

**ATTACHMENT 6**

**THIRD ANNUAL  
REPORT TO THE LEGISLATURE**

**DRAFT**

**COMMONWEALTH OF PENNSYLVANIA  
DEPARTMENT OF ENVIRONMENTAL PROTECTION**

**COAL AND CLAY MINE SUBSIDENCE INSURANCE PROGRAM  
MSI**

**THIRD ANNUAL REPORT**

**STATE FISCAL YEAR  
2005-2006**

**PREPARED BY**

**DEPARTMENT OF ENVIRONMENTAL PROTECTION  
BUREAU OF MINING AND RECLAMATION**

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**I. EXECUTIVE SUMMARY**

This report provides information about the Commonwealth of Pennsylvania's Coal and Clay Mine Subsidence Insurance (MSI) Program and its experience with mine subsidence insurance sales through insurance producers (insurance agents, brokers and agencies who are licensed in Pennsylvania to sell property and casualty insurance). The December 9, 2002 amendments to the Act of August 23, 1961 (P.L.1068 No. 484), as amended, (52 P.S. §§ 3201-3225) (Act), provide that the Department of Environmental Protection (DEP) submit this annual report to the Environmental Resources and Energy Committees of the Senate and House of Representatives. Those amendments also provide that, in addition to the to MSI Program staff who have historically sold MSI policies, insurance producers (agents and brokers who have property and casualty authority in Pennsylvania) are authorized to sell MSI coverage and be paid commissions for their sales. Providing insurance producers with the ability to sell MSI coverage is intended to increase subscriptions.

Established in 1961, Pennsylvania's MSI Program was the first MSI program in the nation. Eight other states now manage MSI Programs. When measured in terms of the numbers of subscriptions, Pennsylvania's MSI Program has always been the most successful of any MSI program that allows property owners to choose or elect coverage. Only states that mandate MSI coverage for all structures that are at risk have programs with more subscriptions.

For more than forty-five years the proprietary MSI Fund has met its mandates to provide affordable coverage and a reliable source of compensation for losses caused by mine subsidence. At the end of the last complete State Fiscal Year (FY), FY 2005-06, the annual premium for the average coverage amount of approximately \$119,000 cost only \$103. Premium rates have not risen in over twenty-five years. The MSI Fund continues to be solvent with an unreserved fund balance or net worth at the end of FY 2005-06 of \$46,034,617. At that same time the total underwritten coverage, which also represents the potential for losses, had grown to almost \$6.75 billion.

Although the MSI Program has successfully met its mandates, greater service can be provided because there are still more than one million structures at risk that are uninsured. Efforts by insurance producers to inform their customers of the availability and need for MSI coverage could significantly increase subscriptions. To efficiently and effectively assist the insurance producers in those efforts, DEP, with the assistance of insurance producers, has developed online application systems that are located on a website accessible via [www.paMSI.org](http://www.paMSI.org). These systems provide underground mine mapping and information that the insurance producers use to evaluate the need for coverage. If they determine that coverage is needed, the insurance producers can use these systems to complete and submit a MSI application in less than five minutes.

The efforts made by DEP to encourage insurance producers to use the online application systems have been successful. Of the estimated 2,500 active insurance producers that are located in the coal and clay mining regions, 1,855 have registered to sell MSI coverage. During FY 2005-06 the registered insurance producers sold 2,959 policies. During that same time MSI Program staff sold 2,134 policies. At the beginning of FY 2005-06 MSI subscriptions totaled 54,749, and by the end of that fiscal year subscriptions had risen to a record 56,567. (The difference between the total number of policies sold (5,093) and the gain to the number of subscriptions (1,818) results from 3,275 policy cancellations, which is normal attrition due mostly to the sale and transfer of property.)

To promote increased subscriptions, mass marketing campaigns have been conducted by DEP that encourage property owners to purchase MSI coverage. In addition, direct marketing efforts have been made to the insurance producers that encourage them to promote MSI coverage to their customers who are at risk and to then make valuable commissions by writing MSI coverage. To further encourage insurance producer sales, the MSI Board, which is the independent body mandated to administer the MSI Fund, established a generous one-time commission of 50% of the first year's premium. The payment of commissions has not resulted in any need to increase premium rates, and the data entry provided by the insurance producers when they submit their online applications reduces the overhead of the MSI Program.

## II. CONCLUSION AND ACTIONS

Pennsylvania's MSI Program continues to be the most successful elective mine subsidence program in the nation in terms of its volume of subscriptions with 56,567 structures insured at the end of FY 2005-06. Only states that mandate coverage for structures at risk have more subscribers. However, there are more than one million structures in Pennsylvania that are at risk and that are uninsured. The unfortunate consequence of the vast majority of structures being uninsured is that the vast majority of losses caused by mine subsidence are borne by individual property owners and not the MSI Fund.

