EXHIBIT B

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Public Education Facilities Property Insurance

Presented by:

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Executive Summary

Project Overview

The Executive Subcommittee issued RFP #BLR-230001 with the clear intent to develop and implement a strategic plan and legitimate framework for provision of reasonably priced property insurance coverage options to K-12 school districts in the State of Arkansas on an actuarially sound basis while providing for oversight of the plans through a governing structure and legislative oversight.

Currently, school districts purchase property insurance coverage through one of two separate entities: the Arkansas Public School Insurance Trust (APSIT) administered by the Arkansas Insurance Department (AID) or the Arkansas School Boards Association (ASBA). For the 2023-2024 plan year, school districts are facing increased property insurance premiums under both of these plans.

It is the objective of the Subcommittee, by entering into a Contract for consulting services, to provide to the members of the Arkansas Legislative Council detailed and accurate information concerning a multi-year strategic path forward for provision of property insurance to K-12 school districts in a manner that will provide for reasonable and predictable premium rates, as well as consistent governance of the plans and legislative oversight, funding mechanisms, and options for revisions to the current plans, including without limitation the possibility of combining the two plans and implementing a self-insured structure or utilizing re-insurance, or some combination of self-insurance with reinsurance above recommended specific aggregate limits.

The final work product shall constitute a spectrum of options with reasonable assumptions as to the economic, logistic, legal, and political ramifications of the various options. Every effort should be made to provide the options in a politically-neutral and option-agnostic approach allowing the Subcommittee to be presented actionable and reasonable data, likely outcomes, and anticipated costs for the Subcommittee to fully analyze, debate, and act upon as they elect to do so. The final work product shall address all aspects of operations of the functioning of the plans to provide property insurance to K-12 school districts in the state.

This report presents a conceptual plan for lowering the cost of property insurance for the State of Arkansas public education facilities. The loss, concentration, and market analyses presented in this report serve as the foundation for recommending a sweeping change to the State's property insurance programs – forming a state-owned captive insurance company. No actuarial study has been performed or relied upon in developing this conclusion; rather, it is recommended that an actuarial study be conducted by the board of directors once the structure is finalized and an operating plan is developed.

Initial Observations

- Three separate programs
  - Staffing for Risk Management and Claims already in place

- Existing programs compete against one another over capacity from the same pool of insurance companies

  - Programs seek similar policy limits

  - Insurance being purchased within expected loss amount

  - Currently operating like an insurance consumer, not an insurance company

  - 5 Major Loss Types- Wind, Hail, Fire, Frozen Pipes, and Other

- The State and school districts are at the mercy of underwriters for coverage at unaffordable pricing

- Rates charged to schools vary

- Inadequate limits of insurance for all programs

- Many scenarios where one major event would exceed the loss limit

- Recent claims activity and study of statements of values raise valuation concerns for some properties

- All programs part of a Trust, with authority concentrated with one individual to make all decisions

- Strategy to maintain rate and keep deductibles low, missed opportunities to build reserves during soft market conditions

- Lack of Corporate Governance

  - Risk Management focus should be on loss prevention, valuation and claims

  - Risk Finance focus should be on protecting the financial health of the insurance company

  - There is a significant difference between buying insurance and managing risk

- Higher-ed comingled with state property as a whole

Recommendations

- Form a single purpose captive insurance company owned and operated by the State of Arkansas. We think "The Diamond State Insurance Company" has a nice ring to it

- Combine all programs to provide catastrophic limits and lever economies of scale

	Insurance Program	Insurance Company
Control	Market sets price, limited control.	Loss history sets price, greater control.
Costs	Premium costs expected to increase over time with natural disaster frequency and loss-cost inflation. Commissions and profit-requirements increase program costs.	Estimated cost savings of $10 to $12 million annually. Scale benefits entering reinsurance market; investment revenue should offset loss-cost inflation.
Values	Limits are inadequate: $500 to $700 million insured value, three separate programs.	Limits are adequate: $2.5 billion insured value.
Resources	Current staff tasked with risk management and purchasing insurance, resulting in sub-optimal outcomes.	Separate functions of risk management and purchasing insurance. Focus on the core competencies of loss prevention and managing claims.
Implementation	Zero implementation risk, "do nothing".	High implementation risk mitigated by use of expert advisors and proper governance.

- Capitalize with a recommended minimum investment of $200 million

- Structure the Insurance Company to retain the first $50 million of losses, and protect the capitalization with sideways insurance on this retention

- Place reinsurance above the retention - up to a minimum of $2.5 billion
    - Necessary to protect against a tornado outbreak, where one or multiple large tornados take a direct path through the highest risk concentrations, resulting in catastrophic damage to multiple properties encompassing the largest high school and/or college campuses
    - Substantially increases limits over current programs – procure more insurance for lower premium

- Charge sufficient premium to the schools to cover the annual expected losses and the cost of reinsurance, creating policyholder surplus to be invested and pay claims

- Establish corporate governance to eliminate conflicts of interest, provides checks and balances - Board reports to Arkansas Insurance Commissioner
    - AID Risk Management Division – Loss prevention, property valuation, claims
    - Board of directors – Captive management, investment strategy, policy language & reinsurance placement

- Board reports to Arkansas Insurance Commissioner

- Implement an investment strategy to invest the capitalization and premium surplus

- Begin operations by 10/1/2024

- The greatest risk is to do nothing. Act now, act decisively.

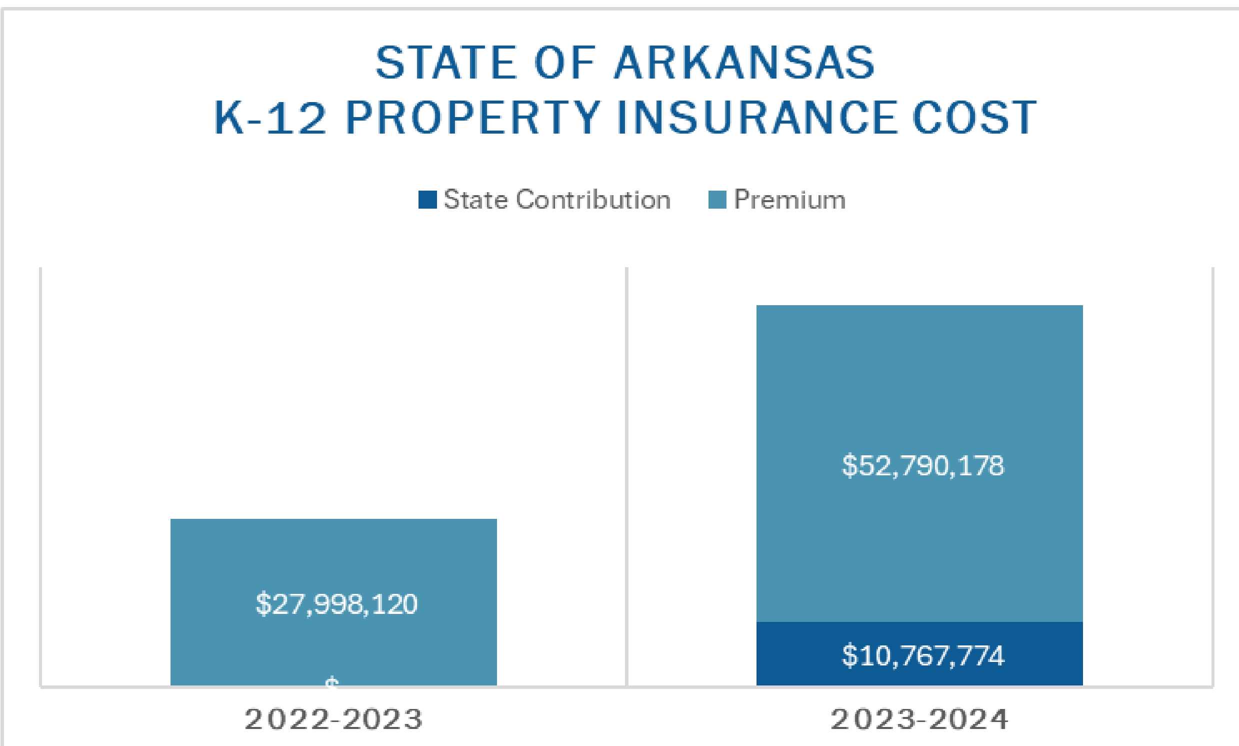
Benefits

- ❖ Protects our schools, by providing controllable, affordable, adequate, and sustainable insurance coverage today and for the future
- ❖ Provides access to a broader breadth of reinsurance markets, creating competition for the placement and greater access to capacity
- ❖ Eliminates the frictional cost of multiple vendors
- ❖ Applies same rate across all schools
- ❖ Provides transparent, responsible Corporate Governance
- ❖ Immediately saves $10-$12 million; current program premiums are $86 million compared to $75 million in this recommended structure
- ❖ Provides investment income to protect the insurance company
- ❖ Reallocates an asset solving complex problem for our schools, as opposed to just spending money doing the same thing
- ❖ State retains the capital investment as an asset
- ❖ Provides the foundation allowing for expansion as needed
- ❖ Flexibility for the board of directors to annually manipulate multiple levers to insure the profitability and health of the insurance company
- ❖ Sets precedent that other states will follow
- ❖ Puts Arkansas on the map as a captive domicile – bringing back captives owned by Arkansas businesses, and more tax dollars as a result

Project Overview & Scope

Causes for Concern

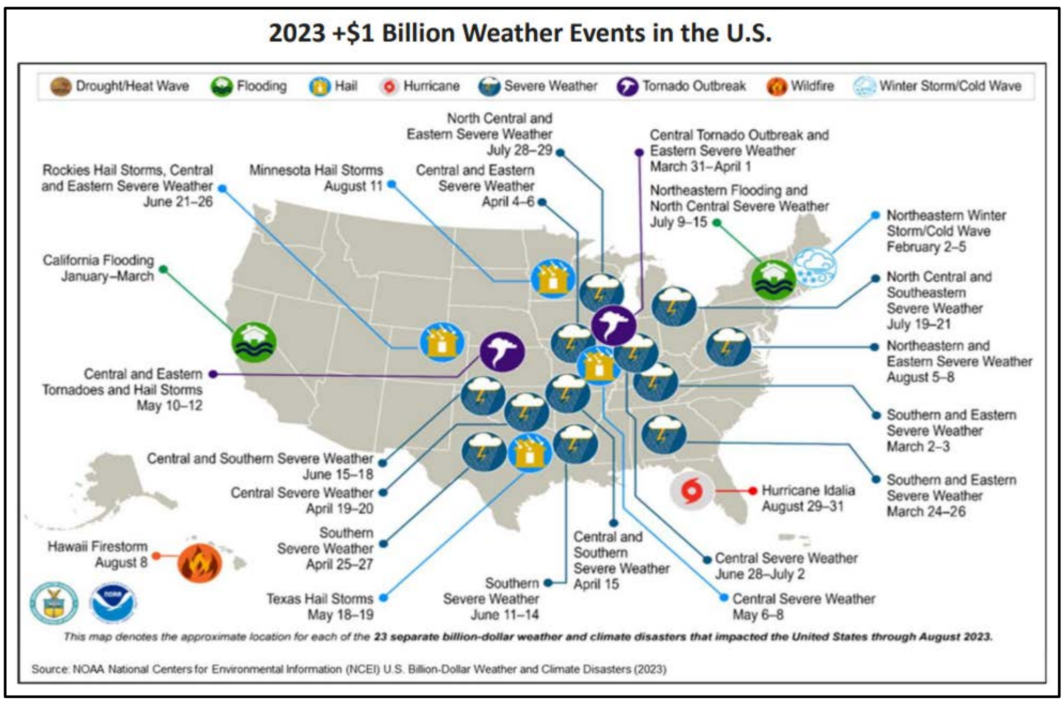
During the renewal prior to the 2023-2024 school year, Arkansas K-12 school districts faced a 130% increase in insurance premiums following elevated claims history the prior few years. In response to this, Governor Sanders subsidized 30% of the increase through an $11 million pledge.[1] Immediately following this, RFP #BLR-230001 was put out by the ALC-Executive Subcommittee for a "public education facilities property insurance study" with the goal of helping the State control the cost of property insurance for public education facilities, and to ultimately avoid costs skyrocketing at renewals.



