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b. A self-insured program with claim administration provided contractually either by an independent service firm or by an insurance company. It would seem that ALPAC might be agreeable to affording such services at reasonable cost. This could be a desirable arrangement, because of the relationship that already exists with this firm and because INA Corporation is heavily involved in self-insurance administration through its subsidiary, Employers Self Insurance Service. However, there are other firms and insurance companies that could provide claim administration services for the State of Alaska and all avenues should be investigated, as costs will vary.

Under any self-insurance plan it would not be desirable to assume the entire risk. It is recommended that insurance be purchased excess of a fairly substantial amount per occurrence. In this way, the State would assume normal and reasonably predictable losses, but would be protected against the financial consequences of the remote, but possible, catastrophic loss involving multiple deaths and injuries. The exact level of excess insurance chosen will depend to a great degree upon premium cost. It is recommended that the retention level be not less than \$100,000 per occurrence nor more than \$250,000 per occurrence.

Presently the employer's liability exposure for crew members of the Alaska State ferries is insured under the "protection and

indemnity" section of the marine policy. All other workmen's compensation and employer's liability exposures are insured under the ALPAC policy. Because of the possibility of borderline cases that might fall within a "gray" area between Federal laws and the Alaska Workmen's Compensation Act, many disputes regarding jurisdiction may be avoided by treating the State's entire workmen's compensation and employer's liability exposure in the same manner. If the State opts for self-insurance, the exposure for all employees should be self-insured. Likewise, if some form of insured plan is retained, the entire risk should be handled by the same insurer.

4. General Liability Risks

A review of the State's general and automobile liability loss experience (Schedule IV) indicates that losses are not highly predictable. Compared to the workmen's compensation experience, the number of liability claims incurred annually is relatively low and the size of claims fluctuates within a fairly wide range. Nevertheless, self-insurance of the liability risk appears desirable because

- Under the present insurance program the loss rating plan operates to impose upon the State all financial consequences of these risks over a period of years, without limit.
- Costs should be lower under a self-insurance plan.
- The last time specifications were sent out requesting bids for auto, general and malpractice liability insurance, the

only response was ALPAC's quotation. Although this would indicate that there are no other insurers interested in providing primary liability insurance, we believe there should be a good market for excess liability coverage.

Under a liability self insurance program, it may not be feasible for the State to administer its own claims, except for minor general liability and auto claims. During the first several years of self insurance, it would seem desirable to arrange for claim administration to be provided contractually by an independent service firm or by an insurance company.

As recommended in the previous section on workmen's compensation, excess insurance should be arranged above a retention level ranging from \$100,000 to \$250,000 per occurrence.

We believe a properly designed workmen's compensation and liability program, incorporating elements of self-insurance and excess catastrophe insurance, can result in annual savings that should range from 10% to 20% of incurred losses. Since losses were incurred last year in the total amount of approximately \$700,000, the dollar amount of savings may range from \$70,000 to \$140,000.

5. Funding - Workmen's Compensation and Liability Self Insurance

If the State decides to self-insure workmen's compensation and general liability risks, it will be necessary to establish a self-

insurance fund. The size of such a fund need not exceed a figure roughly equivalent to the present insurance premium increased by a modest percentage factor to allow for such contingencies as inflation and expansion of State activities creating risks. The rationale for this statement is as follows:

- a. Premium under the current ALPAC "retention plan" is the sum of two factors: (1) expenses, and (2) incurred losses. The term, "incurred losses" includes actual cash amounts paid out plus reserves for open claims, such reserves being the claim adjuster's estimate of the total amounts for which claims will ultimately be settled.
- b. The pay out period for workmen's compensation and liability claims is quite long. Recently, the Kemper Group of insurance companies surveyed a sampling of the major states through the United States to determine a representative ratio of cash pay-out to incurred losses. Their survey indicated that insurance company industry-wide workmen's compensation experience in this regard is approximately as follows:

<u>Year paid for losses incurred the first year</u>	<u>Percentage paid of incurred losses</u>
First year	34%
Second year	31
Third year	13
Fourth year	6
Fifth year	4
Sixth year	3
Seventh year	3
Eighth year	2
Ninth year	2
Tenth year	2

The cash pay-out on incurred liability losses is even slower. For example, on auto bodily injury liability claims two major insurers show a pay-out ranging from 18 to 26% the first year. Even more pronounced is the delay in cash payment on general liability (other than auto) claims, where one major insurer averages 16% the first year and another only 7%.

- c. It is apparent then that the cash claim pay-out in the initial year of a self-insurance program would be substantially less than incurred losses, which last year totalled slightly more than \$700,000.
- d. In addition to the cash pay-out on claims, costs will be incurred for claim handling, safety and excess insurance premiums.

These costs must be determined in order to make a final decision with regard to feasibility of self-insurance. We expect that costs under a self-insurance program will be lower than costs developed under the current "retention" plan.

Estimated standard premium under the ALPAC "retention" plan is \$1,133,132. Essentially, this figure is arrived at by multiplying estimated payroll of \$105,481,186 by a composite rate of approximately \$1.07%. It is suggested that the size of the initial fund be set by multiplying estimated FY 1972-73 payroll by this rate. For example, if the FY 1972-73 payroll estimate is, say, \$115,000,000, the amount of the fund would be \$1,230,500, using this method. This should be more than adequate, if appropriate "excess" insurance is purchased, as previously recommended.

Incurred losses for FY 1970-71 amounted to slightly more than \$700,000. Even if FY 1972-73 incurred losses were double this amount, or \$1,400,000, a loss fund of \$1,230,500 would be adequate to handle all cash payments during the year. If cash pay out on incurred losses is 40% (or almost 20% higher than industry-wide average), a balance of \$670,500 would remain for claim and safety administration costs and excess insurance premiums, clearly much more than needed.

Absolute certainty with regard to claim fluctuations can be achieved by purchase of "aggregate excess" insurance, although this may involve an unpalatable premium charge. Perhaps a better alternative would be a standby loan agreement with another State fund or with a bank or other financial institution.

The self-insurance loss and expense fund should be set up in a manner to allow:

- excess funds to be carried over from year to year, and
- interest on fund assets to accrue to the fund.

Thus, as the fund grows in size over a period of years, the retention level under excess insurance contracts can be gradually increased, thereby reducing excess insurance costs.

Within the last several years, three very large governmental bodies in Southern California have set up workmen's compensation self-insurance programs. In each case the initial self-insurance loss fund was established in substantially the same manner we are suggesting, i. e., the size of the fund was based on current premium rates.

6. Airport Liability

As more fully described in Section III the State's airport liability insurance program provides inadequate limits of liability. A limit of \$50 million per occurrence is the minimum amount of coverage that

should be considered. This should be a blanket limit covering all airports. After this is accomplished, the market should be tested for the availability and cost of an additional \$50 million in coverage for the Anchorage and Fairbanks International Airports, because of the Boeing 747 traffic at these airports.

An airport liability risk retention program, accomplished by means of a large deductible, will most likely not prove to be economically feasible, because

- Large losses are relatively infrequent and unpredictable
- Any significant loss requires expert claim handling and legal attention.

Nevertheless, a deductible sufficient to eliminate small slip and fall and aircraft property damage claims should be considered. The insurer's loss records do not show details on individual losses, but probably a deductible of from \$1,000 to \$5,000 per occurrence will eliminate practically all frequently occurring claims. The insurer should be asked to indicate premium credit for deductibles of this size.

7. Aircraft Liability

As recommended in Section III of this report, aircraft liability insurance should be broadened, should apply to both owned and non-owned aircraft and the limit of liability should be immediately increased to \$20 million per occurrence. When the recommended

excess liability program is arranged, coverage should then be increased to \$50 million per occurrence. A deductible is not recommended.

8. Excess Liability

A broad blanket excess liability insurance program is recommended to cover the State against all liability, marine and non-marine, to a limit of at least \$50 million per occurrence. The exact form which this insurance will take cannot be specified in advance, because much depends upon arrangements which can be negotiated with the various underwriters by careful assembly and skillful presentation of all pertinent facts. Excess underwriters will require underlying policies covering the different categories of liability risks with limits ranging from perhaps as low as \$1 million to \$10 million or higher.

It may be possible to arrange a single policy contract to cover all types of liability risk, both marine and non-marine. This would be very desirable, because it would eliminate possible gaps in coverage and simplify unusual loss adjustments. It may be necessary, however, to break out certain specific liability coverages.

It will require a great deal of professional skill and knowledge to arrange the placement of this coverage on the best possible terms. It is important that both primary and excess liability coverages be melded together in a most cohesive manner, so that all gaps and

redundancies in coverage are avoided and the broadest possible coverage is afforded for risks of catastrophic potential. Furthermore, placement of the coverage must be accomplished at the best possible cost, but in stable and financially strong markets.

9. Marine Risks

a. Marketing

There are only three marine underwriting sources available to provide insurance on the ferry fleet: (1) The San Francisco "Hull Committee," (2) Non-committee companies, and (3) Lloyds of London and foreign insurance companies. It should be pointed out that on marine risks of this magnitude there is only limited market capacity and little true competition.

The values of the Wickersham and Malaspina-class vessels make it imperative that a large part of the marine market be involved in completing placement of the insurance on this particular fleet.

Present underwriters consist principally of domestic insurers (both committee and non-committee), although a small percentage is underwritten in the foreign market.

During the previous policy term, coverage was placed with Underwriters at Lloyd's London (83.22%) and various companies in London (16.78%). Their quotation on the renewal was substantially higher - 2.345% compared to the rate of 2.04861% obtained

through domestic insurers. Presently, the domestic market is more competitive than London, and fortunately it was possible to obtain sufficient capacity in the domestic market to place the entire line at the more favorable rate. In the future, however, it may be necessary to utilize both the domestic and the London market, because of the greatly increased values resulting from the lengthening of Malaspina-class vessels.

