

STATE OF MISSOURI



DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

P.O. Box 690, Jefferson City, Mo. 65102-0690

RE: Examination Report of Missouri United School Insurance Council as of December 31, 2007

ORDER

After full consideration and review of the report of the financial examination of Missouri United School Insurance Council for the period ended December 31, 2007, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, Kip Stetzler, Acting Director, Missouri Department of Insurance, Financial Institutions and Professional Registration pursuant to section 374.205.3(3)(a), RSMo., adopt such report. After my consideration and review of such report, workpapers, and written submissions or rebuttals, the findings and conclusions of the examination report are incorporated by reference and deemed to be my findings and conclusions to accompany this order pursuant to section 374.205.3(4), RSMo.

Based on such findings and conclusions, I hereby ORDER Missouri United School Insurance Council, to take the following action or actions, which I consider necessary to cure any violation of law, regulation or prior order of the Director revealed by such report: (1) implement, and verify compliance with, each item mentioned in the General Comments and/or Recommendations section of such report; (2) account for its financial condition and affairs in a manner consistent with the Director's findings and conclusions.

So ordered, signed and official seal affixed this January 20, 2009.



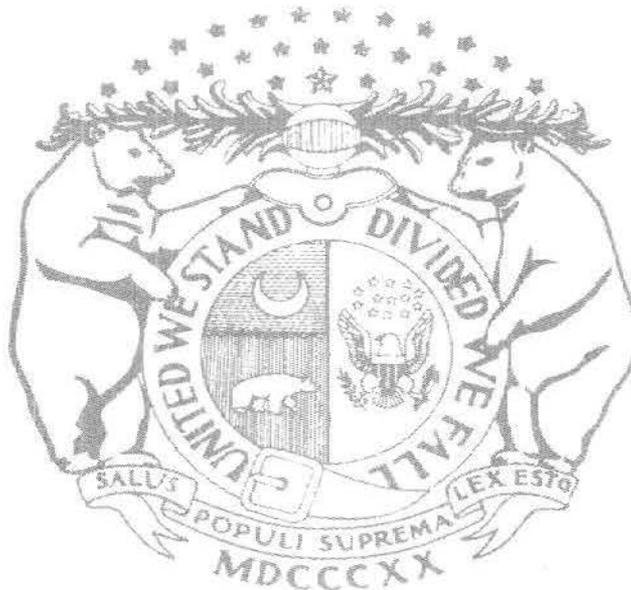

Kip Stetzler, Acting Director
Department of Insurance, Financial Institutions
and Professional Registration

REPORT OF
FINANCIAL EXAMINATION

MISSOURI UNITED SCHOOL INSURANCE COUNCIL

AS OF
DECEMBER 31, 2007

FILED
JAN 3 2008
DIRECTOR OF INSURANCE,
FINANCIAL INSTITUTIONS &
PROFESSIONAL REGISTRATION



STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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December 4, 2008
Saint Louis, Missouri

Honorable Linda Bohrer, Acting Director
Missouri Department of Insurance
Financial Institutions & Professional Registration
301 West High Street, Room 530
Jefferson City, MO 65101

Ms. Bohrer:

In accordance with your financial examination warrant, a financial examination has been made of the records, affairs and financial condition of

Missouri United School Insurance Council

also referred to as "MUSIC" or as the "Association." The examination was conducted at Arthur J. Gallagher and Company, the Association's broker, 12444 Powerscourt Drive, St. Louis, Missouri, 63131, telephone number (314) 965-4346. This examination began on October 6, 2008 and concluded on the date noted above.

SCOPE OF EXAMINATION

Period Covered

The prior financial examination of Missouri United School Insurance Council was performed as of December 31, 2004. The examination was conducted by an examiner from the state of Missouri.

The current full scope financial examination covers the period from January 1, 2005, through December 31, 2007. The examination was conducted by an examiner from the state of Missouri.

This examination also included material transactions and/or events occurring after December 31, 2007.

Procedures

This examination was conducted using the guidelines set forth in applicable regulations of the Missouri Department of Insurance, Financial Institutions and Professional Registration ("DIFP") and statutes of the state of Missouri. The workpapers of the Association's independent auditor, Conner Ash, P.C., were made available to the examiner. Standard examination procedures were modified as deemed appropriate under the circumstances.

Comments Previous Examination

Listed below are the comments and recommendations taken from the prior examination report as of December 31, 2004. The responses or actions taken by the Association are also described below.

1. Comment: Reinsurance

“It was noted during the examination that several of the Association’s reinsurance agreements do not contain an insolvency clause. It is recommended that the Association require its reinsurance carriers to include this clause in all reinsurance agreements.”

