

LAC

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A Review of the South Carolina Insurance Reserve Fund

Members of the General Assembly requested that we conduct a limited review of the state's insurance reserve fund (IRF). The insurance reserve fund is a section of the State Budget and Control Board's Office of Insurance Services and serves, in effect, as an "insurance company" for state and local governments.

This audit focuses on the effect of loans and transfers of revenues from the insurance reserve fund trust account. We found that these loans and transfers have caused state agencies and local governments to pay higher insurance rates. In addition, we examined the administration of the IRF, including the procurement of insurance from private insurance companies.

Loans and Transfers of IRF Funds

We examined the amount of loans and transfers that the General Assembly has authorized to be made with IRF surplus funds. As of June 30, 1994, the IRF had approximately \$120 million in surplus.

We found that \$55 million of this amount has been loaned to state agencies or is reserved for loans to state agencies under two programs. In addition, from time to time, the General Assembly has authorized other loans of IRF funds.

Installment Purchase Program

In 1981, the General Assembly authorized up to \$35 million of the IRF's funds to be loaned to state agencies for various purposes. These loans have been at below-market interest rates.

- For two long-term loans that we examined, the IRF could have earned \$5.2 million more from 1984 through June 1995 if the funds had been invested in United States government bonds.
- From 1982 through March 1988, state agencies obtained 35 short-term loans totalling \$5.47 million. The IRF received an interest rate on these loans of 8% and could have earned an average interest rate of 10.24% from short-term United States treasury notes.

- From April 1988 through January 1995, 45 loans totalling \$12.4 million were made. The IRF received an interest rate of 6.5% and could have received an average rate of 7.25% from United States treasury notes.

Impact of Loans and Transfers

- § Loans and transfers of IRF funds negatively impact the insurance reserve fund in several ways. The IRF uses investment income to lower premiums state agencies and local governments must pay. Therefore, when IRF funds are loaned to agencies at below-market interest rates, state agencies and local governments, in essence, must pay higher premiums to subsidize these loans. The IRF has less revenue available to pay for losses in the event of a catastrophe or emergency.
- § In 1989 the federal government claimed part of the funds that were transferred from the IRF to the state's general fund, and the state paid \$4.9 million to settle the claim. Additional transfers of IRF funds to other accounts might require the state to pay the federal government a share of any transfer.

Savannah Valley Authority

In 1987, the General Assembly authorized that up to \$20 million of the IRF's surplus revenue could be loaned to the Savannah Valley Authority (now a division of the Department of Commerce).

- As of January 1995, \$11.2 million had been loaned to the SVA and the outstanding balance owed was \$10.8 million.
- The loans are made at an interest rate of 8% for up to 30 years. By comparison, long-term United States bonds paid a weighted average interest rate of 7.63% for the same time period. In the competitive bid market, SVA loans would probably pay a higher rate because they are riskier than United States government bonds.

Additional Loans and Transfers

The General Assembly has authorized additional loans to be made with IRF funds for capital improvements and other state government obligations.

- In 1993, \$2.5 million was loaned to the general fund to pay for a portion of the Catawba Indian settlement.
- Six loans totalling \$11.4 million have been loaned to finance various state projects such as building construction and labs. As of June 1994, these loans had an outstanding balance of more than \$5.8 million.

From 1978 through 1992, the General Assembly transferred \$42 million from the IRF to the state's general fund.

- From June 1978 through June 1981, \$632,269 was transferred to pay for improvements to a water system on Broad River Road.
- In June 1984, \$32 million was transferred to the state's general fund.
- In 1992, \$9.5 million was transferred from the IRF to the state's general fund. If the \$9.5 million had not been removed, an additional \$2.3 million in interest income could have been earned between March 1992 and June 1995.

Administrative Issues

The IRF contracts with private insurance companies for certain lines of insurance. Our review of contracts for automobile liability, property reinsurance, and medical malpractice reinsurance found the following.

- The IRF has the potential to reduce operating losses by up to \$1.7 million annually through self-insuring automobile liability insurance.
- The IRF should consider seeking bids for property reinsurance and medical malpractice insurance to determine if better coverage can be obtained.

We reviewed a sample of the IRF's expenditures for FY 92-93 and FY 93-94 to determine if the expenditures were related to the functions of the IRF. We found no material problems.

Agency comments to the audit begin on page 25.

Uncollected Premiums

- § The IRF has not taken steps to collect premiums when counties and state agencies do not pay. As of February 1995, more than \$7.8 million was owed. Approximately \$2.2 million was 120 days past due, and some delinquencies are approximately 5 years old.
- § More than \$27,000 in insurance debts owed by state and local governments have been written off since 1989; we could not find specific statutory authority which would allow debts to be written off.

Copies of all LAC audits are available to the public at no charge. If you have additional questions, please contact George L. Schroeder, Director.