Because of the very limited market for a major marine risk such as this, sending bid specifications to numerous underwriting sources is a waste of time. A risk such as this is subject to rating by the San Francisco "Hull Committee" which sets the rate for all of its member companies. Also, the situation in Lloyds of a marine underwriting leader setting the rate pattern tends to limit any serious competition in that market. The non-committee domestic market is not strong enough to become a potent factor, unless the risk does not involve large hull values.

Allowing various brokers to compete for the business is also not recommended. With only three major underwriting sources to contact, the market is pretty well blocked to any competing brokers on a fleet the size and value of this one. In fact, requesting other brokers to bid without giving them an exclusive "broker of record" letter would be detrimental. Several brokers

in the market at the same time causes much confusion and can result in some underwriters refusing to become involved.

If the State desires alternative concepts, this should be done by interviewing brokers and asking them for their ideas. With a market situation of such limited nature, the holding broker, Robert O. Fleming & Co., would likely be able to block the efforts of any other broker who was given the opportunity to quote on the fleet. The holding broker would have access to "committee" companies and non-committee markets who are currently on the policy. This would leave very little market available for other brokers to obtain firm proposals, other than the possibility of the London market. Other brokers, who could be called upon, would at the very best only be able to give a broker's proposal and would not be able to provide firm commitments without a broker of record letter.

It would not appear likely that another broker would be able to obtain a lower rate than that which is currently available to Robert O. Fleming & Co. The only area of cost consideration would seem to involve the commission that is being paid on the ferry fleet insurance. Information in the file indicates total commission of 12%. Apparently Robert O. Fleming obtains an 8% commission and the remaining 4% is split between the servicing agent and the Agent's Association.

In most cases, the major national brokerage firms could handle an account of this size for a service fee or commission of 5%.

Because of the arrangements with the Alaska Agent's Association and the servicing agent in Juneau, there seems to be a need to obtain higher than normal commissions. Although this increases the premium cost proportionately, it is very possible that the State may feel the services afforded are worth the additional cost.

The Fish and Game fleet consists of small and medium-size "fishing" vessels, which are excluded from the jurisdiction of the San Francisco "Hull Committee." Therefore, the insurance on such vessels may be placed on any terms and conditions the broker can arrange. As with the ferry fleet, Robert O. Fleming & Co. is the placing broker. The lead underwriter is the United Pacific Insurance Company, which is managed by the American Insurance Marine Agency (AIMA).

In Section III of this report it is recommended that hull and machinery insurance be carried only on the three larger vessels (Resolution, Montague and Kittiwake) and that this coverage be dropped with regard to the other vessels. If this is done, it would seem most desirable to add coverage (hull and machinery and protection and indemnity) for these three vessels to the policy covering the ferry fleet. This would accomplish the following:

- Uniformity of coverage on all owned vessels
- The ferry fleet policy provides broader coverage than the current Fish and Game fleet policy
- Possible savings in premium and rate stability

b. Coverage

i. Excess or increased value. The ferry fleet policy grants permission to purchase excess or increased value insurance to an amount not exceeding 25% of insured valuation of vessels. Increased value policies extend the amount of hull insurance but are written separate from the full-form hull policy, covering only total loss of the vessel and certain other types of losses which exceed the amounts recoverable in the full-form hull policy. Because it covers only total loss, the premium rate for an increased value policy is considerably lower than that charged under a full-form hull policy.

The present amounts of insurance on the ferry vessels are substantially less than replacement cost. It is recommended that serious consideration be given to purchase of increased value insurance on the Malaspina-class vessels, the Tustamena and the E. L. Bartlett. We understand the State contemplates replacement of the Wickersham with a new vessel to be constructed in the U. S. Since the Wickersham is a foreign

bottom vessel, it is considered undesirable for the ferry fleet, because of its inability to travel between two U.S. ports. Therefore, its present insured value is probably adequate. We are told the Chilkat would not be replaced, if destroyed, and its approximate actual cash value would appear adequate for insurance purposes.

ii. Loss of revenues

As pointed out in Section III, loss of use of a large ferry during the three summer months would result in an increase in the ferry system deficit. Substantial revenues could be lost, while most expenses would have to be continued. For example, the Taku grounding resulted in loss of its services for 22 days. Estimates indicate this resulted in over \$200,000 in lost revenues, while most expenses continued. An accounting study should be made to more accurately measure this loss exposure. Then, a premium indication should be obtained from the broker, to determine whether insurance is economically feasible. Present practice is unplanned self-assumption of a risk with apparent loss potential of \$1 million or more.

iii. Non-owned vessels. The State presently is uninsured for liability arising out of use of most non-owned boats and vessels. The ALPAC general liability policy excludes all inboard motor boats and vessels and outboard motorboats

and vessels and outboard motor boats where such watercraft are used to carry persons for a charge or while rented to others. Since the State very often uses non-owned watercraft, a substantial potential liability exists. Therefore, coverage for this exposure should be arranged, either under the proposed excess liability program or under a combination of primary and excess coverages. The exact form the coverage should take will depend upon cost and coverage forms available in the marketplace.

iv. Liability limits

Protection and indemnity limits are inadequate under present policies to cover the remote, but possible, catastrophe.

Liability coverage should be increased to a limit of at least \$50 million. This will involve inclusion of marine liability under the proposed excess liability insurance program, but may also involve increased limits under the primary marine policies in order to arrange excess coverage on the most satisfactory terms.

v. War risks

War risks insurance is not often purchased for vessels used in coastal waters, as the possibility of loss is extremely remote. Presently, no coverage is purchased for war risks for either the ferry fleet or the Fish & Game

fleet. Because the loss potential is significant and insurance may be available, the State should again consider this matter and make its decision a part of written risk management policy.

c. Risk Retention

The present policy covering the ferry fleet carries a \$1,000 deductible on hull claims and P & I claims to ferry slips, landing stages, wharves, piers, etc., and \$250 on all other claims. The policy covering the Fish and Game fleet provides for deductibles ranging from \$1,500 to \$7,620. The bid file indicates that increasing the deductible on the ferry fleet policy to \$100,000 on hull and dock damages and \$1,000 on all other claims will result in an annual premium reduction of \$66,190. A determination should be made as to how much additional credit would be allowed for an "across the board" \$100,000 deductible on all losses. Since a deductible of this size would eliminate all frequently occurring losses, a deductible of no less than this amount is recommended. Higher deductibles should also be considered, if economically attractive.

Premium credits should be determined for per-occurrence deductibles ranging from \$100,000 to \$250,000 and for annual aggregate deductibles of \$500,000 and \$1,000,000.

We anticipate that premium credit for a flat deductible of \$100,000 per occurrence will appear more attractive than

higher deductibles. It is doubtful that premium credit for very high deductibles will seem commensurate with the additional risk assumed. It is frequently argued that low deductibles are preferable to high deductibles, because rate credits are insufficient at higher levels. Yet, it is misleading to look at premium dollars credits alone.

Deductibles at a high level have other advantages than the immediate reduction of annual premium. For a marine account of this size, rates and premiums will follow loss experience over a period of years. As losses increase, premiums will tend to increase regardless of other factors. Under a full insurance or low deductible program, the occurrence of small and medium-size deductibles results in the trading of dollars with underwriters. Marine underwriters seek to maintain a loss ratio in the vicinity of 65%, which means that prospective premium increases to take care of such losses will approach a ratio of approximately \$1.53 premium for every loss dollar collected.

Elsewhere in this report, it is recommended that the employer's liability coverage be deleted from the ferry fleet policy and that this risk be included in a self-insurance program incorporating all workmen's compensation and employer's liability risks for the State of Alaska.

B. Administration

1. Organization

To properly administer the functions described in Section I and to efficiently implement the many recommendations set forth in this report, the following risk management organization is recommended.

a. Organizational Position

Because of the importance of the risk management function and the need for direct access to top State management for policy making decisions, it is recommended that a separate Division of Risk Management be formed, which would report directly to the Commissioner of Administration. Placing this function at a high level within the State's organizational structure will give proper stature to the function so that recommendations can be most effectively implemented. It is also important so that the salary range will be at a level high enough to attract a qualified risk manager.

b. Staff Requirements

i. Director, Division of Risk Management

A competent person should be designated as Director, Division of Risk Management. He should have a broad background of experience in corporate or governmental risk management. His principal duties would be identification and measurement of risks, implementation of State policy on the purchase of

insurance and retention of risks, administration of self-insurance funding, coordination of the loss control and other risk management efforts of all State agencies and communication to State administration of all aspects of the program.

ii. Loss Control Engineer

An experienced loss control engineer is critically needed. His principal function would be in designing and coordinating a safety program for the protection of personnel and the public. However, he should also have a working knowledge of fire protection engineering so that he can advise on the design of new facilities and also oversee fire hazard control and maintenance of protective equipment. We suggest that this person report directly to the Director, Division of Risk Management. This would facilitate coordination of all aspects of the risk management program. An alternative arrangement would be to designate this person as Director of Loss Control, reporting directly to the Commissioner of Administration.

iii. Assistant Director, Division of Risk Management

The scope of a properly organized risk management program for the State of Alaska is too great for one man to handle alone. He will need an assistant. For this position it is recommended that the person who is presently handling the "insurance buying" function on a part-time basis be given first priority, because of her competence and familiarity

with the current program. In addition there will be a need for a full-time secretary.

c. Continued Administration by Consultant

Until such time as the State is able to organize and staff the recommended Division of Risk Management, implementation of the other recommendations made in this report may be accomplished by continued use of Warren, McVeigh & Associates on a retainer basis. During the initial year this would require quarterly visits to Juneau and travel to other major cities in Alaska. We propose a flat annual retainer fee of \$6,000, payable in quarterly installments. We would credit against this figure time expended by principals of our firm at the rate of \$35 per hour plus actual out-of-pocket expenses (as for travel, telephone toll charges, etc.).

