaining to loss prevention and risk management.

RECOMMENDATION 6: REGULATE SELF-INSURANCE

The General Assembly should amend KRS 304 (The Insurance Code) to remove the exemption and to place self-insured liability groups under Department of Insurance regulation and oversight.

The Department of Local Government (DLG) has limited review of loans made to counties and the amount of bonding they undertake. DLG has no authority over any entity created through an interlocal agreement, such as the two loan programs offered by KACo, (KARP and KACoLT).

Given that organizations created by interlocal agreements are formed by other regulated public agencies, it would seem logical that the authority of the DLG would extend to these programs.

RECOMMENDATION 7: OVERSIGHT OF KACo LOAN PROGRAMS

The General Assembly should amend KRS 147A to authorize the Department of Local Government to review and oversee all county loan programs created through the Interlocal Cooperation Act.

The KACo Trust Boards Exercise Little Control over the Trust Programs

The TPAs, not respective boards, are the ones who really make all the important financial and programmatic decisions. Because they have a monopoly on the administration of these programs, it can be said that they are the programs.

The lack of Board control is further evident in statements made to Program Review staff during interviews with TPAs. Fred Creasey stated that he makes recommendations to the KACo Executive Board on who should be on the Boards of Trustees of the programs that KRISI administers. Richard Williams of Selective Management Services, Inc., said he had only been to one of the KALF Board meetings since he has been administrator for the program but thought one of his staff may have attended the meetings.

The Boards of Trustees are responsible to the programs they oversee and should take an active role in their administrative affairs. The Boards are accountable to the participating counties and therefore should control the financial and programmatic aspects of the trusts.

One of the reasons the Boards may not have as much influence as they should is due to Board appointment procedures. The KACo Executive Committee chooses Trustees for the Boards. The KACo Executive Committee is chosen by a vote of the KACo Board of Directors. Not all executive committee members' counties may participate in the programs for which they are making board appointments. Thus counties with membership in the programs are not assured

of direct input into the selection of Trust Board members. Trust Board membership should be decided by a vote of all member counties to increase their control over the programs.

Among TPAs There Are Many Instances of Interrelationships That Could Lead to Potential Conflicts of Interest

Many complex interrelationships exist between TPA's (see Figure 5.2). Phil Williams is General Counsel for all KACo programs, a Director on the Board of KRT Insurance Company, and incorporator of Selective Management Services. Fred Creasey resigned as executive director of KACo to take over the administration of the Unemployment Insurance Fund as a for profit private contract provider. He later took on the contract administration of all or part of three additional funds (KRT, KARP, KAMP). Mr. Creasey is also President of KRT Insurance Company, Secretary Treasurer of Government Services, and marketing agent for the KACoLT Program. Bob Harrod, administrator for the Kentucky Association of Counties Leasing Trust (KACoLT), resigned as County Judge Executive to take over the development of this program. He was appointed to the Board of Trustees for KACoLT and then was appointed to serve as chairman. While chairman, he created a private for profit company, KACo Administrative Services, Inc. and was awarded the sole contract to serve as the programs third party administrator. Bob Hart is TPA for the Workers' Compensation Program and Secretary Treasurer of KRT Insurance Company. John Griggs is Executive Director of KACo and Chairman of the Board of KRT.

Concerning whether there is a conflict of interest if the Chairman of the Board of Trustees is also the executive director of the private corporation serving as the third party administrator, which supplies services to the fund, the AG stated in OAG 94-1 that:

Conflicts of interest by trustees are generally viewed in terms of the potential for self-dealing as a violation of a trustee's fiduciary obligation. The trustee's employment as third party administrator was disclosed from the beginning and the situation was incorporated into the founding documents. A court might be reluctant to find that a trustee is in violation of his fiduciary obligation to the beneficiary when the beneficiary has specifically acknowledged that the alleged conflict should be incorporated into the documents creating the trust.

Additional Committee Recommendations

RECOMMENDATION 8: BOARD MEMBERSHIP

KRS 65.210-300 should be amended to require that the board of directors or trustees for entities created by interlocal agreements should have a majority membership representative of and appointed from participating units of government.

RECOMMENDATION 9: REVIEW KRT CERTIFICATE OF AUTHORITY

The Department of Insurance should review it's issuance of the Certificate of Authority for KRT Insurance Corporation. In the light of the Attorney

General's opinion 94-1 which indicates that the KRT Trust is not authorized to own a corporation or to use Bond proceeds to purchase a corporation.