[1] Antoinette Grajeda, "Arkansas Governor Authorizes Aid for Rising School Insurance Rates." *Arkansas Advocate* (2023)

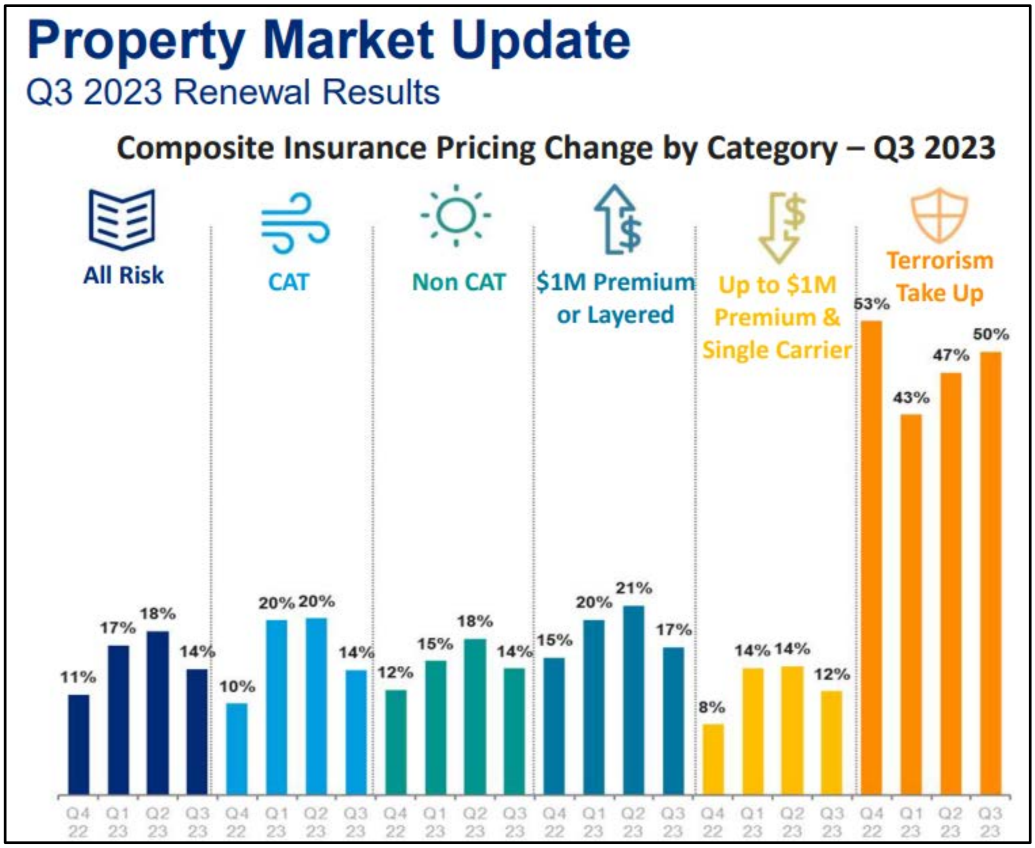
Market Context

In the summer of 2022, the United States had been recovering from tornados, massive hailstorms, floods, polar vortex, wildfires and hurricanes. Coming out of a global pandemic, the world economy was experiencing inflation at the highest rates since the 1970's and early 1980's. Building costs had been relatively flat for years, interest rates the lowest in decades, and construction activity was at an all-time high. Many knew that trouble was brewing, but few did much to prepare for it. Overnight, property valuations soared due to increased construction costs, consuming already strained domestic and international insurance capacity. In previous "hard" insurance markets, insurance carriers needed higher rates and more restrictive terms and conditions in order to return to a more stable market. This time, it's different. Not only are insurance rates increased, in some cases almost doubled, but the new and higher rate also applies to a property value that is typically double.



Source: Marsh

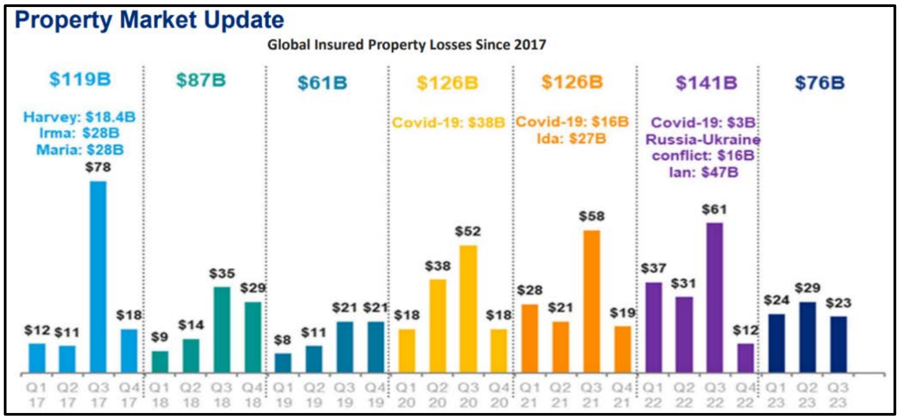
Many forces in the insurance market contributed to escalated rates. Some forces are part of a global crisis in insurance, but some are more targeted towards the State of Arkansas and even the current insurance programs themselves.



Source: Marsh

Globally, the Office of Financial Research (OFR) points to poor returns on invested capital for insurance companies as the reason for a hardened market. The OFR attributes the poor returns to high inflation, greater exposures in high-risk areas, and increases in the cost of reinsurance. The OFR also points to increased losses from modest but frequent convective storms. Through the summation of these factors, the Office of Financial Research claims that "these changes have resulted in the traditional insurance and reinsurance economic models becoming stressed and causing significant disruption in the traditional insurance model".[2] Pursuant to RFP #BLR-230001, Meadors, Adams & Lee emphasizes the importance and opportunity to identify solutions outside of the traditional insurance model.

[2] Arthur Fliegelman, "Wind, Fire, Water, Hail: What Is Going on In the Property Insurance Market and Why Does It Matter?" *Office of Financial Research* (2023)

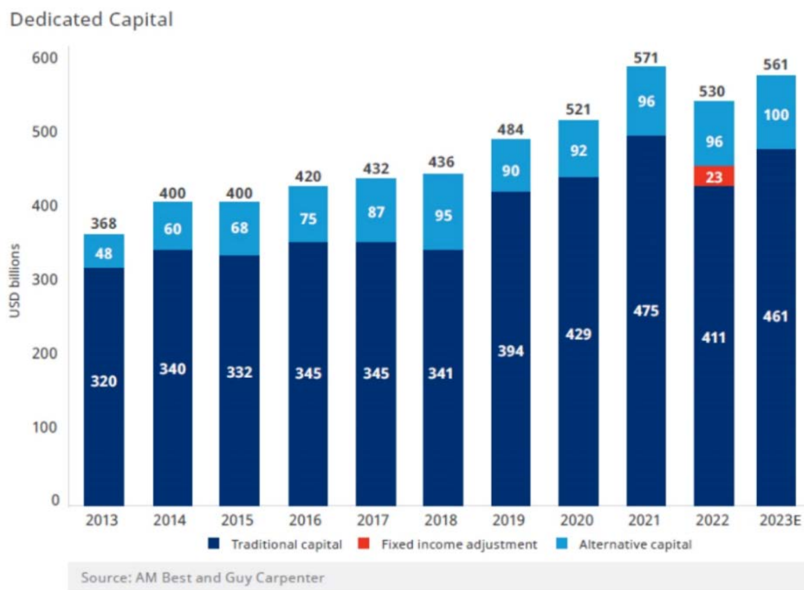


Source: Marsh

Pertaining to the conditions of Arkansas within the insurance marketplace, a series of similar catastrophic events have affected the market since 2017. The increases in rate can be attributed directly to the spike in convective storms, and high reconstruction costs resulting from the losses. Major tornadoes such as the Little Rock and Springdale F-3s seemingly justified much of the fear from insurance companies surrounding tornadic risk in Arkansas. Even risk that had no historical losses experienced dramatic changes in rate, terms, and conditions.

Because reinsurers do not have to be licensed the same way as an insurer, more companies are available, and capital is less constrained. Many carriers choose not to operate in the United States, opting for offshore locations such as London, Bermuda, Japan, etc. They are compliant with the regulations in their jurisdiction but find complying with 52+ different states to be cumbersome.

Reinsurance capacity increased throughout the year ending 2023 due to the improved investment income and favorable underwriting results. This potentially provides stabilization in the marketplace. Guy Carpenter, in conjunction with AM Best, estimates total Dedicated Reinsurance Capital increased by 10% compared with the year ending 2022.



Of the 15 Bermuda Reinsurers that are rated by AM Best as A- or better, more than $200 billion in capacity is available as reinsurance to captives.

Current Status

Of the three programs, two are operated by the Arkansas Insurance Department, and one is operated by the Arkansas School Boards Association. The Arkansas Public School Insurance Trust (APSIT) handles 78 K-12 school districts, while higher-education is covered under the Arkansas Multi-Agency Insurance Trust (AMAIT) that includes all other state property. The Arkansas Insurance Department manages both. The Arkansas School Boards Association currently covers 177 K-12 school districts, and their share is considerably larger than APSIT's. With the number of districts and buildings in the ASBA program, it is understandable why AID is concerned about its ability to simply consolidate the additional schools into the current structure.

Table 1

	ASBA	APSIT	Higher-Ed	Totals
Insured Value	$ 16,036,657,877	$ 9,821,448,040	$ 15,074,537,179	$ 40,932,643,096
Limit	$ 700,000,000	$ 500,000,000	$ 500,000,000	
Premium	$ 40,260,030	$ 23,297,922	$ 23,041,385	$ 86,599,337
Staffing	4	17		21
Districts	177	78	40	295
Buildings	14,322	3,139	2,596	20,057

State property was not included in the scope of this study, and the inclusion of state property could affect the final capitalization and structural recommendations presented herein. State property is referenced because it will either remain in the current trust, absent of higher-ed property, or it will be insured by the proposed state-owned insurance captive. State property will be affected either way.

Sustainability and flexibility are key components of this recommendation. Due to the nature of higher-ed property and state property currently sharing a program, the ability of the captive to absorb additional property as needed is essential for a viable, long-term plan.

Current program summaries are posted in Exhibits 1-3 in the Appendix.