2. Risk Management Policy

A prerequisite for any sound program of risk management is a statement of policy by top management. This statement should clearly articulate management's goals and wishes with regard to the broader portions of the risk management program. A well-stated policy will delineate responsibility and authority for various risk-related functions. As a statement of policy, it should be a relatively permanent document, dealing with the broad goals selected by top management and the general avenues by which they are to be achieved. It should not be a detailed summary of procedures, which would require frequent changes.

The drafting of a State risk management policy will accomplish the following:

- Focus the attention of top State officials on fundamental problems relating to risks of accidental loss
- Give the risk manager (and other officials associated with risk activities) an authoritative guide to action
- Ensure that the thoughts of all concerned have been obtained and a consensus reached.

Rather than attempt to list the various subject matter to be included as part of a policy statement, we set forth below a specific example of a risk management policy, which we suggest be considered for adoption by the State of Alaska:

RISK MANAGEMENT POLICY
STATE OF ALASKA

A. PURPOSE

The purpose of the State of Alaska's policy with respect to risks of accidental loss shall be:

1. To protect the State of Alaska from accidental losses, which are catastrophic in nature.
2. To minimize the total long-term cost to the State of all activities related to the control of accidental loss.

B. LOSS PREVENTION

The policy of the State of Alaska is to place preeminent emphasis

on reduction or elimination, rather than reimbursement, of loss through professional attention to scientific loss control techniques motivational incentives, prompt and just claim payments, and other risk control measures. First priority shall always be given to the safety of employees and the public.

C. DIVISION OF RISK MANAGEMENT

The Division of Risk Management shall be a part of the Department of Administration and shall report directly to the Commissioner of Administration. It shall have responsibility for:

1. Risk analysis for all State activities.
2. Purchase of insurance, where needed.
3. Allocation of insurance and risk costs to the various budgetary units.
4. Coordination of safety, fire protection and security programs.
5. Maintenance of all records pertaining to losses and insurance premiums.
6. Adjustment of all major losses and claims.
7. Coordination of all activities, which bear upon risks of accidental loss.

D. RISK RETENTION

The State's policy shall be to self-assume or self-insure risks where losses occur with predictable frequency or where the loss potential is non-catastrophic.

The following retention levels are to be used as guidelines:

- \$250,000 per any single occurrence
- \$1,000,000 for any fiscal year with respect to risks, or categories of risk, subject to the probability of more than one loss in the same year.

These are maximum risk retention levels. Exceptions should be allowed (1) whenever insurance is necessary to obtain certain services needed, which are not otherwise available; (2) when risk retention does not result in long-term savings; (3) when bond indentures or other contracts require purchase of insurance.

E. PURCHASE OF INSURANCE

1. Insurance shall be purchased, or protection obtained from other sources, whenever the potential loss exposure exceeds the retention levels previously stated. Insurance shall generally not be purchased when the loss potential is less than these retention levels.
2. All insurance shall be purchased through the Division of Risk Management, Department of Administration.
3. Insurance shall be purchased from any source determined by the Commissioner of Administration to be in the long-term best interests of the State of Alaska.

3. Records and Reports

The foundation for an effective risk management program is a complete

and accurate set of records on losses, insurance premiums, claim handling costs, administrative costs and all other costs which are part of total risk management costs. A well organized system of record-keeping is a critical risk management function.

Loss records are the first type of information which should be recorded. These records should include not only insured losses but also all non-insured accidental losses. Present practice is to record only insured losses. A system should be devised to ensure that all losses, insured or not, are reported promptly and accurately to the risk manager. The most important function of the loss data is to provide a central source for analyzing causes of loss in order to direct loss prevention activities in the most effective way. Secondary purposes are to provide information (a) for underwriters on quotations for future insurance and, (b) for projections and estimates of future risk costs.

Very good records are presently kept of all insurance premiums.

State policy on risks of accidental loss should be kept in a permanent file, to which should be added records of all management decisions relating to such policy.

All expired policies relating to liability, employee dishonesty or workmen's compensation should be kept indefinitely in a location safe from fire or other casualty. Present practice in this regard

is good. Claims under these policies may arise many years after their expiration. The policies covering property damage need be maintained only until it is certain that all outstanding claims have been settled.

Communications is a difficult and continuing problem for the person who holds the position of risk manager. He must communicate down in order that all State agencies are aware of the need for loss reporting and other functions critical to effective risk management. He must also communicate up to top State management in order to keep management aware of the effect his activities have on overall State goals. A technique for communicating down is described in the following chapter entitled "Insurance Manual." Upward communications may best be achieved by a system of periodic reports to management of activities, status and results. It is recommended that the Director of Risk Management do this by means of a semi-annual report to the Commissioner of Administration. This report would include:

- Current annual insurance premiums for all categories of risk
- Incurred losses summarized over the previous six months' period
- Status of any self-insurance funds
- Description of unusual losses, claims or administrative items
- Goals and objectives for the next fiscal year
- Status of objectives enumerated in previous reports

4. Insurance Manual

An insurance manual is recommended for two reasons:

- a. It will give the Director of Risk Management an efficient means for communicating with operating personnel
- b. It will provide an easy-to-use reference for field personnel on procedures to follow when losses occur and methods for communicating with the Division of Risk Management on matters such as new hazards and changes in operations.

The manual should be issued to the managers of each State agency and should include the following information:

- Instructions on how to report losses of all types, insured and non-insured. Sample loss report forms should be included in the manual.
- A description of the method of insuring, risks and funding losses without insurance.
- Instructions on how to handle fire protection, safety and security matters and how to deal with inspectors from insurance companies and other entities.
- Emphasis should be made that the Division of Risk Management should be contacted in the event any questions arise with respect to any aspect of risk.
- A brief outline of safety and loss prevention standards
- Procedures for the reporting of important changes in operations or hazards.

A copy of the State's risk management policy should appear as a preface in the manual. Also, the manual should include instructions for handling specific situations such as information on insurance aspects of the use of personal automobiles on State business, limitations on the number of State officials traveling in one airplane, limitations on chartering aircraft or watercraft, etc.

5. Insurance Certificates

There are many occasions when independent contractors perform work under contract for the State of Alaska. Some of the most important are those who contract to perform new construction or repair work on State properties.

The general provisions of the standard construction contract used by the Division of Buildings require the contractor to procure and maintain the following types of insurance:

- Workmen's compensation as required by the State law and "adequate" employer's liability insurance.
- Contractors public liability insurance and vehicle or automobile public liability and property damage insurance with limits for bodily injury of \$50,000 per person and \$100,000 per accident and for property damage of \$100,000.
- Builders all-risk insurance satisfactory to the State (only required if job exceeds approximately \$20,000).

Certificates of insurance are required to be submitted for workmen's

compensation and liability insurance. Such certificates must contain substantially the following statement: "The insurance covered by this certificate will not be cancelled or materially altered except after ten (10) days written notice has been received by the State." The contractor must submit a complete copy of the builders risk policy.

All of this appears to be good procedure. However, it is recommended that the requirements for liability limits be increased. A minimum standard should be:

Bodily injury liability

\$100,000 per person

\$300,000 per occurrence

Property damage liability

\$100,000 per occurrence

On larger contracts and those which involve hazardous operations, consideration should be given to requiring much higher limits. It is recommended that 30 (rather than 10) days written notice of cancellation or material change in coverage be required. Also, it should be pointed out that the wording of the insurance requirements in the construction contracts is imprecise. For example, reference is made to "Contractor's Public Liability Insurance." More precise wording would refer to a comprehensive general liability policy and would indicate whether specific coverages are required, such as for

- Liability arising out of the products (and completed operations) hazard
- Contractual liability

Another important area where effective procedures are needed in requiring insurance certificates is the airlines and other users of the State's airports and airport facilities. With regard to lease agreements on airport property, the Division of Aviation inserts or adds to the agreements an insurance clause, which requires the lessee to furnish "comprehensive public liability, products liability (where applicable) and property damage" insurance with limits as follows:

Bodily injury liability

\$100,000 per person

\$300,000 per accident

Property damage liability

\$50,000 per accident

It is also required that the insurance name the State as an additional insured, contain a waiver of subrogation and provide that the State be notified at least 30 days prior to any termination, cancellation, or material change in coverage.

These requirements are probably all that can be expected, from a practical viewpoint, for small business firms leasing airport terminal space for such purposes as barber shops, retail stores and other non-hazardous uses. However, much higher limits of liability

insurance should be required for any commercial aviation use of airports, for construction work on airport premises, and for other hazardous operations. The most hazardous use of State airports is the jet airliner traffic. Almost all major trunk airlines carry liability insurance with limits of \$100 million per occurrence or more. In order to better protect the State in the event of a serious airliner accident on a State airport, it is suggested that the following be required of all trunk airlines using State airports and facilities:

- a. A contractual agreement holding the State harmless for any liability arising out of the use by the airline of State airport facilities, excepting only liability which is the direct result of the State's sole negligence.
- b. A certificate evidencing aircraft and general liability insurance in a total amount of no less than \$20 million combined single limit per occurrence for bodily injury (including passengers) and property damage liability. This certificate should:
 - Name the State and its officers and employees as additional insureds.
 - Provide for 90 days' written notice of cancellation or material change in coverage.
 - Clearly specify the name(s) of the insurer(s).
 - State that coverage applies to any liability assumed in contractual agreements with the State.
 - Provide that the airline's insurance is primary and not

contributing as to any other insurance maintained by the State.

c. An agreement holding the State harmless for any damage to the airline's aircraft hull and for any loss of use thereof. This agreement should be backed up by the requirement that a waiver of subrogation be furnished by the airline's hull insurer.