Committee Action

The report along with recommendations was adopted by the Program Review and Investigations Committee at its January 10, 1994 meeting.

Legislative Action

Recommendation 6 was addressed in SB 361 (BR1615) - An act relating to liability self-insurance groups. SB 361 was referred to the Banking and Insurance Committee, passed the Senate 37-0, passed the House 85-2, and was signed by the Governor on April 8, 1994.

Recommendations 1, 2, 4, 5, 7, and 8 were addressed in SB 350 (BR 2091) - An act relating to local government. SB 350 was referred to the Senate State Government Committee, but was not acted upon..

CHAPTER VI

PROFESSIONAL EVALUATION REPORTS RELEVANT TO THE SEVEN KACO PROGRAMS

The program evaluations undertaken by the Program Review and Investigations Committee were complicated by the extensive and diverse nature of the seven KACo programs. To provide a more complete picture of these programs, and to evaluate their soundness, the committee requested the assistance of other government agencies and professionals in the fields of insurance actuarials, bond analysis, and financial auditing. The resulting reports served to confirm the findings and recommendations of the Program Review and Investigations Committee study. Because of their significance to this evaluation, the following four reports are summarized in this chapter:

- A management review of KACo and related funds, a contract audit by Eskew and Gresham through the Auditor of Public Accounts.
- A review of the KALF self-insurance program, including contract actuarial comparison by Tillinghast, for the Department of Insurance with an actuarial by Ernst & Young for KACo.
- An evaluation of the (four) KACo program actuarial assumptions, by Dr. Lawrence K. Lynch, under contract with the Legislative Research Commission.
- An evaluation of KACo Bond transactions, their soundness and legality, by Dr. James Ramsey; under contract with the Auditor of Public Accounts.

Auditor Of Public Accounts Report

(Management Review by Eskew and Gresham)

The Kentucky Auditor of Public Accounts (APA) office conducted its own audit of the KACo Trusts at the request of KACo. The APA presented this report to the Committee at its November 8, 1993 meeting and generated similar recommendations concerning the self-insurance and loan programs operated by KACo. The report generally agreed with the Committee's findings on the financial soundness of the KACo programs. However, APA recommendations were directed more specifically toward internal operations and controls.

APA recommendations (see Figure 6.1) included stricter budgeting and reporting requirements; reorganization of the management structure, with greater control and involvement by the Trust Boards in the operation of the funds; eliminating Third Party Administrators' direct responsibility for the funds; and establishing tighter controls over contracts with service providers. The report further recommended restricting inter-party transactions, and that internal controls over the use of program funds and travel and entertainment be more clearly defined. Finally, the report recommended that the KACo programs develop policies to safeguard the investment of funds.

Figure 6.1

Summary of Auditor of Public Accounts Recommendations {XE "Figure 6.1"}

**Kentucky Association of Counties
and Related Programs Management Review
Kentucky Auditor of Public Accounts
November, 1993**

Administrative Area	Recommendation
Internal Controls	Tighter controls over billing, cash receipts, payroll, cash disbursements, and fidelity bonding of employees for KACo and the 7 programs.
UI	All investments activity be appropriately detailed and provided in writing to the Fund's Board at each meeting.
Operating Expense	<p>Funds prepare written policies concerning travel and entertainment to include: the types of expenses consistent with the mission of the fund. Personnel authorized to incur T & E expenses. Types of T & E expenses requiring pre-approval, and to whom authority to approve T & E expenses is given.</p> <p>Only those employees authorized to incur T & E expenses be given access to Fund credit cards; personal transactions be prohibited, and all expenses not properly documented by receipt be considered personal and require reimbursement.</p> <p>Consider reducing the number of board meetings held out of state.</p>
Contracts with Service Providers	<p>Contracts or engagement letters be obtained in support of all major services to be provided.</p> <p>Formal bidding process for the following services: legal, accounting, reinsurance, trustee services, actuarial services, and claims administration.</p> <p>The funds' boards of directors participate in the review of competitively bid services.</p> <p>Contracts for administrative services be negotiated to provide for a fixed expiration date without automatic renewal.</p> <p>TPA's exercise more proactive oversight of claims administration.</p>