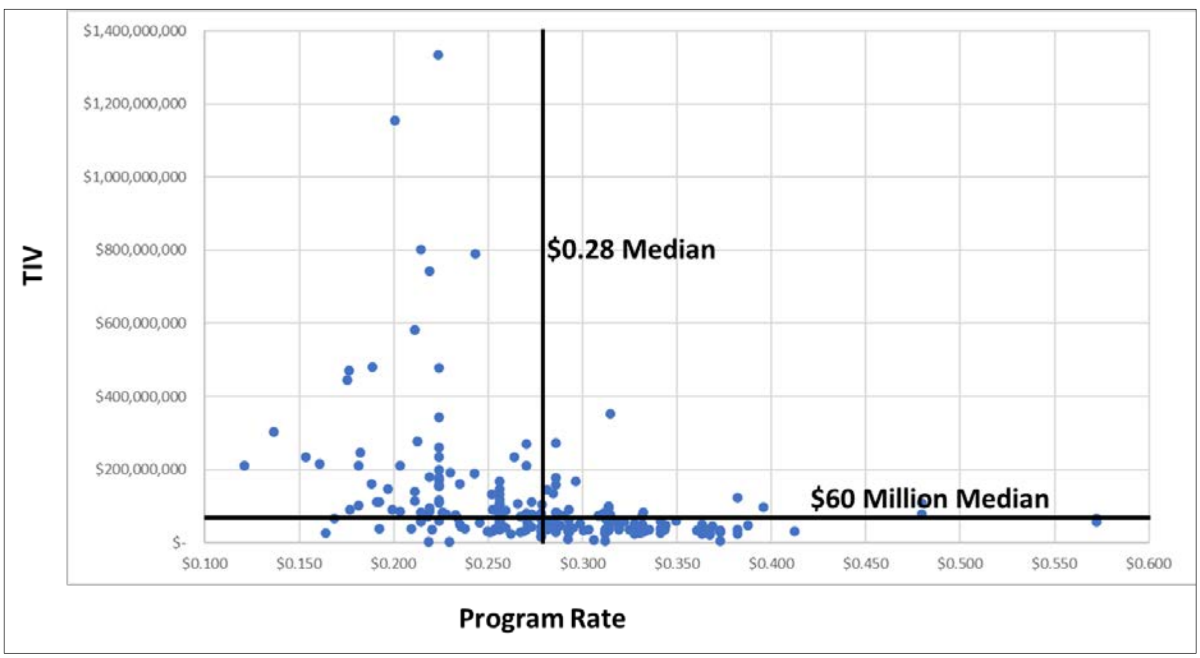
Program Rate Variability

Further study of the current programs led to an interesting observation that most schools were charged a different rate per $100 of insured value. Looking at this from the perspective of athletic classification, it is interesting to note that 2A-5A schools pay 30% to 50% higher rates on average than the larger 6A and 7A schools. In addition, the smaller schools' potential limit utilization is much less at 5% to 15% of the APSIT and higher-ed limit of $500 million, versus 55% to 135% for the 6A and 7A schools.

Conference	% Premium	% Value	Avg Rate	Avg Premium	Avg Value	Avg Limit Utilization
2A	6.3%	4.8%	***0.3101***	$ 129,167	$ 40,545,714	8.1%
3A	13.0%	10.6%	***0.2998***	$ 172,067	$ 57,725,094	11.5%
4A	20.0%	18.5%	***0.2630***	$ 226,333	$ 86,687,990	17.3%
5A	18.6%	18.6%	***0.2460***	$ 381,803	$ 157,753,799	31.5%
6A	16.7%	17.9%	***0.2268***	$ 616,490	$ 274,064,650	54.8%
7A	25.4%	29.6%	***0.1997***	$ 1,407,211	$ 678,272,162	135.6%

Class	Total Premium	Total Value	Avg Premium	Avg Value	Avg Rate	Avg Limit Utilization
2A & 3A	$ 10,714,313	$ 3,519,188,218	$ 155,280	$ 51,002,728	0.3045	10.2%
6A & 7A	$ 23,319,466	$ 10,893,691,364	$ 932,779	$ 435,747,655	0.2141	87.1%

Below is a scatterplot mapping the correlation between rate and insured value for current programs:



As evidenced in the scatterplot and the tables above, larger schools have more advantageous rates, despite their need for larger loss limits. Smaller schools have highly variable rates and tend to pay more for each $100 of insurance coverage.

It is important to understand that a paradigm-shift has occurred within the insurance industry, in which concentrations of high-value property now contribute to rate increases as much as any other factor. Transitioning to a new approach and a new structure would present an opportunity to address the inequities found in the current programs, potentially providing much needed relief to the State's poorest school districts by allowing them to address preventative maintenance issues that have contributed to claims.

Bottom line: Inequitable rate structure penalizes the smallest schools and is the first sign of a need for stronger corporate governance.

Methods

In order to accomplish the goal of the Subcommittee, statements of values and claim information from the past 10 years for the three programs currently in place was requested. Once obtained, the data was combined, locations and insured values were mapped, concentrations of values were determined, and claims were analyzed. This process led to the determination of major loss types and development of the loss forecast.

Data Aggregation

The first step was to aggregate the data from the three programs. After data was requested and obtained by Meadors, Adams & Lee, it was organized separately with each program. Data was transposed into one holistic form for statements of values and loss data, which was critical for analyzing the data thoroughly. As all recommendations are built on the principle of combining the three programs into one program operated by the AID, this was the most complex, yet critical part. Never has there been comprehensive data organized including all public education facilities in Arkansas.

Mapping

From the aggregated file containing every insured building, locations were mapped with corresponding district names and insured value. When placed on a map of the state, there was evidence of high concentration of values in Central and Northwest Arkansas. This was true when looking at K-12, higher-education, and combined. It became clear to us that current program limits were insufficient if a major storm impacted an area with concentrated values. Any plan must increase the limit of insurance with these two concentrations in great consideration to provide adequate coverage for the state as a whole.

After initial mapping, points were then aggregated into hexagonal bins spanning approximately 5 miles from top to bottom. Spaces where there were no public education facilities did not have bins at all, which provided insight into the parts of Arkansas that could be ignored in the study. Coloration in the bins darkened as total insured value within each zone increased.

This analysis provides insight as to where high value properties are concentrated alongside the quantity of buildings, revealing multiple conclusions. It became clear that the current risk financing was inefficient and did not properly evaluate the needs of the largest schools in the most densely populated areas of the state: Central and Northwest Arkansas. The Little Rock and Northwest Arkansas concentrations of value are so large that these areas should determine the loss-limit requirements for the entire state. Additionally, there are a few zones where there may not be an exceptional number of districts/colleges, but the value is so concentrated that it becomes high risk.

Loss Analysis

Once mapping was complete, aggregating losses together from the three programs was another big piece of the puzzle. Each program worked with the loss data according to their methods, so transposition required a clear understanding of how loss events were quantified and categorized. In doing so, the inconsistent approach became apparent.

In previous years, each of the three programs were sent to the marketplace to get quotes around the same time of the year. This caused the same underwriter to consider the loss experience of all the programs at the same time, which had an adverse effect on programs with fewer losses. Going forward with one unified program, a combined loss history will be of great importance in the marketplace.

Major Causes

Through a combination of organizing aggregate data for mapping and losses, the picture started to come together. Concentration mapping illustrated where property values are located, and historical losses show where claims occurred. The study confirmed the significant weather events impacting Arkansas over the past decade.

Losses were first organized by type. The data consisted of many different types, where the loss type would just have a few occurrences in it, making the big-picture hard to grasp. After narrowing down the focus of these types, it became apparent that wind, hail, fire, and frozen pipes were the major causes of loss to focus on. All of the other losses were grouped within the “Other” category.

Table 2

Loss Type	Number	Cost
Lightning	538	$ 16,945,425
Water Damage	474	$ 11,138,429
Theft/Vandalism	160	$ 1,933,637
Snow and Ice	149	$ 2,772,481
Misc.	120	$ 4,646,232
Vehicle	95	$ 750,000
Flood	75	$ 17,893,864
Freeze	14	$ 8,884,997
Sprinklers	1	$ 1,425,000
Total	1,626	$ 66,390,065

Loss data from 2013-2023

In *Table 2*, "Other" claims consist of sprinkler leakage, flood, damage caused by vehicles, snow and ice, and theft. Of interest, 538 claims were caused by lightning damage that incurred $16.9 million in losses. Future lightning damage claims could be prevented with proper loss prevention. The same can be said for other preventable losses such as theft, sprinkler leakage, and general freezes. This is one of the most important focuses of risk management, having a direct and meaningful financial impact on the health of the captive insurance company.

In *Table 3*, the largest property claims over 2013-2023 are identified along with the loss type:

Property	Loss Type	Date	Incurred
Wynne School District	Wind	3/31/2023	$122,000,000
Warren School District	Fire	3/30/2022	$ 16,498,761
UA - 9 Locations	Frozen Pipes	02/17/2021	$ 11,550,000
Fort Smith School District	Hail	4/11/2022	$ 11,000,000
Springdale School District	Wind/Hail	5/4/2020	$ 10,872,009
University of Central Arkansas	Fire	5/4/2022	$ 10,383,826
Springdale School District	Hail	4/15/2022	$ 9,693,864
UA - Pine Bluff	Wind & Hail	3/10/2018	$ 7,950,000
South Arkansas Community Coll	Lightning	4/13/2018	$ 7,623,147
UA - Fayetteville	Flood	10/26/2020	$ 7,235,000
Black River Technical College	Flood	5/1/2017	$ 4,446,586

Forecast

Aggregating this data allowed the development of a loss forecast - the expected total claim amount for the year, after deductibles. Loss forecasting refers to the prediction of future losses through the analysis of past losses. The loss forecast is the starting point for structuring the rest of the program. A loss forecast will never be perfect, and will miss the mark high or low, however, it is integral to maximizing the program's efficiency. Taking into consideration the average losses in the previous 5.5 and 10.5 years, checking the velocity of loss data in more recent years, and considering the impact of large claims such as the $122 million Wynne disaster, a loss forecast can be developed.

Losses within the loss forecast can be reduced by the deductible structure. Historical losses impact the deductible structure by showing the losses that should be retained by the schools, the losses that could be retained by the insurance program or captive insurance company, and, finally, the losses that should be transferred to the marketplace through reinsurance.

The retention level should be placed higher than the loss forecast to capture the most advantageous entry point into the reinsurance market. When the retention is set lower than the expected losses, the program is expecting to have claims on its reinsurance each year. If the program is expecting this, the underwriters assume this to a larger degree, which is reflected in the rate. In recent years, the retention was vastly exceeded which verified this concern for the underwriters. This mispricing created an urgency for underwriters to compensate for the risk to reinsurance, driving premiums through the roof.