Obviously, it wouldn't be practical to require coverage with limits of this magnitude from smaller commercial airlines, fixed base operators, air taxis, etc., but something more than minimum limits is required. Careful consideration should be given to the settling of insurance standards which will

- Bear a closer relation to the hazards of the operations involved.
- Better protect the State for its contingent liability
- Not be unrealistic or impractical

The Division of Supply is responsible for handling competitive bidding and execution of contracts on fixed-wing aircraft or helicopter charters involving specific programs, such as Fish and Game projects, land surveys, etc. This is another area where insurance requirements should be given further consideration. A typical invitation to bid for a special aircraft lease will contain the following insurance requirements:

"The contractors shall carry liability insurance in companies

and in form satisfactory to the State and should file with the Division of Supply certificates in the following principal amounts within 15 calendar days of notice of tentative award:

Bodily injury (excluding passenger)	100M to 300M
Property Damage	100M
Passenger Bodily Injury	50M per seat

Contractor agrees to assume all responsibility for loss and/or damages to hull of aircraft leased as a result of this invitation to bid."

Since potential liability far exceeds these limits, consideration should be given to requiring higher limits. In addition, many of the certificates of insurance backing up these charter and lease agreements are inadequate in various ways, such as:

- Failure to provide for written notice of cancellation
- Failure to identify the insurer
- Failure to name the State as additional insured
- Failure to waive subrogation against the State for hull damage

The persons receiving certificates, in order to do a proper job, must see that the limits and coverage afforded by the policies are equal to those required, that the expiration dates have not passed and that new certificates are furnished when a policy expires. The detail involved in policing all certificates of insurance can amount to a considerable job and still be inadequate because of lack of knowledge on how to check the details of policy coverage and exclusions. A

recommended approach is to use standard insurance certificate forms, especially designed to fit the State requirements.

A typical sample certificate is given on the next page. Similar forms can be used by the State for all occasions where insurance is required of another party. When the certificates are received, they need only be checked to see that the proper blanks are filled in. If proper coverages are requested in the beginning, adequate policing can be achieved by clerical personnel. This procedure gives a little better control without involving a disproportionate amount of administrative time.

6. Contract Review

As often overlooked area of loss exposures is that which is created by legal contracts and agreements, particularly leases of property. Nearly all contracts pertaining to real or personal property have at least two elements which have an effect on risk. These are:

- Requirements for one or the other party to carry insurance or to assume responsibility for the property.
- Hold harmless agreements, where the contracting parties agree as to assumption of liability.

There is little consistency among attorneys in their approaches to these subjects and contract wording will vary considerably. Further, attorneys are not always fully aware of important insurance aspects involved in contracts, nor are they often in a position to weigh and

CERTIFICATE OF INSURANCE

This is to certify that _____
 (Insurance Company)

has issued policies of insurance listed below to:

Insured _____

Address _____

Location of operations insured _____

Description of work _____

POLICIES	LIMITS		POLICY NUMBER	EXPIRATION DATE
	Bodily Injury	Property Damage		
Workmen's Compensation	Statutory			
Public Liability	Each Person	Each Occurrence		
	Each Occurrence	Aggregate		
Auto Liability	Each Person	Each Accident		
	Each Occurrence			

All policies are in effect at this time and will not be cancelled or limited until after 10 days notice has been given to _____

The following coverages are in effect:

Yes No

Longshoremen's and Harbor Workers' Act _____

Date _____

At _____

 (Insurance Company)

 (Authorized Representative)

judge different risk-treatment techniques, such as (a) use of subrogation waivers, (b) using fire and explosion legal liability insurance, (c) naming different parties as additional insureds on policies, (d) intentional risk assumption.

Control of insurance costs, and the extent of assumed risks, may be improved, if the risk manager will work closely with attorneys on all contracts involving insurance or hold harmless agreements. Standard contracts (purchase orders, construction contracts, etc.) should also be reviewed by the risk manager to assure that contract wording agrees with overall risk management policy.

When carrying out a contract review, which should always be done before it is signed, the following points should be observed:

- a. Indemnity agreements should be carefully considered, as they serve only to transfer liability from the party in the greater bargaining position to the other party. If such a clause is desired (such as in connection with the State's airport operations), it should state the intent of each party to respond to its own sole negligence. Joint negligence may be assumed jointly or by either party, but the wording should clearly state the situation.
- b. When the State engages independent contractors to perform services, it is desirable to know that such independent contractors carry adequate public liability insurance. A minimum standard requirement of \$100,000/\$300,000 limits for bodily injury and at

least \$50,000 for property damage liability is recommended. Evidence of such coverage should be provided by standard certificate forms as discussed in the section, "Insurance Certificates."

c. Where the State is the lessee of property, contracts should be checked to be certain that there is no requirement that the property be returned to the lessor at the end of the lease period in the same condition (wear and tear excepted) as it was received. This in effect makes the lessee the complete insurer of premises for all losses including earthquake, flood, collapse, etc.

d. When property insurance is mentioned in a contract, the wording should make it clear as to specifically which perils are covered and which perils are not covered. For example, the term, "fire and allied lines" insurance is inadequate. The normal requirement is for "fire, extended coverage, and vandalism." When this is so, coverage does not apply to earthquake, flood, collapse, theft and other perils often included with an all-risk contract.

e. When property insurance is mentioned, the contract should be clear as to whether insurance is to be carried to replacement cost or actual cash value. Also, any coinsurance clause requirements should be stated.

The State leases many properties for office space and other purposes.

In general a standard lease form is used. In this form one of the covenants of the lessee (State of Alaska) is that the lessee will ". . . leave the premises at the expiration or prior termination of this lease or any renewal or extension thereof, in as good condition as received or in which they might be put by the Lessor, excepting reasonable wear & tear." This phrase makes the State liable for any loss to the premises, regardless of cause. The State would have to repair damages from fire, explosion, earthquake, flood, malicious mischief, vandalism and virtually every other imaginable peril or occurrence. The only exception to this would be damage or loss caused by tortious or negligent act on the part of the Lessor, his agents or employees (as provided by one of the Lessor's covenants).

Broad assumptions of liability such as this should be avoided. This represents unplanned self-assumption of risk, the magnitude of which is most difficult to measure. This liability risk is not covered under the State's present liability program, because of the "care, custody or control" exclusion in the comprehensive general liability policy.

The above example illustrates the importance of contract review by the risk manager.

7. Purchase of Insurance

Presently the State is committed to the purchase of insurance by means of competitive bidding. Specifications are prepared by the

servicing agents and sent out to various insurance companies every three years and even more often for certain types of insurance.

Competitive bidding is desirable, if the market for the type of insurance being bid is open and generally competitive. However, the frequency of bidding is important. If bids are invited every renewal, such as every three years, it is very likely that quotations received will not be as low as otherwise might be expected, or that some sources will not bid at all. On major property and liability lines, competitive bidding once every six years is a recommended balance. More frequent bidding normally would be justified only in the event of dissatisfaction with the current insurer.

There are some types of insurance, such as the marine insurance on the State's ferry fleet, where the sending out of invitations to bid is virtually a waste of time, because of the "tight" and non-competitive market. Proper placement of insurance of this type can best be arranged by negotiation with the marketplace by a single broker, who is knowledgeable and experienced in this particular field.

Insurance specifications should be prepared by someone both professionally competent and objective. They should be drawn up to clearly express the State's needs. Ideally, they should be prepared by the State's own risk manager with assistance as

needed from appropriate outside sources.

By its insurance purchasing practices, the State should not be restricted to only a portion of the marketplace. In this regard, the insurance intermediary's remuneration should be based on a fee for services, which would be a flat sum (perhaps modified by per diem or hourly rates) rather than percent of premium. A fee basis of remuneration would encourage efficient utilization of the entire insurance market. Since the intermediary's remuneration would not be affected by the amount of the insurance premiums, it would encourage him to develop the direct-writing insurance market and to devise and implement non-insurance methods for the funding of risk.

In order to properly negotiate and place large excess property and liability lines on the best possible terms, it is essential that the firm handling this have excellent Lloyd's and foreign market connections plus heavy experience in dealing with the non-admitted or "surplus lines" markets. When the insurance being arranged involves catastrophic exposures and high limits, many insurers both primary and excess may be needed in order to complete the placement on an equitable basis. In some cases adequate coverage can only be obtained by proficient and orderly marshaling of many (often worldwide) markets.

III - RISK ANALYSIS AND EXISTING INSURANCE

A. Property Risks (Non-Marine)

Loss of property caused by a major earthquake, and by fire, explosion and tidal wave, following an earthquake, represents the most serious property loss potential faced by the State. The magnitude of potential loss from such a disaster can only be very roughly approximated, yet it would appear that direct loss exceeding \$20,000,000 is not inconceivable in the Anchorage area. In Juneau loss could also be catastrophic, especially after the new office building is completed.

Fire (not caused by earthquake), severe windstorm, boiler explosion, riot damage, flood, landslide and damage by falling aircraft are examples of other perils which could cause serious financial loss. Indirect consequences of direct property damage can also be serious. For example, destruction of the Anchorage airport terminal could cause a large loss of revenue. Extra expenses to continue operations elsewhere in the event of destruction of a major building can run to sizeable sums.

1. Existing Insurance

Details of the State's current property insurance policies are shown on Charts A through D. All buildings and certain personal property are insured under a single policy by Insurance Company of North America. This is a continuous policy, subject to premium adjustment at the end of each annual period. According to correspondence from the servicing agent, premium for each annual period (beginning

July 1, 1972) will be "negotiated" on the basis of the following factors:

- An updated statement of values
- Loss history for the previous year
- Newly promulgated rates by Pacific Fire Rating Bureau
- Changes in the account, and
- Expected trends.

The key ingredients for premium adjustment are stated to be "the loss ratio and total values involved." The servicing agent indicates that INA considers 40% to be the "permissible" loss ratio. This means that, if insured losses exceed 40% of premium, the subsequent annual premium would be increased proportionately.