Research Report: Kentucky Association of Counties Self-Insurance Program

Administrative Area	Recommendation
Policies and Procedures	<p>Develop procedures for handling cash, billing, collections, cash receipts, cash disbursements and payroll processing.</p> <p>Document the flow of transactions necessary to carry out basic functions of each fund should be prepared.</p> <p>Develop a standard personnel policy and procedures manual across all funds (should be given a high priority).</p> <p>Written policies and procedures be developed in the area of information resources.</p> <p>Basic policies and procedures for the procurement of services.</p> <p>Several policies to safeguard the investment of funds.</p> <p>Policies to guide KACo's new program development efforts, including written proposals covering projected demand, present and expected competition, projected financial returns, capital requirements, and the types of outside services that would be required.</p> <p>Directors/Trustees and officers should only be comprised of persons from the member counties. Management of KACo or any other fund should be prohibited from being a director/trustee or officer other than the KACo executive director who may be named as Secretary/Treasurer. TPA's should also be prohibited from being board members.</p> <p>Term limitation, standardized fees and expenses, specific criteria for information reported in the board minutes, and establishment of a committee structure to allow greater efficiency in reviewing the operations of the funds and certain board decisions.</p>
Organization Structure, Mission and Strategy	<p>KACo consider a formal centralized organization structure for all the funds, and that all the operations of the separate funds be placed under the management of KACo and its Board.</p> <p>Funds establish centralized financial operations that are of sufficient capability to record transactions, process documents and report financial information for each fund.</p> <p>Primary responsibility of KACo and the funds be placed with the KACo Board, while maintaining separate boards of three to four members to maintain a more in-depth oversight of the funds.</p>

Research Report: Kentucky Association of Counties Self Insurance Program

Administrative Area	Recommendation
Contracts with Third Party Administrators	<p>An agreement covering the duties and compensation of the TPA be developed and implemented between KAMP and KRISI.</p> <p>These funds consider re-negotiating the contracts to provide for uniform 1-year contracts.</p> <p>Contracts not provide for automatic renewal or refer to "good cause" when discussing termination.</p> <p>Different formula be used for compensating the KACoLT TPA based on the amount of leases and loans outstanding.</p> <p>Agreements with GSC and SSI be rewritten to reflect the arrangements actually in use, rather than the present contract language.</p>
Related Party Activity	Restrict such inter-party transactions.
Policies and Procedures	KACo and its related funds develop and promulgate written policies and procedures.
Strategic Issues	<p>KACo improve the organization and operation of the financial functions.</p> <p>KACo adopt a formal strategic planning process, and prepare a comprehensive strategic plan document.</p> <p>KACo Board clearly articulate the purpose and intended uses of the excessive resources held by the KACoLT and KARP funds.</p> <p>KACo develop a sufficiently detailed business strategy for KRT and KRTIC which addresses these issues and clarifies their mission with respect to the other KACo funds.</p> <p>KACo take appropriate measures to meet the future obligations of KRT and KRTIC, and if appropriate, terminate the programs.</p>

Department of Insurance Report

(KALF Actuarial Comparison by Tillinghast and Ernst & Young)

The Department of Insurance was requested by the Committee to comment on the soundness of the KACo All Lines Fund (KALF), and presented its findings to the Committee at its November 8, 1993 meeting. After a review of the KALF actuary report, the Department of Insurance determined that the analysis, assumptions and recommendations of the report were based on sound actuarial judgment. However, the Department had some reservations concerning the report and declined to offer a final report until it received additional information from KACo.

Pursuant to the Committee's request on December 15, 1993, the Department of Insurance asked its retained actuaries at Tillinghast to reconcile any differences between their report of December 9, 1993, and the report performed by Ernst and Young on behalf of Kentucky insurance agents who compete with KACo. The following Figure 6.2 represents a comparison of those two reports:

FIGURE 6.2
Comparison of Department of Insurance Actuarial Review (Tillinghast) to Independent Insurance Agents Review (Ernst and Young) of KALF Actuarial Analyses

ERNST & YOUNG	TILLINGHAST
<p>Limitations of Reviews:</p> <p>E & Y believes a further detailed review of the actuarial report and the operation of the Fund is justified and necessary in order to arrive at any valid conclusion.</p>	<p>These comments are not the result of a "due diligence" level of review, and rely in part on information provided by KALF or its representatives.</p>
<p>Actuarial Report:</p>	
<p>Incurred and Paid Loss Pattern:</p>	
<p>Combining would substantially distort the indicated reserves.</p>	<p>Performing loss development analysis on a combined basis could mask true loss development patterns by coverage</p>
<p>Actuarial Report:</p>	