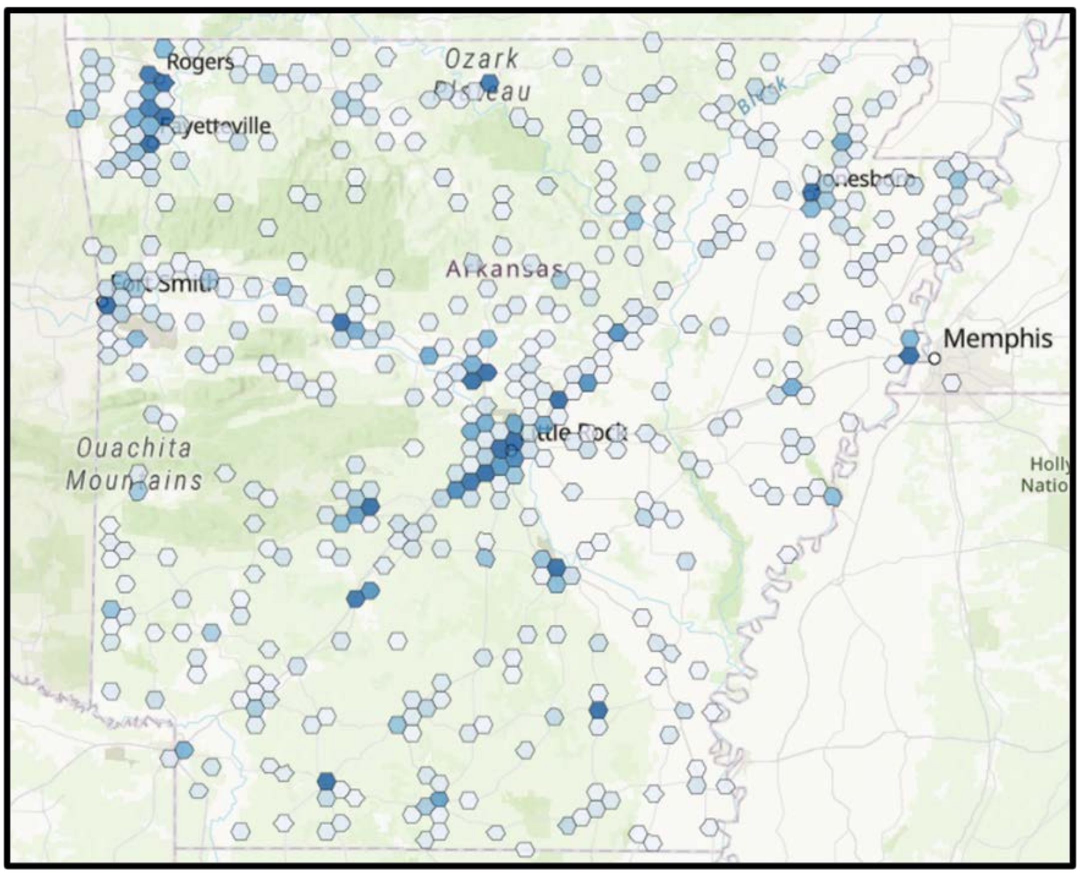
Analysis

Concentration Analysis

Currently, programs are divided into 3 entities, with AMAIT containing all of higher-education, and APSIT and ASBA splitting K-12 districts. Concentration of risk plays a large role in helping to determine the necessary limits of insurance and provides insight into the proper amount of reinsurance needed along with a market entry point.

Current concentrations of risk can be seen below for all of K-12 and higher-education, with each hexagon spanning 5 miles north to south, and darker shades of blue representing more insured value in that zone.

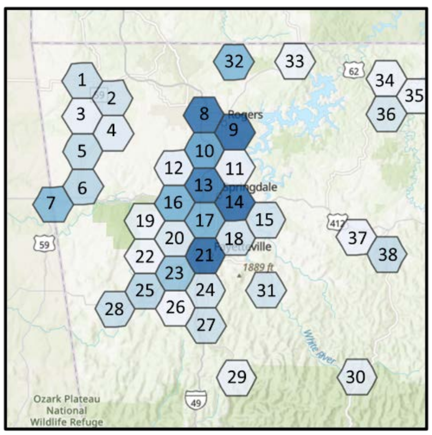
Figure 1



Not surprisingly, Northwest Arkansas and Central Arkansas stand out as the highest-concentrated zones. This is driven by the location of the University of Arkansas in Fayetteville, the Little Rock Campus, UAMS, and the number of school districts demanded by the state's population being concentrated in these two regions.

Below is the analysis of the Northwest Arkansas concentration, for K-12 and higher-education combined. These numbers are drawn from the 2023-2024 policy term.

Figure 2



1	$ 83,423,146.22	12	$ 16,444,335.64	23	$155,732,152.73	34	$ 8,465.35
2	$ 72,518,197.15	13	$ 323,991,859.78	24	$ 65,360,670.22	35	$ 31,620.93
3	$ 16,719,664.72	14	$ 507,436,859.76	25	$107,245,068.58	36	$ 55,409,672.77
4	$ 37,743,063.29	15	$ 65,704,195.02	26	$ 208,203.91	37	$ 5,814,883.29
5	$ 93,604,504.73	16	$ 196,634,513.48	27	$ 77,781,304.30	38	$ 91,396,530.16
6	$106,002,491.88	17	$ 196,369,779.56	28	$ 87,099,154.19	#	$ 7,227,737,893.26
7	$171,857,496.47	18	$ 64,886,849.47	29	$ 201,487.66		
8	$1,134,792,597.26	19	$ 7,068,332.59	30	$ 1,839,001.75		
9	$427,006,583.16	20	$ 49,984,617.87	31	$ 66,942,214.31		
10	$234,189,115.43	21	$3,305,101,997.39	32	$179,628,038.80		
11	$ 14,813,575.54	22	$ 2,149,876.76	33	$ 6,916,923.14		

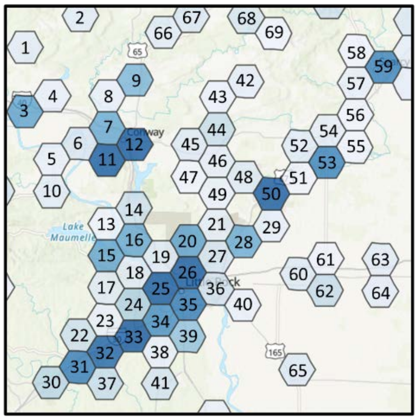
Currently, Northwest Arkansas has an approximate $7.3 billion in total insured value. When considering that the current programs have $500 million and $700 million limits for K-12 schools, as well as a $500 million limit for higher-education, the concentration analysis reveals the inadequate limits within the current programs.

To put the limit inadequacy in perspective, Donald W. Reynolds Razorback Stadium is currently insured for about $435 million. If a tornado impacted the stadium causing a total loss, there would only be $65 million remaining from all other damage from the same storm.

This is one of many examples where the current loss limit could be foreseeably blown by a catastrophic event.

We also looked at the Central Arkansas concentration, for K-12 and higher-education combined. These numbers are drawn from the 2023-2024 policy term and show total insured value exceeding $12 billion.

Figure 3



1	$ 24,945,452.79	15	$ 211,839,009.61	29	$ 18,288,934.16	43	$ 8,216,182.00	57	$ 15,233,007.52
2	$ 27,869,509.03	16	$ 206,487,409.37	30	$ 98,950,771.47	44	$ 74,863,212.59	58	$ 15,424.69
3	$216,241,612.10	17	$ 33,137,131.30	31	$291,183,644.11	45	$ 36,575,570.44	59	$ 281,139,131.01
4	$ 15,776,028.83	18	$ 29,398,372.24	32	$342,098,171.15	46	$ 21,539,115.92	60	$ 35,561,149.73
5	$ 14,319,851.98	19	$ 34,121,280.93	33	$438,440,509.21	47	$ 4,932.18	61	$ 1,635,473.33
6	$ 47,538,997.81	20	$ 216,979,185.71	34	$258,222,255.59	48	$ 33,683,031.98	62	$ 82,309,520.33
7	$200,800,653.77	21	$ 22,637,357.04	35	$298,959,487.66	49	$ 13,388,311.02	63	$ 28,895,028.96
8	$ 16,599,560.13	22	$ 66,674,208.59	36	$ 59,709,482.22	50	$425,869,038.25	64	$ 24,809,440.00
9	$173,227,012.78	23	$ 11,850,574.11	37	$ 80,195,801.78	51	$ 360,803.09	65	$ 37,661,095.36
10	$ 25,368,246.05	24	$ 109,901,580.96	38	$ 15,565,701.11	52	$ 30,287,925.55	66	$ 28,442,360.00
11	$994,572,226.41	25	$4,021,571,694.68	39	$146,885,778.05	53	$283,665,244.58	67	$ 40,222,797.92
12	$600,742,113.40	26	$ 661,696,146.10	40	$ 11,033,801.39	54	$ 21,681,115.81	68	$ 48,462,635.42
13	$ 120,220.10	27	$ 54,896,314.50	41	$ 53,928,361.61	55	$ 347,748.12	69	$ 284,263.68
14	$ 67,274,212.49	28	$ 198,248,713.22	42	$ 22,661,438.02	56	$ 267,055.26	#	$ 12,016,379,428.30

The general purpose of concentration analysis is to develop an idea of probable maximum losses within the property schedule. Through concentration analysis, and loss analysis, predicting what a realistic "worst-case scenario" costs becomes a possibility. Without respect to concentrations, it is impossible to leverage the spread of risk in the insurance marketplace to drive down rates or combat brutal and unjustified increases. A good example of this principle can be seen below, referring to the smaller concentration of UALR and UAMS.

Figure 4

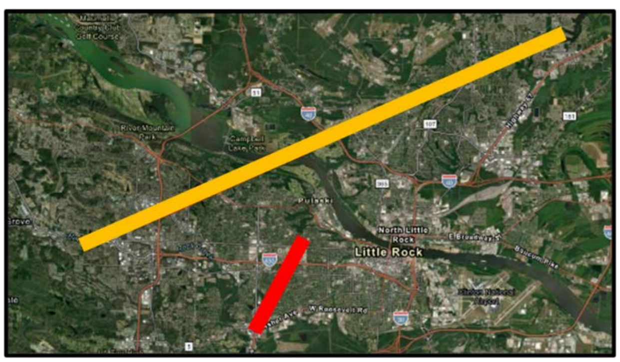


Figure 5

In *Figure 4*, the yellow line is the F-3 tornado that impacted Little Rock on March 31st, 2023. The tornado traveled 29.9 miles northeast, with a maximum width of 1.3 miles and windspeeds up to 165 miles per hour. Also in *Figure 4*, the red line shows a direct path from UALR to UAMS. In *Figure 5*, this path is enlarged, with a specific risk corridor shown in the yellow rectangle. This risk corridor contains approximately $3.75 billion in insured value, with about $1.1 billion and $2.65 billion belonging to UALR and UAMS, respectively. Extending this projected storm line would include Bryant High School, LR Mills and North Little Rock Main which would increase the exposure to loss.

This is a more realistic view of what a probable maximum loss may look like within a combined approach to these insurance programs. It is unlikely that both campuses would be totally destroyed by the same tornado, but it is also unlikely that the tornado would be limited to just a direct path from UALR to UAMS. Therefore, $3.75 billion can safely be assumed to be the high-end of what a worst-case scenario would cost. As it is less probable, the probable maximum loss insured for should be under this number, but far above current loss limits.

Bottom line: It was at this point in the study that it became evident that price was not the biggest problem facing our schools, higher limits of insurance would be needed. It was the inefficient nature of three programs competing for the same capacity from the same insurance companies at the same time every year that led to this problem. The need for consolidating to one program for all public education facilities with a higher, sufficient limit of insurance became evident.

Loss Analysis

Analyzing claim data over the past 10+ years provided insight into what level of claims can be expected on an annual basis.