Surveys of property owners in the mining regions demonstrate that they are knowledgeable of the potential for mine subsidence and of the availability of affordable MSI coverage. At an average policy cost of about \$100 a year, the choice not to purchase MSI coverage is not usually made for financial reasons. Property owners choose not to purchase MSI coverage because they believe the risk of loss is minimal, which is supported by the fact that only about one in every 2,200 insured structures is affected by mine subsidence each year. However, based upon insured structures, the average cost to repair a structure damaged by mine subsidence now approaches \$40,000, a potential loss that should compel the average property owner to insure even though the risk to any single structure is minimal.

Combining the proven ability of the MSI Program to manage claims and provide affordable coverage with the insurance producers unmatched ability to deliver coverage to the customers who know and trust them is expected over time to significantly increase MSI subscriptions and thereby diminish uninsured losses. The potential for increased MSI subscriptions can be realized if insurance producers are convinced of the need for coverage and if they are then able to convince their customers of that need. Although the heightened awareness that will result in significant increases to subscriptions is expected to happen gradually, it could be accelerated sharply if a number of high profile subsidence events causing widespread damage would occur.

Marketing will continue to be conducted to continually educate insurance producers and property owners of the availability and need for MSI coverage and to encourage insurance producers to promote MSI coverage. Increased direct marketing will be conducted to encourage insurance producers to promote MSI coverage to their customers and to make valuable commissions for the policies they write. Increased mass marketing will continue to encourage property owners who own structures located above old abandoned underground coal and clay mines to apply for coverage.

The following actions will also be taken during FY 2006-07 to further promote MSI subscriptions:

- Marketing materials will continue to be improved.
- Online application systems will continue to be improved.
- Electronic payment capabilities will be more fully developed.
- Surveys of the insurance producers will continue to be conducted to better identify their needs.

## III. BACKGROUND

In the late 1950s the private insurance industry excluded mine subsidence from standard property and casualty insurance coverage because the industry could not economically investigate claims and therefore could not provide affordable coverage. Using the resources of its mine regulatory programs, which are now organized within DEP, to investigate claims and provide administrative support, the Commonwealth, through the MSI Board, has for more than forty years successfully managed a solvent MSI Fund that provides very affordable coverage. There are over one million structures in Pennsylvania

that are located above old abandoned coal and clay mines. The subsidence of those mines causes millions of dollars of property damage on average each year.

The MSI Fund was created in 1961 to provide a reliable source of insurance to compensate for losses caused by the collapse of old abandoned underground coal and clay mines. It is a proprietary fund of the Commonwealth for the sole purpose of funding the operations of the MSI Program, which includes the payment of valid claims and the administration of the MSI Program. It was established with a one million dollar grant from the Legislature. Retained premiums of the MSI policyholders and interest income from the investment of those premiums by the State Treasury have resulted in an unreserved fund balance at the end of FY 2005-06 of \$46,034,617. Those funds stood against the nearly six and three-quarter billion dollars in underwritten coverage, which is also the loss potential of the MSI Fund.

Mine subsidence causes substantial losses in Pennsylvania each year to both insured and uninsured structures. Surveys of property owners in Pennsylvania's mining regions demonstrate that there is widespread knowledge of availability and need for MSI coverage. However, only about 5% of the structures in Pennsylvania that are at risk from losses caused by mine subsidence have MSI coverage. By comparison, virtually all structures are covered by standard property and casualty insurance policies, which are written by the insurance producers.

Mine subsidence is highly unpredictable and the damage it causes can be very costly to repair. The absence of mine subsidence coverage exposed property owners to personal financial losses and negatively impacted the economic vitality of the coal regions by also exposing the mortgage industry to the risk of uninsurable losses. Such exposure impaired the ability of lenders to fund mortgages, which resulted in suppressed property values. To provide a reliable source of funding and promote the economic vitality of the mining regions, the Legislature determined that a special proprietary fund organized within and utilizing the resources of state government would allow those at risk to mutually insure against the risk of mine subsidence losses, and do so at affordable premium rates.

As established in the Act, the MSI Board (Board) administers the MSI Fund. The Board is comprised of the heads of three departments of state government. The Secretary of the Department of Environmental Protection (DEP) chairs the Board and the Insurance Commissioner and State Treasurer are members. The Board establishes provisions of the insurance policy, promulgates regulations, and establishes premium rates, which are to be adequate to provide reserves sufficient to maintain the solvency of the MSI Fund.

The expertise provided by the Board members and their staffs contributes greatly to the economic and efficient operations of the MSI Fund and Program. The Insurance Department contributes actuarial and insurance policy expertise. The Treasury, the mandated custodian of the MSI Fund, invests the Fund's reserves. DEP, the agency mandated to administer the MSI Program, contributes mining expertise that allows for the economical investigation of damage claims and also provides operational support through the use of its computer aided systems, which further provides for the economical administration of the MSI Program.

DEP uses its mining expertise and other mining program resources such as underground mining maps and geographic information systems (GIS) to economically manage the operations of the MSI Program. Through the use of these resources, DEP is able to minimize the costs associated with the investigation of claims, which thereby allows the MSI Fund to offer coverage at very affordable rates. DEP uses its extensive computing systems to further add efficiency and economy to the operations of the MSI Program, which, in addition to investigating and processing claims, includes processing applications and renewing coverage.