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<p>Industry Development Pattern:</p> <p>The actuary listed "industry" development factors, but did not explain where these factors were developed or what coverages were included.</p>	<p>Based on conversations with the actuary, the "industry" factors were based on eleven rural southern states that included a combination of property and liability coverage. Notwithstanding 1.a., Tillinghast was comfortable with the data used.</p>
<p>Actuarial Report:</p>	
<p>Tail Factors:</p>	
<p>The tail factors selected by the actuary statutory, thereby understating the indicated reserves.</p>	<p>Tillinghast indicated the projection of incurred losses was not unreasonable in light of their experience.</p>
<p>Actuarial Report:</p>	
<p>Indicated Development Pattern:</p>	
<p>Using data capped at \$100,000 to project development patterns capped at \$250,000 would tend to understate the ultimate losses for the last two policy periods.</p>	<p>KALF's ultimate losses are near the limit of its aggregate insurance protection for two of its last three policy periods.</p>
	<p>When their methodology is viewed in total, CACI's treatment of KALF's retention levels would tend to overstate KALF's losses, not understate KALF's losses, all else being equal.</p>

Research Report: Kentucky Association of Counties Self Insurance Program

<p>Actuarial Report:</p>	
<p>Selected Low Paid Development Factors:</p>	
<p>The resulting implications would appear to understate the ultimate losses on paid claims.</p>	<p>Tillinghast agrees with E & Y's observation.</p> <p>Tillinghast would place more weight on incurred loss projection due to the volatility in a paid loss projection.</p>
<p>Reserve Estimates:</p>	
<p>While we cannot be sure what the total impact would be, it appears that the indicated reserves could be understated. A detailed actuarial report is needed to draw conclusions.</p>	<p>Agrees with E & Y that the presentation of the reserve estimates in KALF's Financial Statements is a problem. Tillinghast believes that the CACI reserve estimates are not unreasonable. (However, Tillinghast found no documentation for CACI's low end of the range of reserve indications. This is an important number, since KALF's Financial Statement relies on it.</p>
<p>Unallocated Loss Adjustment Reserve:</p>	
<p>Based on industry norms that might or might not be appropriate, an unallocated reserve of anywhere between 5 and 10% of the total reserve would not be unreasonable. If this was appropriate for KALF, the current reserve would be deficient by an additional \$150,000 to \$300,000.</p>	<p>Because KALF is not an insurance company, and has a management contract for management, marketing, administrative, claims and investment service, it should not be assumed that insurance industry average ULAE loads are appropriate to include in loss reserves.</p>

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<p>Current Reserves:</p>	
<p>Based on the actuary's report, the current reserves are deficient by \$759,094, or 25.4% of the reserves.</p>	<p>KALF's bond structure appears to provide short-term security to claimants, and KALF appears to have sufficient resources from all sources to meet current obligations.</p>
<p>If an actuary was required to file an actuarial opinion with the Regulatory Officials, this indicated amount of deficiency could lead the actuary to issue a qualified or deficient opinion.</p>	
<p>On the surface, it appears that this fund is under reserve by a substantial percentage and the possibility exists that the adequacy of the reserves could be much higher.</p>	
<p>The current financial statements do not include the required GASB 10 exhibits that show a premium deficiency schedule and a 10-year historical reserve development schedule</p>	<p>Tillinghast concluded that the presentation of KALF's financial liability is materially optimistic and non-standard. Tillinghast agrees that KALF is not in compliance with GASB 10.</p>
<p>If you substituted the actuary's indicated reserve number in the balance sheet for KALF, the June 30, 1993 statement would show a members equity deficit of \$643,878).</p>	

Research Report: Kentucky Association of Counties Self Insurance Program

<p>Comparability of Financial Reporting and Actuarial Reporting:</p>	<p>The income statement does not attempt to match premiums and losses by policy period. Instead, the income statement accounts for the combined impact of all policy periods on the income of the current year. The premiums are compared to the losses paid during the current year from all policy periods, plus the change in the reserves from the beginning of the year to the end of the year.</p>	<p>This is a GASB 10 issue (see response under Financial Reporting).</p>
<p>Reinsurance Costs:</p>	<p>The reinsurance costs, as shown on the financial statement since inception, appear to be unreasonably high compared to recoveries and anticipated recoveries. To draw a conclusion regarding appropriateness, a review of all reinsurance agreements from inception to date would be needed.</p>	<p>Tillinghast did review KALF's "reinsurance agreement," and took no issue with CACI's treatment of them.</p>

SOURCE: Prepared by Program Review staff from reports by Tillinghast, December 28, 1993, Tillinghast, December 9, 1993, and Ernst and Young, December 8, 1993.