Table 4 shows claim history for the combined K-12 programs:

Total K-12 Losses												
Year	**Claims**	**Wind**		**Hail**		**Fire**		**Pipes**		**Other**		**Total Incurred**
2013-2014	280	32	$ 765,570	21	$ 2,773,041	7	$ 611,495	9	$ 70,876	211	$ 3,189,205	$ 7,410,187
2014-2015	240	34	$ 785,686	17	$ 1,926,294	9	$ 3,659,325	1	$ 13,844	179	$ 2,007,000	$ 8,392,149
2015-2016	201	31	$ 391,025	26	$ 4,312,951	6	$ 179,004	0	$ -	138	$ 1,355,463	$ 6,238,443
2016-2017	317	95	$ 980,578	47	$ 1,649,401	4	$ 1,813,503	4	$ 39,618	167	$ 2,020,926	$ 6,504,026
2017-2018	257	53	$ 508,983	28	$ 6,938,900	12	$ 1,192,571	9	$ 17,791	155	$ 1,226,825	$ 9,885,070
2018-2019	275	69	$ 1,541,499	37	$ 2,493,628	8	$ 129,489	0	$ -	161	$ 1,982,083	$ 6,146,699
2019-2020	302	86	$ 2,577,511	32	$ 11,971,356	3	$ 36,847	0	$ -	181	$ 2,281,748	$ 16,867,462
2020-2021	332	47	$ 2,612,177	19	$ 4,589,103	14	$ 278,166	73	$ 1,738,571	179	$ 4,407,728	$ 13,625,745
2021-2022	263	45	$ 4,603,140	30	$ 30,997,789	12	$ 19,490,603	2	$ 927	174	$ 2,519,790	$ 57,612,249
2022-2023	401	106	$ 138,120,395	32	$ 5,382,217	14	$ 4,571,430	48	$ 3,881,320	201	$ 4,898,376	$ 156,853,738
2023 6 Months	71	16	$ 628,619	5	$ 2,521,731	1	$ 1,883,269	0	$ -	49	$ 1,389,122	$ 6,422,741
10.5 AVG	280	59	$ 14,620,494	28	$ 7,195,849	9	$ 3,223,400	14	$ 548,852	171	$ 2,597,930	$ 28,186,525
5.5 AVG	299	67	$ 27,287,880	28	$ 10,537,423	10	$ 4,798,146	22	$ 1,021,967	172	$ 3,177,972	$ 46,823,388

A couple of points become apparent. Total incurred losses have trended higher over the past 5 years. The claim count for "Other" losses shows higher frequency but with lower average amounts paid. There is an opportunity to protect the insurance company through a higher retention that would eliminate the bulk of these "Other" losses. Finally, and unsurprisingly that it only takes a few bad occurrences to turn a good year into one of the worst ones. This is shown with Frozen pipes, and how they had relatively few losses (often none) for most years, but in 2 different years they had 73 and 48 claims incurring $1.74 million and $3.88 million, respectively.

Table 5 shows claim history for higher education facilities:

Total Higher-Ed Losses												
Year	Claims	Wind		Hail		Fire		Pipes		Other		Total Incurred
2013-2014	12	0	$ -	2	$1,908,949	1	$ -	0	$ -	9	$ 54,566	$ 1,963,515
2014-2015	13	0	$ -	6	$1,514,982	1	$ -	0	$ -	6	$ 34,781	$ 1,549,763
2015-2016	18	0	$ -	5	$ 389,321	1	$ -	0	$ -	12	$ 1,226,755	$ 1,616,076
2016-2017	24	1	$8,118	6	$ 234,798	3	$ 252,360	0	$ -	14	$ 4,637,294	$ 5,132,570
2017-2018	38	0	$ -	9	$9,030,900	4	$ 226,448	0	$ -	25	$ 9,714,196	$ 18,971,544
2018-2019	19	0	$ -	5	$ 145,239	3	$ 4,332,607	0	$ -	12	$ 54,526	$ 4,532,372
2019-2020	24	0	$ -	3	$ 7,204	2	$ -	0	$ -	18	$ 2,969,674	$ 2,976,878
2020-2021	28	0	$ -	4	$ 6,966	4	$ 2,048,704	1	$ 11,550,000	19	$ 8,426,784	$ 22,032,454
2021-2022	19	0	$ -	3	$ 127,464	1	$ 10,383,826	0	$ -	15	$ 470,229	$ 10,981,519
2022-2023	41	0	$ -	7	$1,350,000	1	$ -	0	$ -	33	$10,063,375	$ 11,413,375
2023 6 Months	4	0	$ -	2	$ 100,000	0	$ -	0	$ -	2	$ 25,000	$ 125,000
10.5 AVG	23	0.1	$ 773	5	$1,411,031	2	$ 1,642,280	0.1	$ 1,100,000	16	$ 3,588,303	$ 7,742,387
5.5 AVG	25	0	$ -	4	$ 315,795	2	$ 3,048,207	0.2	$ 2,100,000	18	$ 4,001,743	$ 9,465,745

The trend line over the past 5 years is not near as evident. The higher-ed program produces a lower number of claims. However, it is notable that when a claim occurs in higher-ed property, it is often much higher than K-12 property strictly because of the quality of the buildings raising reconstruction costs, alongside often expensive personal property. Finally, preventing frozen water pipe claims should become a priority as the single loss in the 2020-2021 year to the arena at UA-Little Rock exceeded the average annual incurred loss total.

Table 6 combines the data from *Table 4* and *Table 5* to show total incurred losses, by category, for higher-ed and K-12 public schools:

Total Combined Losses												
Year	Claims	Wind		Hail		Fire		Pipes		Other		Total Incurred
2013-2014	292	32	$ 765,570	23	$ 4,681,990	8	$ 611,495	9	$ 70,876	220	$ 3,243,771	$ 9,373,702
2014-2015	253	34	$ 785,686	23	$ 3,441,276	10	$ 3,659,325	1	$ 13,844	185	$ 2,041,781	$ 9,941,912
2015-2016	219	31	$ 391,025	31	$ 4,702,272	7	$ 179,004	0	$ -	150	$ 2,582,218	$ 7,854,519
2016-2017	341	96	$ 988,697	53	$ 1,884,199	7	$ 2,065,864	4	$ 39,618	181	$ 6,658,220	$ 11,636,598
2017-2018	295	53	$ 508,983	37	$ 15,969,800	16	$ 1,419,019	9	$ 17,791	180	$ 10,941,021	$ 28,856,614
2018-2019	294	69	$ 1,541,499	42	$ 2,638,868	10	$ 4,462,096	0	$ -	173	$ 2,036,610	$ 10,679,073
2019-2020	326	86	$ 2,577,511	35	$ 11,978,561	6	$ 36,847	0	$ -	199	$ 5,251,422	$ 19,844,341
2020-2021	360	47	$ 2,612,177	23	$ 4,596,070	18	$ 2,326,870	74	$ 13,288,571	198	$ 12,834,513	$ 35,658,201
2021-2022	282	45	$ 4,603,140	33	$ 31,125,253	13	$ 29,874,428	2	$ 927	189	$ 2,990,019	$ 68,593,767
2022-2023	442	106	$ 138,120,395	39	$ 6,732,217	15	$ 4,571,430	48	$ 3,881,320	234	$ 14,961,752	$ 168,267,114
2023 6 Months	75	16	$ 628,619	7	$ 2,621,731	1	$ 1,883,269	0	$ -	51	$ 1,414,122	$ 6,547,741
10.5 AVG	303	59	$ 14,621,267	33	$ 8,606,880	11	$ 4,865,681	14	$ 1,648,852	187	$ 6,186,233	$ 35,928,913
5.5 AVG	324	67	$ 27,287,880	33	$ 10,853,218	11	$ 7,846,353	23	$ 3,121,967	190	$ 7,179,716	$ 56,289,134

Gathering and combining data provides an opportunity to better understand where losses start to impact and erode within the insurance placement. Low deductibles are attractive to participants because it lowers the amount of risk the insured accepts. This undoubtedly makes the insurance coverage more useful, but results in the insurance company being less profitable, and over time increases cost.

Deductible structures should be low enough to be affordable but set high enough to keep the insurance company profitable. The retention is the retention, and if deductibles are too low, an aggregate retention can be drained by insignificant claims.

If annual claims see an increase and schools cannot afford an increase in charged program premiums, deductible structure can be evaluated as a tool to decrease reinsurance cost as risk would decrease. There have been periods of a softened property insurance market where rates are declining. During these times, the deductible structure could also be lowered to benefit schools as one way to position these savings. This was a mistake made in the past. A soft market should be used as a time to build reserves.

A recommended deductible structure should be considered where higher-education takes a much higher deductible than K-12. The examples used applied a deductible structure for K-12 of $50,000 and $250,000 for higher-education. Actual deductible structure should be set by the captive’s board of directors.

Deductibles are lower for K-12 in comparison to higher-education for two reasons. Primarily, higher-education operates very differently than K-12 from a financial perspective, typically having larger budgets with more cash reserves to handle smaller losses. Additionally, they have greater opportunity to increase their budget by departments such as athletics and merchandising being structured to generate profits. These avenues are not available to K-12 schools.

Equally important is that higher-education typically has better and more substantial property. Buildings are built to higher standards, and the technology and contents within the buildings will be more advanced and expansive than those in K-12 buildings.

Both of these factors combine to increase the average property loss amount for higher-education facilities than K-12 facilities. In short, a $50,000 loss on higher-education property could be a hole in a wall, whereas a $50,000 loss in K-12 could be an entire room. The scale is different, but pertinent to tailoring a deductible structure that enables the schools to continue participating within the same program.

More insight was gained by breaking out loss analysis into K-12 and higher-education separately. By comparing these, the importance of building quality and the role proper maintenance can play in reducing risk is evident.

Finally, we took a deep dive into the 2022-2023 policy year since it was the worst year on the chart for K-12 schools. 106 wind claims totaling $138,120,394 stands out. This was largely driven by a $122 million loss at Wynne School District from the 3/31/23 tornado.

Wynne's loss demands individual attention, as it is surrounded by unique factors that led to its severity. Property damage for the Wynne tornado was approximately $80 million, but outside factors increased the loss to $122 million. Despite the inclination to characterize 2022-2023 as an anomaly, the increasing velocity of claims in recent years is undeniable, leading to the Wynne loss negatively impacting the programs in such a drastic fashion.

Bottom line: With an annual loss forecast of $40 million, it became evident that the structure would have to be drastically altered to achieve the goal of adequate coverage for less premium.

Valuation

Property insurance policies include a limit which sets the maximum amount that the insurer will pay in the event of a loss. It's important to evaluate property values annually to make sure the limit established for each building and the personal property inside of it is sufficient to repair or replace the covered property in the event of a total loss.

In recent years, valuations have increased due to pronounced construction cost inflation and general property appreciation. Raw material inflation and labor shortages have directly impacted valuations by raising replacement costs. Insurance carriers often establish an annual Construction Cost Adjustment Factor that is referenced by underwriters to increase property limits by a set percentage when the policy renews.

It is best practice for the insured, their agent, and/or insurance carrier loss control representative to physically tour each building once a year. All parties will check the square footage and collect underwriting information to assist the carrier in establishing a sufficient limit. This also provides an opportunity to check their statement of values to make sure that all properties are covered. In addition, agents will question the insured on major asset purchases made during the past year to make sure personal property limits are adjusted.

The goal of effective valuations is to have sufficient limits to put the insured back in the same position they were in prior to the loss. However, an equally important goal is to make sure that the insurance company receives the proper premium for the corresponding risk.