Since premium for the first annual period is \$783,700, the "permissible" loss ratio allows for payment of \$313,480 in losses and the balance of \$470,220 apparently is intended to pay for acquisition costs, inspection services, insurance company overhead and "true" insurance (or reinsurance) for the catastrophic loss. It is interesting to note that this latter amount of \$470,220 exceeds the entire premium paid for the period July 1, 1970 to July 1, 1971 (\$414,228).

This is what may be termed a "prospective loss rating" plan, under which the State will pay for all of its losses over a period of time, except for such losses (or portions of losses) as might be considered by the insurance company to be of "catastrophic" size. Exactly how large

a loss must be in order to be considered "catastrophic" is not specified.

2. Current Risk Retention

As shown in Chart A, deductible assumption on insured losses is subject to an annual aggregate maximum retention of \$250,000, disregarding all losses of \$10,000 or less. Other risks presently uninsured are:

- Earthquake, with maximum possible loss of catastrophic proportions (conceivably \$20,000,000 or higher).
- Personal property owned by the State (with certain exceptions such as, contents of Governor's mansion, legal liability for personal property of others, the computer in basement of Alaska Office Building, and equipment of certain Federal programs).
- Additional expense to continue operations elsewhere as a result of damage to buildings to the extent such additional expense exceeds the \$5,000 coverage under the INA policy.
- Loss of revenues (business interruption)
- Landslide and earth movement
- Depreciation
- Electronic data processing media
- Works of art in State Museum in Juneau (except Samuel Johnson collection, which is insured).
- Money and securities
- Aircraft and vehicles licensed for highway use
- Damage by vandals (except ASHA property leased by State, which

is insured for vandalism and malicious mischief).

- Damage caused by explosion of steam boilers and steam, gas or internal combustion engines
- Collapse of buildings or structures
- Flood and tidal wave

The above listing of uninsured risks is not intended to be all-inclusive, but only to illustrate the fact that the State is already assuming substantial property risks without the benefit of commercial insurance.

3. Risk Identification and Measurement

The scope of our audit, as authorized by the Division of Supply, did not provide the time nor funds for complete, in-depth identification and measurement of all property risks. Much work remains to be done in these areas. Risk identification is a never ending job, but is an indispensable function of risk management. It can be accomplished best, on a continuing basis, if the State follows our recommendation for the staffing of a complete State risk management department.

Examples of areas calling for further work in the identification and measurement of property risks are:

- a. More complete evaluation of presently uninsured personal property risks is needed. A recent computer tabulation of personal property located in the McKay Building in Anchorage shows book values exceeding \$300,000. A complete tabulation of all personal

property values by location should be made to determine whether there are other concentrations of personal property which expose the State to significant loss potential.

b. A professional property engineering survey should be made of major locations to determine maximum possible loss potentials. There are a number of reasons why this should be done. First, this information will be most helpful in testing the market to determine the economic feasibility of remarketing this insurance on a layered excess basis. Second, INA proposed in their original quotation a 5% reduction in annual premium if the State would accept a limit of \$20 million per occurrence rather than the present blanket limit of \$135 million. It would seem that this fact alone would be justification for the State to spend a little money and time to determine with precision the maximum possible loss that could arise out of a single insured occurrence, because

- Since 5% of current annual premium is \$39,185, the economic reward is substantial.
- Our discussions with the Division of Buildings indicate that \$20 million per occurrence is probably more than adequate at the present time.

c. Business interruption (loss of revenues) exposures should be determined at major revenue producing facilities such as the Anchorage International Airport.

d. Maximum concentration of values for automotive vehicles should be determined.

4. Comments and Recommendations

General recommendations made in Part II call for proposals to re-structure and remarket the State's property program. Although the general recommendations appear feasible for a number of reasons (primarily because of the high overhead factors built into the present "prospective loss rating" plan), any changes will take some time to accomplish. In the meantime the following comments and recommendations are made with respect to individual policies currently in force:

a. Blanket Property Insurance (Chart A)

An attempt should be made to accomplish the following:

i. Determine additional cost to cover all personal property.

This will entail the need for a tabulation of values by location, as previously suggested. When cost is determined, an informed decision can be made with regard to retention vs. transfer. It would be preferable to have coverage on an all property basis, including personal property, even though a slightly higher deductible may be required to keep premium costs in line. If the decision is made to add coverage under this policy for personal property, the exclusion of vehicles licensed for highway use should be deleted.

ii. If possible, the cancellation clause should be amended to require at least 60 days notice of cancellation by insurer. It is

very doubtful that this coverage could be replaced in today's insurance marketplace in the 30 day period presently specified.

iii. Presently only ASHA property is covered for vandalism and malicious mischief. These perils should apply to all property covered under this policy. The additional premium, if any, should be negligible. This is recommended, because it is often difficult to distinguish between riot and vandalism damage.

iv. Architects' or engineering fees are excluded, except cost of supervision during construction or reconstruction. The Division of Buildings indicates that it would not be possible, in most cases of serious loss, to use the original plans for reconstruction of a building. Therefore, this exclusion should be deleted.

v. The policy contains an exclusion with respect to loss caused by or resulting from "explosion, rupture or bursting of (a) steam boilers, steam pipes, steam or gas turbines and steam, gas or internal combustion engines, or (b) moving or rotating parts of machinery caused by centrifugal force or mechanical breakdown and (c) property undergoing test . . . etc." Since it is standard practice to cover steam boilers and machinery breakdown under a separate boiler and machinery policy, the exclusion of steam boilers, pipes, etc. is not unusual. However, this exclusion goes beyond the normal steam boiler exclusion in that it refers also to explosion of gas turbines and gas or internal combustion engines. Damage caused by explosion of these objects should not be excluded. Further,

the reference in the exclusion to "property undergoing test" seems much too broad. The "testing" exclusion should only apply to steam boilers and other objects usually covered under separate boiler and machinery policies.

vi. Under a loss rated plan, such as this, it is most desirable to have all cost and insurance factors spelled out in detail. Questions that should be answered by the servicing agent are:

- At exactly what point in size does a loss cease to become rate-able for prospective premium adjustment?
- Exactly what portions of the total premium are allocated to "excess" (catastrophe) insurance or reinsurance?
- What portions of the total premium are allocated to overhead items, such as (1) inspection services, (2) loss adjustment costs, (3) taxes, (4) profit, (5) other expenses?

The State should know exactly what its premium dollars are buying.

vii. The present contract contains a clause which imposes 100% coinsurance with respect to rental values and 90% coinsurance with respect to all property. Since the State uses what appears to be an accurate method for calculation of insurable values, it would seem a reasonable request to ask the insurer to eliminate the coinsurance clause. This would avoid the possibility of argument over a coinsurance penalty on a major loss. It is not uncommon for insurance on a large account such as this to be written without a coinsurance clause.

b. Property Insurance - Alaska Ferry Terminal (Chart B)

This coverage must be maintained in force in accordance with agreement between Canada and Alaska.

c. Property Insurance - Computer (Chart C)

It is the practice of the State, in general, not to purchase insurance to cover personal property. Apparently, the reason this policy was purchased was because of the relatively high value of the equipment and its susceptibility to damage. We see no reason to treat this property any differently than other personal property. As recommended previously, an evaluation should be made of all personal property by location, additional premium should be determined to include all personal property under the INA blanket property policy, and an informed decision can then be made regarding retention vs. insurance. Until this is accomplished, this particular policy should be kept in force.

d. Scheduled Property Floater - State Museum (Chart D)

This policy covers a small collection of art objects owned by Samuel Johnson and loaned to the Alaska State Museum. In order to have the benefit of these objects, it was necessary for the Museum to agree to purchase insurance in the amount of \$27,000. This policy is required by contract, thus must be continued in force. In the future, it is recommended that similar situations be handled by indemnity agreement, rather than insurance, unless the value of the property

exceeds the State's risk retention capabilities.

B. Crime Risks

The State is exposed to substantial risks of loss arising out of criminal and negligent acts of employees and criminal acts of non-employees.

1. Employee Risks

There are two ways in which the State may suffer property loss from the activities of its employees:

- Through active defalcation or embezzlement of money or other property.
- Through failure of an employee to perform a function which is required, either through negligence or ignorance.

The substantial flow of money and securities through the State's organizational structure, coupled with the increasing susceptibility of loss brought about by expanded computerization of financial functions, suggests that the risk of loss by employee crimes and negligence is of a very high order of magnitude. Unfortunately, there is no scientific method to estimate the probability of loss occurrence from this source, nor can the maximum possible loss potential be measured in any precise way. Past experience is of little benefit in estimating future loss probabilities.

Although there is an obvious concentration of potential loss exposure in the Treasury Division, a review of security arrangements was recently made by Peat, Marwick, Mitchell & Co. and we understand

many of the recommendations in the report have already been implemented. Even though large financial transactions may be scrutinized carefully, a sizeable loss in this and many other areas is not inconceivable.

The best audit controls are sometimes inadequate. Further, many business firms and public bodies have suffered substantial employee dishonesty losses through the conversion of relatively small amounts of money or property over long periods of time. Certainly, a loss of \$1,000,000 or more, though not probable, is possible.

a. Existing Insurance

Details of the State's current public employees and officials bonds are shown on Charts E through H.

Certain public officials are required by statute to furnish bond, as shown on Chart H. Although statutes do not require bonds for other public employees, prudent management dictates that State assets be protected by the bonding of all public employees. The existing Public Employees Blanket Position Bond (Chart E) provides indemnification for both dishonest acts and for failure to faithfully perform duties, but the bond limit is quite low - \$20,000 on each employee (\$25,000 on the Director of Office of Economic Opportunity).