Evaluation Reports of KACo Program Actuarial Assumptions

(Dr. Lawrence K. Lynch)

At the request of the Program Review and Investigations committee, through a contract with the Interim Committee on Appropriations and Revenue, Larry Lynch reviewed the assumptions and methods employed in the actuarial assessments of the KACo All Lines Fund, Unemployment Insurance Fund, and the KACo-KLC Workers' Compensation Self-Insurance Fund, by Casualty Actuarial Consultants, Inc. (CACI). The Lynch Reports are provided in Appendix E. The following is a summary of his opinions and recommendations:

KACo All Lines Fund (KALF)

The CACI analysis was based upon reasonable assumptions and used appropriate methods to develop its estimate of KALF's outstanding liabilities for property and liability claims incurred through June 30, 1993.

The CACI analysis was based upon the claims information provided by Carroon. In performing its analysis, CACI found and corrected several coding errors, and found instances where expenses could not be linked to specific claims. It is recommended that an audit be conducted of Carroon's claims files, to ensure that they are accurate and timely.

KALF's exposure on liability claims was increased from \$100,000 to the current level of \$250,000 just two years ago. There is yet insufficient data to determine whether the claims development pattern or ultimate losses will differ materially under the higher SIR. It is recommended that a separate claims development analysis be conducted for the period of higher exposure, when data become available.

It is recommended that the valuation of potential very-high losses be closely monitored while litigation is pending or even before lawsuits are filed. KALF paid a \$1 million-plus loss on a liability claim in 1990-91; if several of such large losses were to be incurred within a brief time period, KALF would face a serious impact.

Unemployment Insurance Fund

The CACI analysis was based upon reasonable assumptions and used appropriate methods to develop its projections of losses and its assessment of premium income adequacy.

As more years of loss experience are added to the database, the statistical basis for estimated probability distributions of annual losses will become far more reliable. Meanwhile, it is recommended that the probabilities be based upon a t distribution rather than a normal distribution.

KACo-KLC Workers' Compensation Self-Insurance Fund

The CACI analysis was based upon reasonable assumptions and used appropriate methods to develop its estimate of KACo-KLC's outstanding liabilities for workers' compensation insurance claims incurred through June 30, 1992. The CACI rate analysis, too, was based upon reasonable assumptions and applied appropriate methods to develop its recommended rates.

It would appear, however, that the workers' compensation losses incurred by KACo-KLC have been higher than they ought to be, in comparison with other industries. It is recommended that the KACo-KLC workers' compensation program be reviewed by qualified insurance experts to identify the reasons for the high losses.

Report on KACo Bond Transactions

(Dr. James R. Ramsey)

At the request of the Program Review and Investigations Committee, the State Auditor of Public Accounts contracted with Dr. James R. Ramsey to issue a report to the Auditor's Office in June, 1993. The executive summary of that report, entitled Review of Kentucky Association of County Debt Issues, is as follows:

The Kentucky Association of Counties (KACo) and/or corporations created pursuant to the Kentucky Interlocal Cooperation Act (KRS 65.210-65.300) have incurred nearly \$300,000,000 in debt over the past six years. This report attempts to provide a background and analysis of the individual bond transactions.

It is concluded in the report that the KACo debt management program can be described as aggressive and complex. The transactions of KACo utilized creative financing techniques that are complicated and involved the services of numerous outside advisors and consultants. The transactions of KACo all involved variable rate debt and letters of credit. The economic viability of the KACo issues was dependent upon the ability of the issuer to earn investment income in excess of the interest rate on the variable rate bonds. For example, in one transaction the proceeds of the issue were to be used to establish a company to sell reinsurance to KACo-participating counties. The bond issue was completed prior to approval from the Department of Insurance to sell such reinsurance. This implies that the bond issue had to be structured to be self-supporting, since no guarantee of insurance premiums to cover debt service payments would be forthcoming. In the second transaction, KACo borrowed funds to help participating counties finance capital projects. Nearly three years into the project, less than 15 percent of the bond proceeds have been loaned for such projects.

KACo has borrowed for non-traditional purposes; i.e., the establishment of the reinsurance company. Normally, tax exempt bonds are used to finance long-term capital projects with a multi-year life. Short-term borrowing for cash flow purposes, etc., are common and accepted uses of tax exempt bonds; however, borrowing to establish a corporate entity is unusual.

As noted above, the KACo transactions are complex and involved the use of numerous consultants and advisors. An assessment of the legitimacy of the fees paid

to these advisors is difficult to determine, since it is the "bottom line" interest cost that determines the success of a bond transaction. Given the observations cited above that KACo, in certain instances, borrowed funds for purposes that were not completely defined, and given that the economic viability of these transactions depended upon the investment of the bond proceeds at interest rates in excess of the borrowing cost, it appears that outside advisors and consultants presented complex financing proposals to KACo, KACo endorsed these proposals, and then KACo borrowed funds with the hope that the funds would be utilized for the stated purposes.