Property valuations are currently performed by both programs. Early in the study, there was much debate over the valuation process of ASBA, APSIT, and higher-ed. It was determined that AID had the best process. At that time, the risk manager of the AID provided an in-depth description of their process and an overview of the staff performing the valuation work. The informal process utilized at ASBA will require the Risk Management Department to develop a strategy and timeline to evaluate the additional properties. Of note, this process must occur whether the report recommendations are adopted or not since the decision has already been made for ASBA to be transferred into AID. These expenses, likely including additional personal expenses, will be incurred regardless of what happens from this point forward.

Exhibit 5 in the Appendix provides a sample of the recommended valuation report, as taken from the AID Risk Management Division.

Bottom line: It became evident that risk management could not effectively serve all the functions of the program. Focusing risk management on loss prevention and valuation is paramount to the success and financial health of the program by mitigating claims and ensuring the sufficient collection of premiums for insured exposures.

Corporate Governance

A fundamental difference between captive insurance companies and insurance trusts is the level of regulatory oversight. The current trust structure within the Arkansas Insurance Department is as shown below:

<table>
<tr><td rowspan="6">Trust</td><td>Arkansas Insurance Commissioner</td></tr>
<tr><td>AID Risk Manager</td></tr>
<tr><td>Placement, risk analysis, accounting, valuation, risk engineering, loss prevention, claims oversight, adjudication, and settlement</td></tr>
<tr><td>Review of Deductibles, Policy Terms, and Conditions</td></tr>
<tr><td>Evaluation of Sublimits, including Earthquake and Flood</td></tr>
<tr><td>Determine Level of Coverage</td></tr>
</table>

Arkansas captive insurance legislation provides strict regulations, permitting the Captive to be a "regulated insurance company." As part of the regulations, a captive requires the oversight of a number of entities through a defined corporate governance structure.

Should the State of Arkansas form a captive insurance company, corporate governance would start with the State of Arkansas as the owner and ultimate beneficiary. The State elects the board of directors, and sitting below the board are a number of service providers who work together to manage the insurance the captive provides. These include the captive manager, the risk manager, a reinsurance broker, and claims administrator.

<table>
<tr><td rowspan="9">Captive</td><td colspan="5">Arkansas Insurance Commissioner</td></tr>
<tr><td colspan="5">Board of Directors</td></tr>
<tr><td colspan="3"><u>Risk Finance</u></td><td colspan="2"><u>Risk Control</u></td></tr>
<tr><td>Reinsurance Broker</td><td>Captive Manager</td><td>Investment Advisor</td><td>Risk Manager</td><td>Claims</td></tr>
<tr><td>Placement
Risk Analysis</td><td>Accounting
Auditing
Actuarials
Tax</td><td>Strategy</td><td>Valuation
Risk Engineering
Loss Prevention
Claims Oversight</td><td>Adjudication
Settlement</td></tr>
<tr><td colspan="5">Annual Assessment of Insurance Company Retention</td></tr>
<tr><td colspan="5">Review of Deductibles, Policy Terms, and Conditions</td></tr>
<tr><td colspan="5">Evaluation of Sublimits, including Earthquake and Flood</td></tr>
<tr><td colspan="5">Determine Level of Coverage</td></tr>
</table>

In addition to these service providers, officers may be elected by the board of directors to take up specific roles critical to the operation of an insurance company. As a regulated insurance company, the captive must follow claims adjudication processes while following the rules and regulations that bind all insurance companies.

The captive manager, by regulation, manages the services of a lower tier of advisors including but not limited to tax consultants, underwriters, actuaries, investment advisors, auditors, and accountants. These advisors provide the financial tools necessary for the captive to draft and price policies, comply with statutory requirements, and grow through investments.

Trusts and captive insurance companies are subject to differing regulations. A few examples of these are contrasted below:

Contrasting Regulation & Authority	
Captive Insurance Company	**Insurance Trust**
Requires Board of Directors	No Board of Directors required
Board of Directors oversees operations	Risk Manager is responsible for all functions
Annual Third-Party Audit and financial report to the Arkansas Insurance Commissioner	Internal financial reporting to Risk Manager
Captive Insurance Company inspected by Arkansas Insurance Commissioner routinely	N/A

For further information, please refer to trust and captive regulations attached in the Appendix section of this report.

It is of great importance that there are two distinct functions of the board: risk finance & risk control. The risk manager should oversee the function of risk control, which includes: valuation, risk engineering, loss prevention, and claims oversight. These directly and profoundly impact the profitability of the insurance company. Risk finance should oversee captive management, reinsurance placement, and investment strategy.

Risk finance and risk control work together to protect the financial health of the insurance company. The functional levers of captive retention, reinsurance limits, policy level deductibles, terms and conditions, level of retention, policy sublimit coverages (earthquake and flood) should be evaluated and modified annually as necessary to the board. The insurance commissioner will provide final approval.

An insurance trust typically has all authority and responsibility placed within the trustee. A benefit of this is that less oversight and regulation increases flexibility and decision-making abilities. There are financial reporting requirements, but the current standards for oversight (corporate governance) are suitable at a much smaller scale with substantially less capital and surplus.

This recommendation is for a minimum of $200 million in capital. A broader board with clearly defined functions and representation from each area of operational responsibility is appropriate given the size and scope of the model. The board would report direct to the Arkansas Insurance Commissioner, the captive's regulator, which validates the captive's viability in the market due to perceived reduction of risk that added governance brings. A drawback of the captive model is that decision-making moves slower, a symptom of increased checks and balances.

As an insurance company, the captive would comply with regulations set forth by the State that all insurance companies must follow. The captive would write policies approved by the Arkansas Insurance Department. A board of directors would provide guidance for the captive as its needs evolve over time.

Bottom line: Providing stronger corporate governance more appropriate for the necessary capital investment guards against conflicts of interest and a lack of organizational balance.

Function

For the purposes of this study, a conservative approach has been taken to limit the amount of capitalization and overall sticker shock of getting the program launched. Sufficient capitalization eliminates the appearance of cashflow underwriting. As policyholder surplus builds, the captive will have the ability, but not the obligation, to take on more risk. Providing good results, it will reap the rewards.

One of the goals of this insurance captive function is to correct the current issue of limit inadequacy across the programs. For example, K-12 has a limit of $500 million which our concentration study shows to be significantly insufficient. Reinsurance should be purchased above the loss forecast in layers up to $2.5 billion. This potentially solves the issue of limit adequacy.

Entering the reinsurance market at a point above the loss forecast makes reinsurance more affordable, allowing the State to have higher limits while charging a lower premium than the school districts are paying today. When coupled with investment income, the model will cover expected losses and solve the affordability issue. It should also create a policyholder surplus.

The cost of capacity in the reinsurance marketplace is constantly changing. There are levers/variables that the State can manipulate to affect the resulting reinsurance rate.

The levers/variables and the values used are as follows:

One-Time Levers:

- Capitalization
  - $200-$300 Million
- Captive Effective Date
  - 10/1/2024

Annual Levers:

- Captive Retention
  - $50 Million
- Deductibles Charged to Schools
  - $25,000 K-12
  - $250,000 Higher-Ed
- Amount of Reinsurance Purchased
  - $2.5 Billion
- Program Rate Charged to Schools
  - .1850
- Policy Level Terms and Conditions

- Percentage of Schedule to Self-Insure

Through contacts with foreign reinsurance markets, based upon general assumptions, structure, and functionality, the estimated reinsurance rate of .1050 per $100 of insured value was indicated for these given variables. In order to build policyholder surplus, .0800 per $100 of insured value is added to the reinsurance rate to develop the proposed .1850 controlled program rate. As shown below, this structure creates policyholder surplus of $32.5 million for retained losses and to build capital.

Policy Term	Total Insured Value	Reinsurance Rate	Reinsurance Premium
2023-2024	$ 40,593,458,670	0.1050	$ 42,623,132
		Policyholder Surplus Rate	Policyholder Surplus Premium
		0.0800	$ 32,474,767
		Controlled Program Rate	Controlled Program Premium
		0.1850	$ 75,097,899

As shown above, this structure creates policyholder surplus of $32.5 million for retained losses and to build capital, when combined with investment income from capitalization.

Other Assumptions:

- Total Insured Value from current Policy Term (K-12 + Higher-Ed)
- Investment return of 4% annual
- No initial contribution to maintenance & upkeep
- Expense of captive operations included in program rate

The board of directors should evaluate the idea of the captive retaining more risk. When the captive develops sufficient surplus, the board of directors could decide to increase the level of self-insurance. This would reduce the amount of reinsurance premium paid which increases the amount of policyholder surplus.

As an example, the next table shows that the financial impact of self-insuring districts with less than $25 million in total insured value is meaningful. This scenario would lower the ceded premium by $4 million and increase surplus from $32 million to $36 million.

Policy Term	Total Insured Value	Retained Value	Reinsurance Rate	Reinsurance Premium
2023-2024	$ 36,775,405,351	$ 3,818,053,319	0.1050	$ 38,614,176
			Expense Reduction: $4 Million	Policyholder Surplus Premium
				$ 36,483,723
			Controlled Program Rate	Controlled Program Premium
			0.1850	$ 75,097,899

Data was analyzed in *Table 7* to show how a Special-Purpose Captive would have performed using data from the past 10 ½ years:

Policy Year	Incurred	Deductible $25k-$250k	Retention $50M	Reinsurance	Loss Fund	
2013-2014	$ 9,373,701	$ 3,101,843	$ 6,271,858		$234,202,909	
2014-2015	$ 9,941,911	$ 2,720,138	$ 7,221,773		$260,504,019	
2015-2016	$ 7,854,518	$ 2,544,422	$ 5,310,096		$288,678,810	
2016-2017	$ 11,636,598	$ 3,108,385	$ 8,528,213		$313,711,951	
2017-2018	$ 28,856,615	$ 4,006,931	$ 24,849,684		$322,294,896	
2018-2019	$ 10,670,073	$ 2,508,283	$ 8,161,789		$346,912,877	$232,312,978
2019-2020	$ 19,844,340	$ 3,151,628	$ 16,692,712		$363,667,452	$249,067,552
2020-2021	$ 35,658,201	$ 4,766,395	$ 30,891,805		$365,881,696	$251,281,796
2021-2022	$ 68,593,768	$ 3,193,744	$ 50,000,000	$15,400,024	$348,419,781	$233,819,882
2022-2023	$116,267,114	$ 8,033,510	$ 50,000,000	$58,233,604	$330,193,539	$215,593,639
2023 6 Months	$ 6,547,742	$ 862,067	$ 5,685,675		$356,281,622	$241,681,722
TOTAL	$325,244,581	$37,997,346	$213,613,605	$73,633,628		
10.5 YR AVG	$ 30,975,674	$ 3,618,795	$ 20,344,153	$ 7,012,726		
5.5 YR AVG	$ 46,832,952	$ 4,093,750	$ 29,351,269	$13,387,932		

*Loss Fund = (Policyholder Surplus + (Previous Term Loss Fund*1.04)) – Retained Claims*