Company Response:

“An insolvency clause will be requested of all reinsurance carriers at the Association’s December 31, 2005 renewal, and thereafter.”

Current Findings:

The Association only has one contract that is designated as a reinsurance agreement, and it obtained an insolvency clause on this agreement immediately after the prior examination. However the various insurance policies by which the Association maintains excess coverage effectively represent reinsurance if the only named insured on these policies is MUSIC. It was noted during the examination that some of these policies name both MUSIC and the members as named insureds, but several only name MUSIC. It is recommended that the Association obtain insolvency clauses on all excess policies that do not name the Association’s members along with MUSIC as named insureds.

2. Comment: Members’ Fund Balance

“The Association reported a negative members’ fund balance at year-end 2004 and year-end 2003. The Association has discussed its financial situation with MDI (now DIFP). The Association should take steps to ensure that a positive members’ fund balance is achieved by early 2006.”

Company Response:

“The Association is currently projecting that there will be a positive members’ fund balance by the end of 2005, or during the first quarter of 2006. While every effort is being taken to bring this about, there will always be some inherent degree of uncertainty within a risk financing organization. The Association will continue to submit quarterly, unaudited financial statements to MDI (now DIFP) for review and comment.”

Current Findings:

The members’ fund balance began recovering almost immediately after the last examination due to a rate increase in 2005 of 10.5% and another 5% in 2006. The fund balances for 2005, 2006 and 2007 were \$5.3 million, \$20 million and \$32.9 million, respectively.

HISTORY

General

MUSIC was formed on December 4, 1985 under Chapter 537 RSMo to provide risk management for its member public school districts, junior college districts and public community colleges. Forty-seven districts instituted the Association with an initial assessment of \$2,286,692. The Association currently has four hundred seventy members. The assessment for 2007 was \$67,627,901.

Capital Stock

The Association is a not-for-profit entity and has no capital stock.

Dividends

Section 537.635 RSMo (Entity to be treated as corporation--not to produce profit--may pay dividends, when) permits the paying of dividends provided the Association has a positive surplus both before and after the dividend is declared. MUSIC has not paid any dividends since its inception.

Management

The Board of Directors consists of nine members duly elected by the membership as authorized by the by-laws. Directors serving as of December 31, 2007 were:

<u>Director</u>	<u>District</u>
Paul Fedchak	Clayton
Martin Garrison	Bolivar R-I
Richard Davis	Harrisburg R-VIII
Dr. Bernard DuBray	Fort Zumwalt R-II
Brad Barwick	Three Rivers CC
Rob Dowis	Jefferson C-123
Dr. Larry Ewing	Fort Osage R-I
Blane Keel	Clearwater R-I
Dr. Sally Knight	Gasconade Co. R-II

Officers serving as of December 31, 2007 were:

Chairman	Paul Fedchak
Vice-Chairman	Martin Garrison
Secretary	Richard Davis
Treasurer	Dr. Bernard DuBray
Executive Director	Gary VanMeter

The Association by-laws authorize the formation of an Executive Committee consisting of the officers of the Association. The Executive Committee is empowered to conduct those items of business that do not require action by the entire Board but that should not rest solely with the Executive Director.

Conflict of Interest

MUSIC has a policy requiring officers and directors to complete conflict of interest disclosure statements annually. The conflict of interest statements were reviewed for each year during the examination period. No material conflicts were indicated on any of the statements.

Corporate Records

The minutes of the Board of Directors meetings and of the General Membership meetings held during the examination period were reviewed. The minutes appear to properly support and approve the corporate transactions and events for the period under examination. The minutes reflect that the Board reviewed and approved the prior examination report on October 20, 2005.

No changes were made during the period of this examination to either the articles of association or to the by-laws.

Acquisitions, Mergers and Major Corporate Events

There have been no acquisitions, mergers or other major corporate events during the examination period.

Surplus Debentures

MUSIC has not issued any surplus debentures.

AFFILIATED COMPANIES

The Association is not a member of a holding company nor does it have any subsidiaries or affiliates.

FIDELITY BOND AND OTHER INSURANCE

MUSIC maintains a \$25,000 fidelity bond on the Association treasurer. Each Association member is also covered by a \$25,000 treasurer fidelity bond. The Association is also covered by a \$250,000 employee theft policy and by a \$2,000,000 trustees' errors and omissions policy. In addition, MUSIC has the following coverage, which is provided to all Association members:

<u>Coverage Type</u>	<u>Limit</u>
General Liability	\$2,375,000 per occurrence
Crime Coverage	\$1,000,000
Workers' Compensation	Statutory
Employer's Liability	\$1,000,000

EMPLOYEE BENEFITS

The Association has an employment agreement with its Executive Director. Under the agreement, the Executive Director receives vacation, sick leave, medical, dental and life insurance benefits. The Association does not provide pension or retirement benefits to employees.