Opinions of the Attorney General

The Attorney General, between July 6, 1993, and January 7, 1994, issued five opinions relevant to the seven KACo programs. The impact of those opinions is discussed in Chapter III and, where applicable, in other areas of this study. The five opinions are reproduced as Appendix D.

APPENDIX A

Research Report: Kentucky Association of Counties Self-Insurance Program

PURPOSE & MEMBERSHIP

KACo PROGRAMS	PURPOSE	MEMBERSHIP	BOARD OF TRUSTEES REQUIREMENTS	BOARD OF TRUSTEES INITIAL MEMBERS
KACo ALL LINES FUND KALF 9/1/87	Create a self-funded insurance trust for general liability, public officials' errors & omissions, police liability & other forms of insurance at a reasonable cost.	Political entities, agencies and subdivisions of KY. Criteria for membership or eligibility is determined by the Trustees.	No more than 5 members. First 2 years: Trustee must be an elected official, designated representative of a public agency or a political subdivision of KY or a representative of KACo. After 2 years: Trustee must be an elected official or designated representative from a public agency or political subdivision who is a trust participant and a designated representative of KACo.	Dave Pribble - Pendleton Bill Owens - Fleming Jim Allen - Clark Rod Maffet - Hardin Randall Phillips - Taylor Serves until their resignation or replacement
KACo TRUST LEASING KACoLT 1/24/89	Administer a pooled leasing program to finance capital and equipment needs.	Any public agency. Criteria for membership or eligibility is determined by the Trustees.	Three members	Robert Harrod (Chair) Franklin Sue Carole Perry - Shelby Denny Nunnelley - Woodford
KACo REVENUE PROGRAM KARP ADVANCE	Assist counties to meet public agencies' anticipated cash flow needs.	Any public agency. Criteria for membership or eligibility is determined by the Trustees.	Three members	Terry McKinney - Lyon Steve Watts - Rowan Stephen Tackett - Perry
KACo REINSURANCE TRUST KRT 6/19/90	Adopt a reinsurance program; finance program through the issuance of revenue bonds, notes, or indebtedness of the issuer.	Limited to the two parties of the trust. Party must participate in at least one self insurance pool.	Three members	John Griggs, Exec. Dir. KACo David Pribble - Pendleton Mike Miller - Marshall
KACo PROGRAM MEDICAL KAMP 7/1/92	Assist public agencies in providing health benefit coverage for the employees of the agency. Irrevocable trust for the benefit of the employees.	Any public agency. Criteria for membership or eligibility is determined by the Trustees.	Five members	David L. Pribble - Pendleton Denny Nunnelley - Woodford Carol Woodyard - Grant Nina Mooney - Bullitt Dwayne "Pie" Jett - Bracken

APPENDIX B

Research Report: Kentucky Association of Counties Self-Insurance Program

TRUSTEES

KACo PROGRAMS	BOARD OF TRUSTEES VACANCIES	QUORUM & PROXY	ANNUAL MEETINGS	OFFICERS
KACo ALL LINES FUND KALF 9/1/87	Vacancies due to death, resignation, or disqualification or inability to act may be filled by the remaining Board of Trustees.	Written proxy to the Chairman is allowed. Majority of current members is a quorum. Written proxies are not counted in determining the quorum.	The Board shall meet within a reasonable time after the appointment of the Board of Trustees and annually thereafter to elect officers and transact business. Other necessary meetings may be requested in writing by the Chairman or by 2 members of the Board.	Chairman and Vice Chairman are elected. The Board designates a Secretary - Treasurer to keep minutes and records and sign all checks on behalf of the trust.
KACo LEASING TRUST KACoLT 1/24/89	Vacancies due to death, resignation, or disqualification or inability to act may be filled by the action of KACo.	Written proxy to the Chairman is allowed. Majority of current members is a quorum.	The Board shall meet within a reasonable time after the appointment of the Board of Trustees and annually thereafter to elect officers and transact business. Other necessary meetings may be requested in writing by the Chairman or by 2 members of the Board.	Chairman and Vice Chairman are elected. The Board designates a Secretary - Treasurer to keep minutes and records
KACo ADVANCE REVENUE PROG. KARP June 1991	Same as above	Same as above	Same as above. The trust will comply with the open meetings act.	Same as above
KACo REINSURANCE TRUST KRT 6/19/90	Vacancies due to death, resignation, or disqualification or inability to act may be filled by the remaining Board of Trustees. If all Trustees resign, their replacements may be named by the Administrator	Same as above	Same as above	Same as above
KACo MEDICAL PROGRAM KAMP 7/1/92	Vacancies due to death, resignation, or disqualification or inability to act shall be filled by the action of KACo.	Same as above	Same as above The trust will comply with the open meetings act.	None