As shown on Charts F and G, Fish and Game licensing officers are bonded for amounts ranging from \$1,000 to \$5,000 and Motor

Vehicle commission agents are bonded for amounts ranging from \$1,000 to \$20,000.

b. Comments and Recommendations

Although determination of a proper bond limit is very difficult, it is safe to say that coverage provided by the existing Public Employees Blanket Bond is inadequate. There are a number of formulas which can be used as rough guidelines. One such formula is given by Mr. Philip P. Laing in Special Bulletin 1957E of the Municipal Finance Officers Association (October 1, 1957). This formula suggests that the magnitude of risk is a function of annual revenues plus the value of negotiable securities of which physical custody is held. Use of this formula and other rough "rules of thumb" leads to the recommendation that the blanket bond limit be set at a figure no less than \$2 million.

A bond limit of \$2 million per occurrence should be considered a minimum amount and much higher limits should be given serious consideration. The rationale for very high limits is:

- Many organizations have suffered employee dishonesty losses considerably in excess of \$1 million. In recent years a large eastern bank suffered a \$6,000,000 loss and another large banking firm incurred a loss in excess of \$40,000,000 (the largest single loss in the history of fidelity bonding).
- A bond limit of \$20,000,000 is not uncommon for major

DETERMINATION OF BOND LIMIT

The following formula is suggested by Mr. Philip P. Laing, in Special Bulletin 1957E of the Municipal Finance Officers Association (October 1, 1957) and is reproduced from "Municipal Risk Management," a handbook published by The National Underwriter Company of Cincinnati, Ohio:

The first step in this formula is calculation of an exposure index, which is 10% of the sum of (1) total annual revenues from all sources, and (2) market value of all negotiable securities in physical custody. This exposure index is then used to enter Table H to find recommended bond limit.

TABLE H

SUGGESTED MINIMUM AMOUNTS OF BONDING COVERAGE							
Exposure Index		Bracket No.	Amount of Bond				
\$	Up to --	\$	25,000	1	\$	15,000	25,000
	25,000 --		125,000	2		25,000	25,000
	125,000 --		250,000	3		50,000	75,000
	250,000 --		500,000	4		75,000	100,000
	500,000 --		750,000	5		100,000	125,000
	750,000 --		1,000,000	6		125,000	150,000
	1,000,000 --		1,375,000	7		150,000	175,000
	1,375,000 --		1,750,000	8		175,000	200,000
	1,750,000 --		2,125,000	9		200,000	225,000
	2,125,000 --		2,500,000	10		225,000	250,000
	2,500,000 --		3,325,000	11		250,000	300,000
	3,325,000 --		4,175,000	12		300,000	350,000
	4,175,000 --		5,000,000	13		350,000	400,000
	5,000,000 --		6,075,000	14		400,000	450,000
	6,075,000 --		7,150,000	15		450,000	500,000
	7,150,000 --		9,275,000	16		500,000	600,000
	9,275,000 --		11,425,000	17		600,000	700,000
	11,425,000 --		15,000,000	18		700,000	800,000
	15,000,000 --		20,000,000	19		800,000	900,000
	20,000,000 --		25,000,000	20		900,000	1,000,000
	25,000,000 --		50,000,000	21		1,000,000	1,250,000
	50,000,000 --		87,500,000	22		1,250,000	1,500,000
	87,500,000 --		125,000,000	23		1,500,000	1,750,000
	125,000,000 --		187,500,000	24		1,750,000	2,000,000
	187,500,000 --		250,000,000	25		2,000,000	2,250,000
	250,000,000 --		333,325,000	26		2,250,000	2,500,000
	333,325,000 --		500,000,000	27		2,500,000	3,000,000

financial institutions and many organizations (both private and public) carry \$10,000,000 limits for employee dishonesty coverage.

- For employees with access to large amounts of money or negotiable securities, protection far in excess of \$2 million is undoubtedly needed. Extremely sensitive positions would include employees of the Treasury Division and other divisions of the Department of Revenue.
- Presently, the flow of money, securities and other property throughout the State's organizational structure is substantial. Further growth in financial and other State activities is predicted as the result of future increased North Slope oil industry operations.

Although the exact bond limit needed is a matter of conjecture and arbitrary judgment, the foregoing discussion supports the need for a blanket bond with a very high limit. A blanket limit of \$10 million per occurrence would not seem unrealistically high. A higher limit should be considered, if premium cost is reasonable.

The insurance market should be tested to determine availability of coverage and premium costs for bond limits of \$2 million, \$5 million, \$10 million and beyond. These are "per occurrence" limits.

Recommended coverage is that which is referred to as public

employees "faithful performance blanket bond coverage." Such a bond covers not only dishonest acts but also failure to perform duties of office. Although this form of bond is more expensive than bonds covering only employee dishonesty, it provides much broader protection for the State. It also provides broader protection for the State official, since it is possible for the official to be held liable for losses caused by failure of his subordinates to faithfully perform their duties.

Some public entities attempt to keep premium costs in line by arranging a blanket bond at a relatively low level to cover all employees and then purchasing specific excess coverage on certain officials and other employees considered to be in sensitive financial areas. Although this approach may reduce premium cost somewhat, a major drawback is that there would always be the chance of overlooking persons or positions that should be bonded for the maximum amount. We favor purchase of a single blanket amount applicable to all employees, rather than attempting to pre-determine where a loss is most likely to occur. Certainly there is more risk concentrated in the Treasury Division and certain other areas, but if proper underwriting information is furnished to the bonding companies, the premium charged for a high blanket limit should reflect the fact that high concentrations of exposure exist only in certain areas.

In securing premium quotations for faithful performance blanket bond coverage, there are some exclusions under the standard bond form that should be considered. First the definition of "employee" does not include any official or employee required by law to file an individual bond. Second, coverage does not apply to "any Treasurer or Tax Collector by whatever title known." In putting together a high limit blanket bond, such persons would either have to be bonded separately to the limit chosen or the blanket bond would have to be amended to apply excess of the statutory bonds in force.

The following modifications to the standard bond form should also be requested:

- Under the current bond, Federal food stamps are excluded. This exclusion should be deleted.
- The standard cancellation clause requires only 30 days written notice by insurer. If possible, this should be increased to at least 60 days.
- The standard form provides that coverage is cancelled as to any employee immediately upon discovery by the insured or obligee of any act on the part of such employee which would constitute a liability of the surety. This could be interpreted to mean that knowledge by any officer of the State would cause cancellation and this would probably apply not only to criminal acts but also errors and omissions constituting

failure to properly account for property or failure to faithfully perform duties. It would be desirable to amend this clause so that cancellation with respect to an employee would not be effective unless knowledge of a dishonest act committed by such employee was made known to the Commissioner of the Department of Administration.

- An extension of coverage that should be considered is coverage for claims preparation expenses. Employee dishonesty claims, particularly if they involve defalcations occurring over a long period of time, require extensive accounting procedures (and often the help of outside accounting experts) to determine all of the factors involved, as well as the exact amount of the loss. Such accounting costs can run into significant figures. This extension of coverage is not always possible to arrange, but its availability should be investigated.
- Also it is possible there may be certain non-employees in financially sensitive positions of trust. If so, coverage for such persons should be specifically provided by endorsement to the bond.

2. Non-employee Crime Risks

Loss of money and securities and forgery of incoming and outgoing financial instruments are the principal non-employee crime risks to which the State is exposed. These are not nearly as significant as the

employee crime risks discussed in the foregoing section.

a. Money and Securities

During the period 7/1/67 to 7/1/70, the State purchased insurance covering money and securities for loss by destruction, disappearance or wrongful abstraction. The amounts of coverage were limited to \$50,000 for money and \$100,000 for securities. Such coverage would provide protection for loss of money and securities caused by criminal acts of persons other than employees. Also, since money and securities are excluded under standard fire insurance policies, the broad form money and securities policy is virtually the only way to insure such property against loss by perils such as fire, explosion, etc.

Due to inability to obtain adequate underwriting data, we are informed that no insurer was interested in renewing this coverage.

A detailed survey should be made to determine the money and securities exposures at each location and the protection (safes, etc.) afforded such property. Until this information is developed the State will remain uninsured for risks the true nature and magnitude of which are unknown. Although this is the type of exposure that generally should be retained rather than insured, proper identification and measurement procedures may uncover concentrations of money and/or securities with values exceeding the risk retention capabilities

of the State. Without complete identification and measurement, the retention of the money and securities risk is involuntary and achieved by default. The result could well be a large and unexpected loss, which might have been prevented or insured against, if the exposure had been recognized.

b. Forgery

Another non-employee crime risk is the possibility of financial loss due to forged warrants or other instruments purported to have been issued by the State. Also, there may be the possibility of a large incoming check or draft being fraudulently cashed by someone not an employee.

The State does not purchase forgery insurance. It would appear that this is not a relatively significant risk and is within the State's ability to assume. It is a risk best treated by appropriate audit and control measures.

c. Theft of Property

This is normally considered a property risk. Recommendations for the treatment of this risk are set forth in Section II. It is not considered a major risk.

d. Federal Food Stamps

The Food Stamp Program has been expanded to statewide coverage with an estimated \$1 million in stamps being distributed monthly.

These stamps are sent from the Federal Bureau of Printing directly to Loomis Armored Car Service in Anchorage and Fairbanks. It is estimated that Loomis will have in storage at their premises in Anchorage stamps valued at approximately \$2.5 million. Values at their premises in Fairbanks are estimated at about \$1 million. Loomis distributes these stamps as needed to the various district offices of the Division of Public Welfare. Values at these offices range from \$50,000 to \$150,000. Most of these offices have safes, but not all safes are of high quality. We understand nine new safes have been ordered for the major offices.

There have been three recent attempted burglaries at the Anchorage district office, but only one was successful, resulting in loss of stamps valued at \$21,250. This amount had to be repaid to the USDA. We understand the Anchorage office now rents a "good" safe from Loomis.

The values of stamps held at the various district offices appear to be within the State's risk retention capabilities, but this should be checked periodically for abnormal concentrations of values. The value of stamps held by Loomis is substantial. We have seen only part of the legal agreement with Loomis. The entire contract should be carefully reviewed to confirm that Loomis is entirely responsible for the stamps while in their possession and they should be required to furnish certificates evidencing adequate insurance.