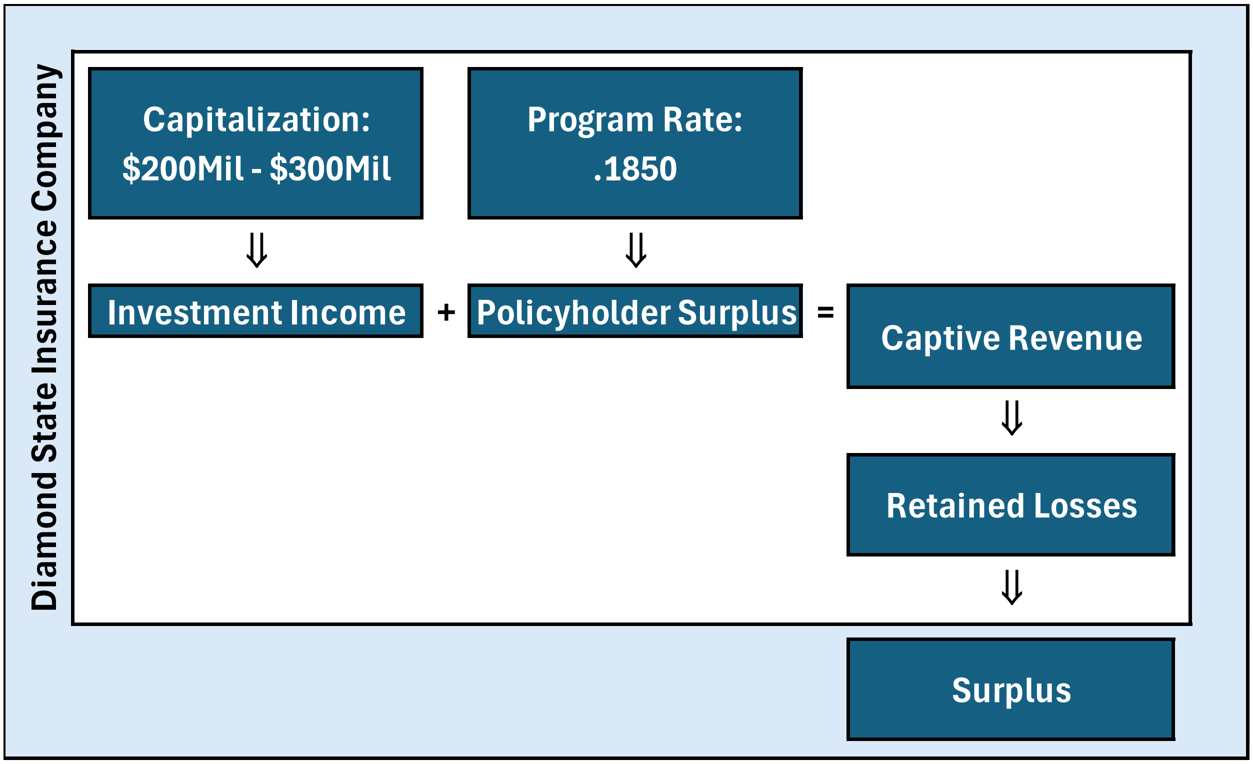
Assumptions:

- Initial captive insurance company capitalization: $200 million
- Sideways insurance purchased to protect capitalization
- Loss forecast: $40 million
- K-12: $25,000 property deductible
- Higher-Ed: $250,000 property deductible
- After deductible, captive pays up to $50 million in losses
- Reinsurance is purchased for losses exceeding $50 million

Data was also analyzed in *Table 8* looking forward to the next 10 years and how a Special-Purpose Captive would perform:

Policy Year	Incurred	Deductible $25k-$250k	Retention $50M	Reinsurance	Loss Fund
2024-2025	$ 43,000,000	$ 4,618,566	$ 38,381,434		$ 198,621,583
2025-2026	$ 32,000,000	$ 3,463,925	$ 28,536,075		$ 206,949,816
2026-2027	$ 41,500,000	$ 4,041,245	$ 37,458,755		$ 206,602,470
2027-2028	$ 28,500,000	$ 3,175,264	$ 25,324,736		$ 218,286,693
2028-2029	$ 30,000,000	$ 2,886,604	$ 27,113,396		$ 228,558,465
2029-2030	$ 31,000,000	$ 3,463,925	$ 27,536,075		$ 238,724,591
2030-2031	$ 70,000,000	$ 5,773,208	$ 50,000,000	$ 14,226,792	$ 226,736,837
2031-2032	$ 31,000,000	$ 3,463,925	$ 27,536,075		$ 236,634,059
2032-2033	$ 59,000,000	$ 5,773,208	$ 50,000,000	$ 3,226,792	$ 224,360,880
2033-2034	$ 34,000,000	$ 3,752,585	$ 30,247,415		$ 231,243,982
TOTAL	$ 400,000,000	$ 40,412,455	$ 342,133,961	$ 17,453,584	
10 YR AVG	$ 40,000,000	$ 4,041,246	$ 34,213,396	$ 1,745,358	

Recommended Structure & Strategy



Operational Structure

Arkansas is a revered domicile for the captive, independent of the ownership of the captive. Arkansas passed captive legislation in 2001 and revised it in 2017. The captive legislation follows the models of the largest captive domiciles in the United States, providing flexibility for the regulator and commissioner of insurance. At the end of 2022, 15 captive insurance companies were domiciled in the state with a premium volume of $357 million. The captive industry respects Arkansas as a “highly available” home to “experienced state captive regulators.”[3] Arkansas, as a captive-friendly state, would greatly benefit from the establishment of an Arkansas captive to serve the needs of government entities and schools.

A Special Purpose Captive Insurance Company established in the State of Arkansas would be subject to checks and balances through a tiered organization. The captive would have its own board of directors, assigned as prescribed by the Arkansas legislature. The board of directors

[3] Captive.com

would formally meet quarterly to evaluate the health of the captive, overseeing the operations of the Captive. Additionally, the board members select the service providers hired to manage the day-to-day operations of the captive, to provide direction to the service providers and evaluate their performance. The board of directors is required to be comprised of at least three individuals with no limit to its size. It is common practice that the board consist of an odd number of board members to prevent deadlock at the board level. An effective board member would be an Arkansan of the public sector having business knowledge, and a willingness to work with the service providers for the day-to-day operation of the insurance company. At least one member of the board must be a U.S. citizen. The board members would be required to confirm and complete a Statement of No Conflict of Interest which requires the board member, when acting as a board member, to put the needs of the captive first.

As an insurance company, the Special Purpose Captive Insurance Company would be subject to the oversight of the Arkansas Insurance Department. The Arkansas Insurance Department provides approval for the policies written by the insurance company and the engagements the insurance company enters into with third parties, such as service providers. Examinations by the Arkansas Insurance Department are required one time every five years or whenever the Insurance Commissioner determines it to be prudent. This examination consists of a thorough examination of its affairs, financial condition, and ability to fulfill its obligation. Such expenses and charges incurred from the examination will be billed to the captive as part of its ongoing expenses.

While the board of directors provide final say on the actions of the captive as the voice of the insureds, the day-to-day operations are handled by an array of service providers, experienced in their niches. The primary service provider is the captive manager. A captive manager is the direct connection between the Arkansas Insurance Department and the captive. There are many options for captive manager; however, given the unique nature of the Special Purpose Captive, this captive manager must be intimately aware of the objectives set forth by the State. As part of their services, the captive manager engages the other service providers necessary to run the captive: an accountant, an auditor, actuaries, legal counsel, underwriters, bankers, investment managers, and policy writers.

The policies issued by the captive follow forms approved by the Commissioner of the Insurance. With permission, these policies may follow Insurance Services Office (ISO) or American Association Insurance Services (AAIS) verbiage. To provide specificity to the policies written by the Captive, endorsements may be issued by the captive manager. A combination of the underwriter and/or the actuary provide the rating manuals provided to the Commissioner.

An Arkansas bank assigned to handle the premiums paid into the captive will invest the assets in accordance with National Association of Insurance Commissioners (NAIC) Guidelines for Insurance Companies. Arkansas Code requires that “a pure captive insurance company or industrial insured captive insurance company is not subject to any restrictions on allowable investments contained in the Arkansas Insurance Code." The commissioner may prohibit or limit an investment that threatens the solvency or liquidity of the company. The primary concern for the investments of premium is the solvency of the captive. While the investments will generate revenue, the investments will be safe investments allowing for liquidity in the event of a claim.

Claims may be outsourced such that a third-party adjuster may adjudicate claims and oversee the cost of reconstruction or repair. The third-party adjuster must be mutually agreed upon by the Arkansas Department of Insurance and the reinsurers. Regardless of the TPA engaged by the captive, the board of directors will have control over the claims adjudication process. Loss control may be outsourced such that a third-party may provide opinion regarding safety, protection, and engineering.

A maximum probable loss scenario is a possible scenario in which the maximum amount of damage could occur. Maximum possible losses could include situations in which a tornado, or a series of tornados, follow just the right path of destruction. Less likely scenarios include mass fires or wildfires. In the event of a maximum probable loss, the program would benefit from insurance covering losses above a certain threshold.

The current loss limits far exceed the proposed reinsurance for losses above $50 million. ASBA purchases limits up to $700 million per loss; APSIT purchases limits up to $500 million per loss; and AMAIT purchases limits up to $500 million per loss which is shared with state property.

Reinsurance, at its most fundamental level, is insurance purchased by insurance companies. Due to the nature of the high limits, reinsurance is a form of catastrophic risk insurance – a failsafe in the event of a maximum loss. One such reinsurance arrangement is a treaty agreement. Treaty agreements are where a ceding insurer provides a premium to the reinsurer for reinsuring a pre-agreed class of business, coverages, limits, etc. The portfolio of values and the portfolio of policies insured by the ceding insurer are indemnified to the ceding insurer. The reinsurer is providing reinsurance, synonymous with a bank giving a customer a line of credit. The reinsurer is basing their pricing on the integrity and characteristics of the portfolio insured and the underwriting methodology of the insurer. Under a Treaty Reinsurance Agreement, the reinsurer might agree to reinsure 50% of claims excess of $100 million each occurrence. This is also referred to as proportional reinsurance. Another reinsurance arrangement is facultative reinsurance. Facultative reinsurance protects a specific contract like a policy issued to a property not meeting the qualifications of the insurance company's treaty guidelines.

An alternative to reinsurance, parametric insurance, applies not on specific limits but on a certain trigger. With a parametric policy, the loss payout is predetermined prior to the issuance of the policy. There are then certain measurable metrics, called the "trigger(s)," that need to be met for the payment to be made. Once all conditions of the trigger have been met, the parametric policy pays out the predetermined loss amount to the policyholder. There are two necessary criteria for determining the trigger: 1) it must be independently and objectively measurable, and 2) it must be able to be modeled.[4] Some parametric policies may have more than one trigger that must be met before payout occurs, or may have several triggers depending on the situation, such as a gradation in payout based on the intensity of a storm.

The descriptions above are long-term considerations, not first-year considerations. This is in keeping with the sustainability and multi-year-plan aspects of the initial request at the genesis of this study. It is meant to show the flexibility in operating a state-owned insurance company, should the captive see success that allows for a more aggressive strategy. As the market changes, the board of directors would have the ability to consider and adopt other means of risk transfer, such as those referenced above.

In summary, the Special Purpose Captive Insurance Company provides three specific benefits to the State of Arkansas:

1. Access to market. The Special Purpose Captive Insurance Company would allow for more rapid formation than a traditional insurance company and would have a specific purpose of offering coverage to affiliated educational facilities. Without a Captive option, property insurance may not be available nor affordable to school districts, colleges and universities.