APPENDIX C

KACo Workers' Compensation Self-insurance Fund

In 1978, KACo and the Kentucky League of Cities joined together to form a self-insurance program for workers' compensation. However, effective July 1, 1993, the KACo-KLC program was split into two separate continuation programs: the KACo Workers' Compensation Program and the KLC Workers' Compensation Program. One hundred and seventeen counties participate in the KACo program. Jefferson, Fayette and Muhlenberg opted not to participate. Four hundred and eighteen special districts and public agencies have also paid premiums for FY 1993-94.

The program is governed by a five-member Board of Trustees. The members are appointed by the KACo Board of Directors. The Board members are:

David Pribble	Pendleton
Sue Carole Perry	Shelby
Chester Henderson	Boone
Freddie Combs	Perry
Harold Taylor	Daviess

The Board of Trustees appoints the Third Party Administrator, which is responsible for the daily operations of the fund. The Third Party Administrator is Governmental Services, Inc., which has an executive director and eleven administrative staff members.

KACo Unemployment Compensation Self-insurance Fund

UI

In 1979, KACo established the Unemployment Compensation Self-insurance Fund (UI) to allow eligible governmental entities to establish a group account as reimbursing employers. All 120 counties are represented by program participants.

The UI Fund is governed by a seven-member Board of Trustees approved by the KACo Board of Directors. The UI Fund Board members are:

Ray Bailey, Chairman	Bath County
Denny Nunnelley	Woodford County
Bobby Brady	Washington County
Terry McKinney	Lyon County
Nina Mooney	Bullitt County
Ralph Smith	Livingston County
Glenn "Tuck" Evans	Simpson County

The Third Party Administrator is Kentucky Related Insurance Services, Inc. (KRISI). Fees paid to KRISI are determined by the UI Fund's Board of Trustees. KRISI has identified Fred Creasey as the owner and executive director; there are three administrative staff members.

In FY 1992, the UI Fund had revenues of \$1,896,506 and expenditures of \$1,710,632, ending the fiscal year with \$185,874, to be placed in reserves for future claims. The UI Fund total balance ending FY 1992 was \$6,210,000.

KACo Leasing Trust

KACoLT

The KACo Leasing Trust (KACoLT) was established January 24, 1989 to provide a lease financing program. The program offers counties the option to finance or refinance the acquisition, construction, maintenance or improvement of public facilities. Any public agency may participate. Eligibility criteria are determined by the Board of Directors. Approximately 60 counties, special districts or public agencies have participated in the program.

KACoLT is governed by a three-member Board of Trustees. Board members are:

Bob Harrod	Executive Director/Owner, KAS
Denny Nunnelley	Woodford County
Sue Carole Perry	Shelby County

KACo Administrative Services, Inc. (KAS) is the Third Party Administrator. KAS's administration fee is .25% or 1% of the total revenue bonds issued by the Trust and Pendleton County on behalf of the Trust. KAS has received \$500,000 annually in administration fees. KAS identified Bob Harrod as the owner and executive director; there are two full time and one part time administrative staff members.

KACo also provides administrative, monitoring and marketing assistance to KACoLT. In exchange, KACoLT is considered an associate member of KACo and pays dues to the organization. In 1993, KACoLT has paid \$37,274 to KACo as dues.

The KACoLT Fund balance as of March 31, 1993, is \$7,599,993.

KACo All Lines Fund

KALF

The KACo All Lines Fund (KALF) was created in September 1987 to provide a self-insurance pool for property and casualty insurance needed by counties and political subdivisions. KALF was initially financed through a \$25 million bond issue. Information provided by KALF staff identified 569 entities participating in the program. Participants include counties, special districts, ADDs, associations and public agencies.