C. Workmen's Compensation And Liability Risks (Except Airport, Aircraft And Certain Marine Liability Risks)

The following risks are insured by Alaska Pacific Assurance Company under a "loss rating" plan:

- Workmen's Compensation and Employer's Liability
- General and Automobile Liability
- Professional Malpractice Liability

For convenience and clarity these risks and the insurance coverages in existence will be discussed separately and in combination, as follows:

1. Risk Analysis

(a) Workmen's Compensation and Employer's Liability

The Alaska Workmen's Compensation Act imposes legal liability, without regard to negligence, on all Alaskan employers, including the State and its political subdivisions. The benefits payable to injured employees are prescribed by the Act and are limited, particularly when compared with the virtually unlimited awards which are possible from public liability.

In Alaska the liability of an employer (including the State) for work injuries of employees is exclusive and in place of all other liability of the employer. An Alaskan employer could still, however, incur a claim in tort under circumstances, such as:

- If an employee is injured out of state but within the scope of his duties, the compensation law of that state might apply and could allow tort claims under certain circumstances.

- An employee may be subject to federal law rather than the State Compensation Act.

There are three principal areas where federal law applies in place of State statutes:

- Longshoremen and harbor workers, where a federal compensation law applies
- For crews of ships, where there are welfare benefits plus negligence laws, and
- For railroads, where negligence laws apply.

The following quotation from the 1963 Attorney General's Opinion No. 28 will serve to illustrate one area where federal law applies: "...all employees on the Alaska ferry system who meet the classification of seamen or members of the crew within the scope of the Jones Act have an exclusive federal remedy within the terms of the Jones Act to the exclusion of the Alaska Workmen's Compensation Act, except as to those injuries that occur or fall within the 'twilight zone' between local and federal jurisdiction."

Although the possibility of a single accident resulting in workmen's compensation claims in excess of \$1 million is exceedingly remote, such an eventuality is not impossible.

(b) Liability Risks - General and Automobile

Section 09.50.250 of the Code of Civil Procedures allows "contract, quasi-contract or tort" claims against the State, although immunity

still is reserved for certain discretionary acts and such acts or situations as: imposition of a quarantine, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit or interference with contract rights. These represent legal defenses. If Alaskan case law follows the trend in other states, the effect will undoubtedly be an erosion of those immunities which still remain. Unquestionably, the State can be, and is, held liable for an almost infinitely wide range of liability claims.

The size of court awards has increased tremendously in recent years. In 1963, the \$1 million barrier was broken in a New York court case, which was awarded to one person. In 1970 the \$2 million barrier was broken in an automobile case, which also was awarded to a single person. Numerous other examples can be cited of cases where awards or settlements exceeding \$2 million have occurred involving several injured persons and damaged property.

There is no question that the potential exists for truly catastrophic tort liability losses. Although there is no way to precisely determine the maximum possible loss potential, it does not take much imagination to envision the occurrence of a negligently caused explosion or fire involving a concentration of people in a public place, such as a school or hospital.

(c) Professional Malpractice Liability

We are told that a malpractice claim has never been filed against the State. Undoubtedly, this is due in part because the legal climate for malpractice liability suits is not as acute in Alaska as in other states, such as California. Apparently Alaskans are not yet as "claim conscious" as Southern Californians. Also, the exposure base is not great, although liability certainly could arise out of the operation of the mental hospitals, the health clinics and the Pioneer Homes and also through the activities of public nurses.

Although the probability of a serious medical malpractice claim would appear slight based on past experience, it would not be wise to rely heavily upon what has happened in the past. In other states medical malpractice litigation has proliferated at an astonishing rate in recent years. In 1957, only two medical malpractice cases had actually been paid for an amount exceeding \$100,000. Today, a \$500,000 settlement is not remarkable.

2. Existing Insurance

For premium computation purposes, the policies described in Charts I through K are combined under a single three year "retention plan". The terms and conditions of this plan are set forth in endorsement #17 attached to the workmen's compensation policy. This plan can be summarized as follows for the first annual period:

Standard Premium (est.)	\$1, 133, 132
1. Retention Fee	19.0% of standard
2. Loss conversion factor	113.5% of incurred losses
3. Tax multipliers:	
Liability	1.042
Workmen's Compensation	1.038
"Average"	1.04
4. Maximum premium	100% (percentage of standard premium)

The final premium is calculated by adding together the retention fee and converted losses and multiplying this sum by the tax multiplier, but the final premium will not exceed the standard premium in any one year.

Endorsement #15 of the workmen's compensation policy states in part:

"It is further agreed that no interim or annual rate adjustment will be effected, except (1) those resulting solely from an increase or decrease in seventy of the Alaska Workmen's Compensation Act as a result of statutory changes in that Act as determined and certified in writing by the National Council on Compensation Insurance and shall be applicable under the policy from the effective date of the statutory change. (2) The expense in any one annual period is sufficient to create an underwriting loss of greater than 10% of the projected annual premium."

The retention plan chosen by the State contains no provision for limitation

of individual losses with respect to premium calculation. ALPAC did offer such a plan, which would have limited individual losses to \$50,000, but this would have increased the retention by 6% (\$67,988) and was rejected in favor of the present unlimited plan.

From the above, it can be seen that over a three-year period, this "retention plan" operates as a loss leveling device, not as one of risk transfer.

Since there is no "per occurrence" limit to losses entering into the premium computation and the carrier can raise the "standard" premium prospectively to recoup any "underwriting loss", no element of true insurance appears to be involved. Under this plan the State will pay its own losses without limit over a period of years plus the insurance company overhead and adjusting costs, in accordance with the retention plan factors previously quoted.

The following figures show approximately how the final first year premium would be calculated, if incurred losses total \$700,000.

Standard premium	\$1,133,132
Retention (19% of standard)	215,295
Incurred losses	700,000
Loss expense (13.5% of losses)	<u>94,500</u>
	\$1,009,795
Average taxes (4% of \$1,009,795)	<u>40,392</u>
	\$1,050,187

Therefore, it can be stated that, for every incurred loss dollar, the insured will pay out approximately \$1.50 in premium (\$1,050,187 + \$700,000 = 1.50). Expressed another way, the "permissible" loss ratio for this plan is 66-2/3%.

In analyzing the above cost factors, there are various items to be considered:

- As mentioned elsewhere in this report, approximately \$37,000 will be spent on safety engineering. Of this amount, \$15,000 will come from the Alaska Agents Association (in the form of return of commission) and the balance is contemplated in the retention fee. If the State should decide to fund the safety program directly, presumably the retention fee would be reduced proportionately.
- The tax factors (which average 4%) appear high. ALPAC is a domestic Alaskan insurance company and will pay no State taxes on premiums until April 1972, and thereafter will pay only 1-1/2% of premiums. They are also liable for a filing fee of \$10.00 and an annual continuation fee of \$65.00. According to the Division of Insurance, this is the extent of their tax liability at the present time.
- According to a letter from ALPAC dated September 7, 1971, the retention fee of 19% includes a "variable" charge of 9% for reinsurance. Since there is no limit to the amount of losses entering

into the premium calculation, this reinsurance does not appear to benefit the insured.

A separate policy is purchased by the State covering so-called "police professional liability." Details of this policy are shown on Chart L. The policy limits are quite low, but coverage in excess of these primary limits is provided under the ALPAC general liability policy.

There are a number of problems with this arrangement, such as:

- The primary policy includes the individual law officers as insureds, but the ALPAC policy does not.
- The ALPAC policy includes "elective or appointed officials" as insureds, but the primary policy does not.
- Under the ALPAC policy, the "personal injury liability" endorsement applies excess of \$100,000 per person aggregate and \$300,000 general aggregate (with respect to the primary policy). However, the actual limits of liability shown on the primary police professional policy are: \$100,000 each person, \$300,000 each incident and \$500,000 aggregate.
- Coverage is provided under the primary policy for assault and battery committed before the injured person is brought before magistrate or like official, authorized to hold a preliminary hearing. The ALPAC policy does not specifically provide coverage for assault and battery.

- Coverage is provided under the primary policy for "erroneous service of civil papers", but not under the ALPAC policy.

There are many other differences between these two policies, but these serve to illustrate the non-concurrency of coverage. An unhappy result can be that different aspects of the same lawsuit might have to be defended by different law firms. An extreme example would be the case where a plaintiff claims false arrest, assault in jail after the arrest and violation of a civil right. Defending such a suit might involve different law firms on the first two counts and the State Attorney General on the third.

3. Current Risk Retention

The preceding analysis of the "retention plan" clearly illustrates the fact that, under the existing arrangement, the State will pay its own losses over a period of time plus a substantial handling charge. It is true that premium cost will not exceed the "standard premium" in any one fiscal year and this is helpful in preparing budget estimates. However, adverse loss experience, due either to increased frequency or catastrophic losses (or both), will result in a corresponding increase in rate and premium for the subsequent year.

Therefore, it is apparent that, with regard to the workmen's compensation and liability risks covered by these policies, the State is practicing virtually unlimited risk retention in that all financial consequences of these risks must be repaid to the carrier (in the form of premiums) over a

period of years. There is also the very real possibility of a catastrophic liability loss which could exceed the relatively low limits of coverage provided by these policies.

Aside from the above considerations relating to the financial effects of the "retention plan" and the inadequate limits of coverage, the existing policies do not cover certain liability risks, either because of policy exclusions or the limited scope of policy wording. For example, coverage does not apply to liability arising out of:

- Property in the care, custody or control of the State.
- Liability arising out of oral contracts.
- Errors or omissions in the performance of computer programming or data processing for others.
- Erroneous advice given to employees with regard to employee benefit or retirement programs.
- Inverse condemnation.
- Ownership, maintenance or use of inboard motor boats and vessels, and aircraft (also discussed elsewhere).
- Giving advice (or issuing permits) on matters of health, safety, building construction, etc.