STATUTORY DEPOSITS

Missouri statutes do not require the Association to maintain funds on joint deposit with the state.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

MUSIC is licensed by the Missouri DIFP under Chapter 537 RSMo (Torts and Actions for Damages). Public school districts and community colleges in the state of Missouri comprise the membership of the Association. The Association had 470 members at year-end 2007.

MUSIC contracts with consultants to perform many of its insurance functions. These contracts are described below:

Broker Contract

Arthur J. Gallagher & Company is the broker of record for MUSIC and provides the following services under contract:

- Marketing and selection of reinsurers
- Premium accounting and allocation
- Oversight of the loss control function
- Evaluation of the Association's insurance program
- Review of all contracts entered into by the Association
- Arbitration of loss settlements

The fees paid to Arthur J. Gallagher & Company during the examination period were as follows:

<u>Year</u>	<u>Service Fee</u>	<u>Percentage of Assessments</u>
2005	\$1,188,228	2.01%
2006	\$1,226,256	1.89%
2007	\$1,260,588	1.86%

Claims Administration Contract

Gallagher Basset Services, Inc. provides claims administration adjudication and loss control and prevention services for MUSIC. These services also include providing seminars and training sessions for member school districts in order to reduce or eliminate losses.

The fees paid to Gallagher Basset Services, Inc. during the examination period under this contract were as follows:

<u>Year</u>	<u>Service Fee</u>	<u>Percentage of Assessments</u>
2005	\$2,170,824	3.67%
2006	\$2,289,304	3.52%
2007	\$2,511,420	3.71%

Policy Forms & Underwriting

Under Chapter 537 RSMo, the Association is not required to submit its policy forms or premium rates to the Missouri DIFP. The Board of Directors reviews all school districts before acceptance into the Association.

MUSIC has a blanket policy called the Plan Document which is issued to all members. As described in the Plan Document, the following coverage is provided to all members:

- Property Coverage
 - Basic Property Coverages
 - Special Property Coverages
 - Inland Marine Coverages
- Automobile Coverages
 - Automobile Physical Damage
 - Automobile Liability
- Liability Coverages
 - Commercial General Liability
 - School Board Liability
 - Employment Practices Liability
 - Miscellaneous Medical Malpractice
- Commercial Crime Coverages
 - Crime Coverages
 - Treasurer's Bond
- Worker's Compensation
 - Worker's Compensation
 - Employer's Liability
- Boiler and Equipment Breakdown Coverages
- Catastrophic Violent Act Coverage

Advertising and Sales Materials

MUSIC advertises on a limited basis. A review of the Association's advertising did not indicate any misrepresentations.

Treatment of Policyholders

MUSIC is not required to maintain a record of members' complaints. However, the Association does appear to address its members' concerns.

REINSURANCE

General

The Association uses excess reinsurance agreements to provide coverage for its member school districts. The Association's per occurrence retention limits for 2007 were as follows:

Workers' Compensation	\$500,000
Automobile Liability	\$375,000
General Liability	\$375,000
Property	\$500,000
Crime	\$100,000

Assumed

The Association does not assume any reinsurance business.

Ceded

For 2007, MUSIC had the following excess insurance coverage limits:

General Liability	\$2,375,000
Automobile Liability	\$2,375,000
School Board Legal Liability	\$2,375,000
Miscellaneous Medical Malpractice	\$2,375,000
Employment Practices Liability	\$2,375,000
Workers' Compensation	Statutory Claims
Employer's Liability	\$1,000,000
Property	\$500,000,000
Crime	\$1,000,000
Auto Physical Damage	Actual Cash Value
Boiler & Machinery	\$100,000,000
Special Events	\$2,000,000
Trustees' Errors & Omissions	\$2,375,000

The Association's reinsurance coverage is brokered by Arthur J. Gallagher and Company. Several reinsurers participate in the excess property coverage at various levels. The Association appears to have obtained sufficient excess coverage.

The prior examination report included a comment that several of the Association's reinsurance agreements did not contain an insolvency clause. A recommendation was made that the Association require its reinsurance carriers to include an insolvency clause in all reinsurance agreements.

The review of reinsurance agreements during this examination again noted that several reinsurance agreements do not contain insolvency clauses. However it was noted that some agreements reflect both MUSIC and the Association Members as named insureds. Where this is the case an insolvency clause is not necessary. However the policies that do not include both MUSIC and the Association Members as named insureds should include an insolvency clause. It is recommended that the Association require its reinsurance carriers to include an insolvency clause in all reinsurance agreements that do not include both MUSIC and the Association's Members as named insureds.