KALF is governed by a five-member Board of Trustees. Trustees are:

David Pribble	Pendleton
Bill Owens	Fleming
Jim Allen	Clark
Rod Maffett	Hardin
Randall Phillips	Taylor

The Third Party Administrator is Selective Services, Inc. (SSI). Governmental Services, Inc. (GSI) has assigned the contract with KALF over to Selective Services, Inc., with no fees or obligations assigned to GSI. SSI receives 12.5% of premiums collected as its administration fee. SSI has identified Richard Williams as the company president; there are two executive vice president's, one secretary/treasurer and four administrative staff members. As an additional service provider KACo receives 2% of the gross contribution from each participant's premium as a marketing fee.

In FYE June 30, 1992, KALF reported total revenues of \$8,432,626 and total expenses of \$8,431,590, for an excess in revenues of \$1,036. The cumulative fund balance is \$111,275.

KACo Reinsurance Trust

KRT

The KACo Reinsurance Trust (KRT) was created in May 1990 to help counties and other public agencies obtain affordable insurance. KRT fund issued a \$50 million revenue bond to finance a reinsurance company, the KRT Insurance Company, Inc. The KRT Insurance Company can reinsure any governmental entity. However, KACo All Lines Fund has been the only client to date.

The KRT Insurance Company, Inc. is governed by a three member Board of Directors. Board of Director members are:

Fred Creasey	President
Bob Hart	Secretary/Treasurer
Phil Williams	Director

The KRT Fund is governed by a three member Board of Trustees. Board members are:

John Griggs	Executive Director, KACo
David Pribble	Pendleton
Mike Miller	Marshall County

The Third Party Administrator of the KRT Fund is chosen by the Board of Trustees. Kentucky Related Insurance Services, Inc. (KRISI) is the Third Party Administrator. KRISI has identified Fred Creasey as the owner and executive director and five administrative staff members.

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A 1991 Statement of Income and Expenses identified total revenues of \$2,490,359 and total expenses of \$2,941,248 for a net loss of \$450,889.

KACo Advanced Revenues Program

KARP

KACo Advanced Revenues Program (KARP) was created in July 1991 to arrange short-term loans for counties and public agencies. Although the primary purpose of these loans is to cover monthly cash flow deficits at the beginning of a new fiscal year, counties may use the proceeds for investment purposes alone.

KARP was initially funded by a \$42,965,000 bond issue. In the first year of operation, 52 counties participated in the program. Currently, 64 counties have signed up to participate.

KARP is governed by a three-member Board of Trustees. Board members are:

Terry McKinney
Steve Watts
Stephen Tackett

Lyon County
Rowan County
Perry County

The Board of Trustees selects the Third Party Administrator. The Third Party Administrator is Kentucky Related Insurance Services, Inc. (KRISI). KRISI has identified Fred Creasey as the owner and executive director; there are five administrative staff members.

The first fiscal audit of the KARP Fund has just been completed. No financial information regarding fund revenues, expenses or fund balance was made available to Program Review staff.

KAMP

The KACo Medical Program (KAMP) was created July 1, 1991 to provide health and accident insurance coverage for county employees under a self-insurance trust program. Presently, KAMP serves approximately 50 counties.

The program is governed by a five-member Board of Trustees. Trustees are:

David L. Pribble	Pendleton County
Denny Nunnelley	Woodford County
Carol Woodyard	Grant County
Nina Mooney	Bullitt County
Dwayne "Pie" Jett	Bracken County

The Board of Trustees may enter into a contract with an administrator chosen by the Directors. The primary Third Party Administrator is Multi Benefits System of Kentucky, Inc. (MBS). MBS provides the administration of claims, billing and case management. It receive 5% of collected premiums.

There are several service providers to KAMP. Additional service providers, their service and fees are: 1). Kentucky Related Insurance Services, Inc. (KRISI), Boyce & Associates, Inc., receives 1.25% of collected premiums as an administrative fee; 2). a marketing firm, paid 5% of collected premiums; 3). Shenandoah provides general insurance coverage. In FY 1993, Shenandoah was paid \$3,256,074. 4). ESLU, a managing general broker, provides reinsurance. ESLU receives 6.5% of collected premiums. 5). Health Group Benefits Company (HGB), a cost containment company, receives claims over \$5,000 for review. HGB receives \$75 per hour for case management and 25% of savings resulting from audits. 6). Re Stat Co. covers pharmaceutical claims.

Research Report: Kentucky Association of Counties Self-Insurance Program

In FY 1993, KAMP had \$6,452,006 in cash available. The disbursements for the year totaled \$5,332,251, for an ending cash balance of \$1,119,755.

INSERT KY RELATED INSURANCE SERVICE, INC. CONTRACT
STATUS REPORT FOR KACO MEDICAL PROGRAM

APPENDIX D

APPENDIX E