Many of these liability risks have already been called to the attention of the State by the servicing agent. These (and others that could be named) represent significant but infrequently occurring risk exposures. Risks such as these should properly be covered under policies designed for catastrophe protection, such as "umbrella" excess liability contracts,

rather than basic (or primary) liability policies.

4. Comments and Recommendations

Recommendations are made in Part II, which call for self-insurance and "excess" liability and workmen's compensation insurance proposals. Self-insurance of these risks appears feasible, if coupled with purchase of "excess" insurance above a reasonable per occurrence retention. Since obtaining and analyzing proposals will require several months, the following immediate comments and recommendations are made with regard to the existing policies:

(a) The current retention plan provides no limit for individual losses which enter into premium calculations. ALPAC previously quoted a premium of 6% of standard to limit losses to \$50,000 per occurrence. Determine whether this is still available. Also, determine premium charge to limit losses at higher per-occurrence levels. Past loss experience indicates that \$50,000 per occurrence is too low to eliminate all frequently occurring losses. Loss limitation to some reasonable figure is recommended not only with respect to any self-insurance program, but also for any loss rated insurance program, such as this. Unlimited retention is most undesirable. It is recommended that retention be no less than \$100,000 per occurrence nor more than \$250,000. The insurance charge will determine the most economic retention level.

(b) The workmen's compensation policy, under endorsement #8, has the following wording (Clause 3):

"Such insurance does not apply to the liability of the insured to provide transportation, wages, maintenance and cure to any such employees."

Apparently on July 1, 1971, it was decided to delete the employer's liability coverage under the P & I policy covering the Department of Fish and Game vessel fleet and to add the coverage to the workmen's compensation policy.

Under maritime law, the owner of a vessel is liable for transportation, wages, maintenance and cure of an injured crew member. It would seem possible that the State of Alaska could incur fairly substantial expenses, such as hospital bills and wages, for an injured crew member of a Fish & Game vessel. Therefore, the rationale for this exclusion should be determined, although the matter is not of critical importance under a loss rating plan such as this where the State will ultimately pay all such costs anyway (plus the overhead costs built into the retention plan).

(c) Endorsement #15 to the Workmen's Compensation policy deletes the cancellation condition in its entirety and substitutes the following phrase:

"It is further understood and agreed that the policy to which this endorsement is attached will not be cancelled during its term except for non-payment of premium".

We understand similar endorsements were issued, deleting the cancellation conditions of the liability policies, although copies of these were not furnished to us. It would seem that cancellation by the State should be permitted and should not involve any penalty that would exceed an amount equivalent to the difference between the three year retention plan and the one year plan also quoted by ALPAC. This difference is 5% of the initial one year's standard premium.

(d) With regard to endorsement #17 (Retention Plan Endorsement) there is one word in paragraphs 4(a) and 4(b) which is most undesirable. Each of these clauses set forth the method of computing the "maximum loss adjusted premium" in the event of cancellation and refer to the "estimated" standard premium. The word "estimated" is imprecise. The question is: "How is it estimated and by whom?"

A more precise method would be to compute the maximum loss adjusted premium (in event of cancellation) by determining the amount of the standard premium for the period the policy was in force and then extending this amount (on a pro-rata basis) to the normal expiration date of the policy.

(e) If possible to arrange, the police professional liability policy should be discontinued and coverage added to the ALPAC general liability policy. The endorsement accomplishing this should be carefully worded to eliminate present non-concurrency of coverage. Under a loss rated (or self-insured) primary liability program,

the "police professional liability" risk should be treated in the same manner as other liability risks.

(f) The general liability policy contains a "liquor liability" exclusion both in its basic form and in the contractual liability endorsement. The servicing agent has already asked the insurer to delete these exclusions and we are in agreement, as it does appear that the State has at least a contingent liability in this area.

(g) Exclusion (c) of the personal injury liability endorsement excludes coverage for "personal injury sustained by any person as a result of an offense directly or indirectly related to the employment of such person by the named insured." Most insurance companies are willing to delete this exclusion for a negligible charge.

(h) Exclusions (m) through (p) of the contractual liability endorsement should be deleted.

D. Airport Liability Risks

The State's ownership, operation and maintenance of airports and seaports create potential liability of catastrophic proportions. Failure to properly maintain runways or to keep animals or people off runways, for example, could result in an airliner crash for which the State could be held liable. The potential liability for a Boeing 747 is almost astronomical, even when reasonably conservative estimates are used, such as:

350 passengers @ \$200,000 =	\$ 70,000,000
Hull value	<u>25,000,000</u>
	\$ 95,000,000

Even smaller jets such as 707s and DC-8s represent tremendous potential liability, estimated as follows:

135 passengers @ \$200,000 =	\$ 27,000,000
Hull value	<u>8,000,000</u>
	\$ 35,000,000

These are rough and rather conservative estimates of potential liability, because

- Loss of use of the hull is not taken into consideration,
- The average passenger liability settlement is now probably closer to \$250,000 than the \$200,000 figure used,
- Seating capacity varies and may exceed the figures used, and
- Hull values for certain aircraft configurations may exceed amounts shown.

Additional airport liability exposures of significant proportions are:

- Injury to concentrations of people in airport terminals by fire or explosion.
- Possible liability for aircraft in public tie-down spaces (so-called hangarkeeper's liability)
- Contingent liability arising out of operations of airport facility lessees or concessionaires.

The scope of our audit did not allow for personal inspection of airports. Information was developed by correspondence and interview of underwriters, State personnel in Juneau, the servicing agent and other persons familiar with Alaskan airports.

1. Risk Analysis

Several different and somewhat conflicting estimates were received as to the number of airports presently owned by the State of Alaska. The present airport liability insurer indicates there are now 597 state-owned airports, of which 325 are actually maintained by the State. There is scheduled jet service at 14 hub airports and intermittent jet traffic at 40 other airports. We are told that there is 747 service only to Anchorage and Fairbanks.

Considering the extremely large exposure base, the loss experience in recent years has been surprisingly good. Aside from the usual number of minor slip and fall cases and small aircraft property damage claims, only two incidents resulted in sizeable claim reserves. There is a bodily injury claim reserved at \$25,441, as the result of a person falling in an airport terminal. The other major incident occurred at Cordova in 1968. The insurer indicates this involved a 727 which struck a moose on the runway while landing. The current reserve is \$102,984 and there is some question whether anything at all will be paid, other than expense.

Although there are a number of relatively small slip and fall cases shown on the insurer's loss record, we received an indication that many minor claims are settled directly by the State, presumably by the Attorney General's office, and are paid out of airport revenues. This information was not confirmed. No reports on any such payments are received and recorded by the Division of Supply.

It is our understanding that the State rents public tie-down space to several hundred aircraft owners at both Anchorage and Fairbanks and a space rental charge is made. We are told that a procedure is followed of having the aircraft owners sign a form or statement to the effect that he is using the tie-down space at his own risk, etc. Nevertheless, it is possible that actions of State employees could create a bailment with regard to these aircraft. Furthermore, we believe the State may have, in the past, paid some claims directly and thereby created precedents.

The value of individual aircraft using State tie-down or hangar facilities may range from a few thousand dollars to over \$1 million for the more exotic corporate jets. The concentration of aircraft using State tie-down facilities suggests the possibility of significant potential hangarkeeper's liability. This loss exposure should be thoroughly investigated and analyzed with regard to every major airport operated by the State. The legal liability risk should be clearly identified and the maximum possible loss potential should be determined.

2. Existing Insurance

Details of the current airport liability policy are set forth in Chart M.

Coverage under this policy is limited to \$20 million per occurrence at the Anchorage and Fairbanks International Airports and \$5 million per occurrence with respect to all other airports and seaplane facilities.

These limits are inadequate.

This policy does not cover liability for property damage to aircraft in the care, custody or control of the insured or as to which the insured is for any purpose exercising physical control, although there is coverage for property damage to aircraft when the insured's control is solely traffic control over the movement of such aircraft. There is also an exclusion with respect to liability for property damage to any aircraft while the aircraft is being serviced or fueled by the insured. As previously discussed, a detailed survey is needed to determine to what extent, if any, the State is exposed to potential loss in these excluded areas.

The policy also excludes "...bodily injury or property damage due to any airmeet, air race or air show or to the conduct of any contest or exhibition involving the racing of automobiles or motorcycles, parachute jumping or sky diving, permitted, sponsored or participated in, by the insured". Since the wording of this exclusion is quite broad, a careful study should be made to determine whether actual exposures are excluded.

For example, the word "permitted" could be interpreted in a number of ways. Normally, "to permit" means to give express or formal consent, but it also can mean to make possible or to give an opportunity. Thus, for example, failure to expressly deny use of an airport for an airmeet, etc., could imply passive permission. This exclusion further supports the need for a great deal of risk identification work.

Considering the premium being paid for this insurance and the fact that the current insurer should be well acquainted with the risk they have underwritten for many years, it would seem possible to eliminate this exclusion for little, if any, additional charge. Certainly, the request should be made.

If this exclusion cannot be deleted, it is recommended that the State issue a written public directive expressly prohibiting the use of any State airports for any of the excluded activities. It would be far better to have the exclusion deleted.

Also recommended is deletion of the exclusion with respect to property damage to any aircraft while the aircraft is being serviced or fueled by the insured. Although we were told that the State is not officially involved in aircraft servicing and fueling operations, the actions of an employee could very well expose the State to liability falling within the scope of this exclusion.

A significant exposure may exist for so-called hangarkeepers liability. If this fact is confirmed, premium quotations should be obtained from the current insurer for broad hangarkeeper's liability insurance with a single limit of coverage per occurrence in an amount adequate to protect the State against the possibility of a catastrophe, such as a wind of hurricane force, which could snap tie-down chains on numerous aircraft. We caution against purchase of any such coverage with a low limit per aircraft. To keep premium cost as low as possible, the state should