ACCOUNTS AND RECORDS

The Association is audited annually by an independent accounting firm. The Association's auditor for the years under examination was Conner Ash, P.C.

The Association's reserves were established by CAI Casualty Actuaries, Inc.

FINANCIAL STATEMENTS

The following financial statements present the financial condition of the Association as of December 31, 2007, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the financial statements or comments regarding such are made in the "Notes to the Financial Statements," which follow the financial statements.

There may have been additional differences found in the course of this examination which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial in relation to the financial statements and therefore were only communicated to the Association and noted in the workpapers for each individual item.

ASSETS

Cash and cash equivalents	\$ 52,393,004
Investments	80,588,704
Member assessments receivable	18,133,408
Accrued investment income	925,219
Reinsurance recoverable on paid claims	651,838
Reinsurance recoverable on unpaid claims	16,287,363
Prepaid expenses	<u>40,748</u>
TOTAL ASSETS	<u>\$ 169,020,284</u>

LIABILITIES AND MEMBERS' FUND BALANCE

Unearned member assessments	\$ 67,206,593
Claim and claim adjustment expense reserve	25,000,000
Accounts payable and accrued expenses	222,777
Liability for uncleared checks and drafts	812,467
Claim and claim adjustment expense reserve	<u>42,904,247</u>
TOTAL LIABILITIES	\$ 136,146,084
 MEMBERS' FUND BALANCE	 <u>\$ 32,874,200</u>
 TOTAL LIABILITIES AND MEMBERS' FUND BALANCE	 <u>\$ 169,020,284</u>

STATEMENT OF OPERATIONS

Members assessments	\$ 67,627,901
Investment income, net	<u>4,709,199</u>
TOTAL REVENUES	<u>\$ 72,337,100</u>
Incurred claims and claim adjustment expenses	\$ 35,962,685
Premiums for excess reinsurance coverage	19,115,064
Insurance services	4,413,825
General and administrative	439,397
Premium taxes	<u>1,167,222</u>
TOTAL EXPENSES	<u>\$ 61,098,193</u>
REVENUES OVER EXPENSES	\$ 11,238,907
NET CHANGE IN FAIR VALUE OF INVESTMENTS	\$ 1,678,740
MEMBERS' FUND BALANCE, prior year	\$ 19,956,553
MEMBERS' FUND BALANCE, current year	<u>\$ 32,874,200</u>

NOTES TO THE FINANCIAL STATEMENTS

None.

EXAMINATION CHANGES

There are no examination changes.

GENERAL COMMENTS AND RECOMMENDATIONS

Reinsurance

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The review of reinsurance agreements during this examination noted that several reinsurance agreements do not contain insolvency clauses. It was also noted that some agreements reflect both MUSIC and the Association Members as named insureds. The Association should require its reinsurance carriers to include an insolvency clause in all reinsurance agreements if the agreements do not include both MUSIC and the Association's Members as named insureds.

SUBSEQUENT EVENTS

None.



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January 12, 2009

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Chief Financial Examiner & Acting Division Director
301 West High Street, Room 530
P.O. Box 690
Jefferson City, MO 65102-0690

RE: Financial Examination as of December 31, 2007

Dear Mr. Heese:

Please let this letter serve as our response to your letter of December 15, 2008 asking for a response or rebuttal to the Department's financial examination of the Missouri United School Insurance Council dated December 4, 2008. We do wish for this response to be included in the report as part of the public document.

The examination lists one item under General Comments and Recommendations. The recommendation is as follows:

The review of reinsurance agreements during this examination noted that several reinsurance agreements do not contain insolvency clauses. It was also noted that some agreements reflect both MUSIC and the Association Members as named insureds. The Association should require its reinsurance carriers to include an insolvency clause in all reinsurance agreements if the agreements do not include both MUSIC and the Association's Members as named insureds.

Response:

Upon the renewal effective December 31, 2008, all reinsurance carriers were instructed to include the Missouri United School Insurance Council and its Members as named insureds. We will check all agreements as they are received to ensure the named insured is accurate and will ensure all future agreements are compliant.

Thank you very much and I wanted also to take this opportunity to compliment the knowledge and professionalism of Mr. Richard Hayes, our assigned examiner. He was very easy to work with.

Sincerely,

Dr. Gary VanMeter
Executive Director

RECEIVED

JAN 14 2009

INSURANCE SOLVENCY
&
COMPANY REGULATION