To improve the outreach to the owners of the more than one million uninsured properties, routine advertising campaigns were initiated by DEP in the late 1990s. Although the campaigns were effective and subscriptions increased, MSI's market share did not appreciably improve. In an effort to significantly increase subscriptions, the Legislature amended the Act in December of 2002 to allow insurance producers to sell MSI coverage and be paid commissions for the policies they create. There are more than 2,500 insurance producers licensed with property and casualty authority located in Pennsylvania's Anthracite and Bituminous Coal Regions. These insurance producers are now able to directly inform their

existing customers, who are essentially the owners of all the structures that are at risk from mine subsidence damage, of the availability and need for MSI coverage. They can then encourage them to insure against that risk.

To promote and assist in the efforts of the insurance producers, DEP developed online systems that provide all the tools the insurance producers need to conduct their MSI operations. These include an online application, which automatically submits the application data to DEP's computers so that it can be processed in real-time. To make sure these systems met the needs of the insurance producers, DEP worked with insurance producers who volunteered to assist in the development and testing of the online systems. Insurance producers are routinely surveyed in an ongoing effort to provide them with the best systems and services possible so that they are able to meet the needs of their customers.

As directed by the MSI Board, DEP has conducted mass marketing campaigns to encourage property owners to contact their insurance producers to purchase MSI coverage. It has also conducted direct marketing to the insurance producers to encourage their efforts to promote MSI coverage to their customers who are at risk. In addition to these efforts, DEP has developed the following products and services to support insurance producer sales:

- Marketing and sales kits.
- Online underground mine mapping systems to determine underground mining conditions and customer risk.
- Support systems including a toll free help line and extensive information about mine subsidence.
- Special newsletters to the insurance producers sent via email that updates them on mine subsidence events and new tools and services being provided to them by DEP.

## **V. FY 2005-06 MSI PROGRAM PERFORMANCE**

During FY 2005-06, the MSI Program staff created 2,134 new MSI policies. At the end of FY 2005-06, the MSI Fund had 56,567 structures insured. At that time its Unreserved Fund Balance or net worth was \$46,034,617, and the total underwritten value or loss potential was almost \$6.75 billion. Based upon the MSI Fund's historical operating performance, the MSI Board deemed those reserves to be adequate to stand against normal and catastrophic losses.

## **VI. FY 2005-06 INSURANCE PRODUCER IMPACTS**

Of the estimated 2,500 active insurance producers that are located in the Anthracite and Bituminous Coal Regions, 1,855 have registered to use the online application systems. During FY 2005-06 those insurance producers sold 2,959 policies, for which they received \$201,525 in commissions.

## **VII. TEN YEAR STATISTICAL/FINANCIAL SUMMARY**

The statistical and financial information in this summary demonstrates the operational and financial performance of the MSI Fund and Program and documents the contributions made by the insurance producers. The data is tracked on a fiscal year (FY) basis. To provide a historical perspective, the summary begins with data from FY 1996-97. The first fiscal year that insurance producers were eligible to submit MSI applications was FY 2002-03, and their first full fiscal year was FY 2003-04. Please note that the number of "POLICIES IN FORCE" from year to year is a function of the number of new policies less the number of policies that cancel. Policy cancellation is the normal attrition to subscriptions that is caused by the sale or transfer of ownership and averages about 10% per year.

<b>STATISTICAL/FINANCIAL SUMMARY</b>								
STATE FISCAL YEAR	POLICIES IN FORCE	UNDER-WRITTEN COVERAGE IN \$ MILLIONS	UNRESERVED FUND EQUITY	POLICIES CREATED BY MSI PROGRAM	POLICIES CREATED BY INSURANCE PRODUCERS	REGISTERED INSURANCE PRODUCERS	PRODUCER GENERATED PREMIUMS	COMMISSIONS PAID
1996-97	43,589	\$3,478,793	\$15,039,743	3,203	0	0	\$0	\$0
1997-98	44,319	\$3,640,974	\$17,149,560	3,117	0	0	\$0	\$0
1998-99	44,574	\$3,746,272	\$19,927,027	2,743	0	0	\$0	\$0
1999-00	45,420	\$3,945,403	\$22,759,927	2,481	0	0	\$0	\$0
2000-01	52,395	\$4,754,237	\$27,187,788	7,217	0	0	\$0	\$0
2001-02	53,309	\$4,950,738	\$30,375,641	3,554	0	0	\$0	\$0
2002-03	53,280	\$5,134,789	\$33,211,797	2,943	9	35	\$2,539	\$0
2003-04	53,487	\$5,484,411	\$34,935,305	1,980	1,405	791	\$178,424	\$67,446
2004-05	54,749	\$5,972,256	\$38,345,724	1,992	2,144	1,520	\$271,392	\$124,767
2005-06	56,567	\$6,728,375	\$46,034,617	2,134	2,959	1,855	\$429,553	\$201,525