2. Oversight by the Arkansas Insurance Department. It may be necessary (depending on further review of the State Captive Legislation) that the surplus in the insurance company be used only for claims by the insureds and any distribution of funds as dividends or other appropriation can only be made with the express written authorization of the Commissioner of Insurance.

3. Access to Reinsurance Markets. Insurance companies spread risk by purchasing reinsurance from other insurance companies called reinsurers. The reinsurance market will potentially be more amenable to engage with the State of Arkansas if the program is implemented with a captive insurance company rather than a trust because of the aforementioned regulatory oversight.

[4] https://us.milliman.com/en/insight/parametric-insurance-a-capitavating -solution

Captive Formation and Operations Outlined

A. Arkansas as a Captive Domicile

1. Captive legislation was passed in 2001 and revised in 2017.
2. At the end of 2022, Arkansas had 15 captive insurance companies domiciled in the state and $357 million of premium volume.
3. Industry views Arkansas as a domicile having "highly available and experienced state captive regulators" (Source: Captive .com)
4. For business, Arkansas is an attractive domicile, in part, given the capitalization requirement ($250,000) and low captive premium tax rates. For example, the tax rate on direct written premiums up to $20 million is 0.025 percent, while a 0.150 percent tax is assessed on the next $20 million of direct premiums and 0.050 percent tax is set on premiums exceeding $40 million, with a maximum annual tax of $100,000.
5. Arkansas is a captive-friendly state. What better way to demonstrate to businesses in Arkansas and those enterprises looking to establish in Arkansas than for the state to have a captive insurance company to serve the needs of government entities and schools? This would also bring business back to our state as many Arkansas businesses currently have Captives domiciled in other states.

B. Captive Statute and Reporting

1. "Captive insurance company" means a producer reinsurance captive insurance company, branch captive insurance company, pure captive insurance company, association captive insurance company, sponsored captive insurance company, special purpose captive insurance company, or industrial insured captive insurance company formed or licensed under this subchapter; (Ark. Code 23-63-1601 paragraph (8))

   a. Subject Captive would be formed as a Special Purpose Captive Insurance Company.

   b. Formed as a Corporation with Articles of Incorporation and Bylaws

   c. Not For Profit

2. Before March 1 of each year, or within an extension of time that, upon good cause shown, has been granted by the Insurance Commissioner, a captive insurance company shall submit to the commissioner a report of its financial condition, verified by oath of two (2) of its executive officers.

3.

   a. Except as provided in § 23-63-1604 and 23-63-1605, a captive insurance company shall report using generally accepted accounting principles unless the commissioner approves the use of statutory accounting principles.

   b. The commissioner may require, approve, or accept appropriate modifications or adaptations for the type of insurance and kinds of insurers to be reported upon, supplemented by additional information.

4.

   a. Unless provided otherwise, an association captive insurance company and an industrial insured group shall file their reports in the form required by § 23-63-216(a).

   b. The commissioner shall prescribe by rule the forms in which producer reinsurance captive insurance companies, pure captive insurance companies, and industrial insured captive insurance companies shall report.

C. Examination by Arkansas Department of Insurance

1. At least one (1) time every five (5) years, or whenever the Insurance Commissioner determines it to be prudent, the commissioner or a person appointed by the commissioner shall visit each captive insurance company and thoroughly inspect and examine its affairs to ascertain its financial condition, its ability to fulfill its obligations, and whether or not it has complied with this subchapter.

2. The expenses and charges of the examination shall be paid to the state by the company or companies examined, according to the Arkansas Insurance Code.

3. All examination reports, preliminary examination reports or results, working papers, recorded information, and documents and copies of documents produced by, obtained by, or disclosed to the commissioner or any other person in the course of an examination made under this section, are confidential and

are not subject to subpoena and may not be made public by the commissioner or an employee or agent of the commissioner without the written consent of the company, except to the extent provided in this subsection.

D. Board of Directors

1. At least one member of the board must be a U.S. Citizen
2. Must confirm and complete Statement of No Conflict of Interest
3. Oversee the operations of the Captive Insurance Company and the performance and selection of service providers.
4. Many boards have subcommittees. Boards typically meet quarterly and at least annually.

E. Policy Issuance and Rating

1. Policy forms approved by the Commissioner of Insurance (with permission these may follow ISO or AAIS verbiage).
2. Endorsements issued by the Captive Manager
3. Rating Manual filed with Commissioner
4. Actuarial Determination of Rates

F. Recommended Program Specifics

1. Before the offer to insure and as part of the underwriting process, each applicant will have a loss control assessment completed by the AID Risk Manager which will identify construction issues, maintenance, square footage, and construction underwriting information.
    a. Valuation will be based upon replacement cost of subject buildings utilizing a valuation service such as Marshall and Swift. As a second check of adequate value, the original construction cost of the building may be adjusted for inflation to derive the replacement cost valuation.
    b. Replacement Cost indemnification could be limited to 115% of the replacement cost value agreed by the insured (as recommended by the board of directors).

2. Through the combination of the premium exposure bases of the three current programs, the Captive Insurance Company will fund the primary $50 million of each and every loss.

   a. Subject Captive will purchase aggregate reinsurance that will limit the financial impact of the second catastrophic occurrence and subsequent catastrophic occurrences. This coverage will be purchased to protect the solvency of the captive and the integrity of the coverage provided to the insureds.

   b. An occurrence is inclusive of similar occurrences within a 72 hour period. Examples include successive storm system that cross the state spawning tornadoes, or an earthquake with aftershocks.

   c. Subject Captive will purchase reinsurance for occurrences excess of $50 million up to $2.5 billion.

   d. Captive will be capitalized by the State of Arkansas with a minimum capital contribution of $200 million.

3. Captive will offer prospective insureds deductible options whereby the entity or agency may purchase property insurance selecting retentions concurrent with the insured's risk appetite. Higher deductibles will produce lower premiums through the application of premium credits as filed and approved by the Arkansas Department of Insurance.

G. Banking and Investments

   1. Arkansas Banks and Investment Management Firms

   2. Investments in accordance with NAIC Guidelines for Insurance Companies (Note: Arkansas Code "A pure captive insurance company or industrial insured captive insurance company is not subject to any restrictions on allowable investments contained in the Arkansas Insurance Code." The commissioner may prohibit or limit an investment that threatens the solvency or liquidity of the company.)

H. Claims Handling and Loss Control

1. Claims may be outsourced such that a third-party unrelated interest professional, such as Sedgwick, may adjudicate claims and oversee the cost of reconstruction or repair.
2. Claims must be adjudicated by a third-party administrator (Independent Professional) mutually agreed upon by the Arkansas Department of Insurance and the Reinsurers
3. Loss Control may be outsourced such that a third-party unrelated interest professional may provide opinion regarding safety, protection, and engineering. Sprinkler protection would be concurrent with NFPA 25, which is the baseline for inspection, testing and maintenance of water-based fire protection systems.

Reinsurance for Occurrences exceeding $50 million

A. Discussion of Maximum Probable Loss Scenarios

1. A fire (wildfire included) has a lower maximum probable loss scenario than convective storm. A convective storm (or weather system containing multiple convective storms) may affect a larger geographic area. A fire event, unlike a tornado event, may be contained.
2. At this point Meadors, Adams & Lee would provide some loss modeling to illustrate the values at risk in the event of a fire, earthquake or convective storm system
3. Reinsurance is a contractual agreement. Based on loss amounts paid by the insurance company (cedant), the reinsurer will pay amounts excess of a particular limit -- $50 million. There exists a cost of capital for an insurance company providing excess coverage or reinsurance above a particular loss limit just as there is a cost of capital for a bank lending money.
4. In the current scheme, there are three programs asking many of the same insurers and reinsurers to provide the same level of limit for properties subject to the same perils and loss scenarios.

Bottom line: The framework for the formation of a state-owned captive insurance company already exists.

Investment Strategy

INTRODUCTION

Insurance companies require capital to fund losses, and to generate investment returns to lower the overall costs of providing insurance. An optimal capital structure provides financial and operational benefits including maintaining liquidity to pay claims; maintaining solvency to attract policyholders and create business permanence; subsidizing premium costs; raising claims retention rates and lowering reinsurance utilization; and reducing risks financed through scale effects and the ability to retain risks.

The premiums and claims history of the organization serves as the foundation for forecasting the future cash flows of the newly formed captive insurance company. In turn, the cash flow estimates help estimate the capital and investment assets necessary to sustain the captive's operations. Once the appropriate capitalization of the insurance company has been determined using the risk-free rate of return on investment assets, the investment strategy can be optimized to generate the highest-risk adjusted returns that meet the needs of the organization.

CAPITALIZATION AND INVESTMENT ASSETS

Based upon a 10-year forecasting horizon, initial premiums of $75 million, average annual claims of $34 million, a 2.1% premium inflation rate, and a 4.00% return on investment assets, the captive insurance company would require $200 million of capital to generate a surplus over the planning horizon. In the example below, the forecasted surplus is $31 million after ten years of operation.

$200 Million Capital FYE Ending June, $000's	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 76,590**	**$ 78,134**	**$ 79,732**	**$ 81,386**	**$ 83,098**	**$ 84,869**	**$ 86,703**	**$ 88,601**	**$ 90,566**
Investment Income	8,000	7,945	8,278	8,264	8,731	9,142	9,549	9,069	9,465	8,974
Gross Revenue	**$ 83,098**	**$ 84,535**	**$ 86,412**	**$ 87,996**	**$ 90,117**	**$ 92,240**	**$ 94,418**	**$ 95,773**	**$ 98,067**	**$ 99,540**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	38,381	28,536	37,459	25,325	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	400	400	400	400	400	400	400	400	400	400
Operating Expense	**$ 84,476**	**$ 76,206**	**$ 86,759**	**$ 76,312**	**$ 79,845**	**$ 82,074**	**$ 106,406**	**$ 85,876**	**$ 110,340**	**$ 92,657**
Operating Income	**$ (1,378)**	**$ 8,328**	**$ (347)**	**$ 11,684**	**$ 10,272**	**$ 10,166**	**$ (11,988)**	**$ 9,897**	**$ (12,273)**	**$ 6,883**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ (1,378)**	**$ 8,328**	**$ (347)**	**$ 11,684**	**$ 10,272**	**$ 10,166**	**$ (11,988)**	**$ 9,897**	**$ (12,273)**	**$ 6,883**
OPERATING METRICS										
Loss Ratio	46%	34%	43%	29%	30%	30%	53%	29%	51%	30%
Expense Ratio	55%	56%	57%	58%	59%	59%	60%	61%	62%	63%
Combined Ratio	**102%**	**90%**	**100%**	**87%**	**89%**	**89%**	**113%**	**90%**	**113%**	**93%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	148,622	156,950	156,602	168,287	178,558	188,725	176,737	186,634	174,361	181,244
Capital & Surplus	$ 198,622	$ 206,950	$ 206,602	$ 218,287	$ 228,558	$ 238,725	$ 226,737	$ 236,634	$ 224,361	$ 231,244

Source: MA-Lee

Using the same assumptions, the cede capital can be adjusted from $200 million to $100 million to assess whether a smaller investment portfolio would support insurance operations. The lost investment revenue results in a deficit of $20 million at the end of ten-years, which is not optimal.

$100 Million Capital FYE Ending June, $000's	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 76,590**	**$ 78,134**	**$ 79,732**	**$ 81,386**	**$ 83,098**	**$ 84,869**	**$ 86,703**	**$ 88,601**	**$ 90,566**
Investment Income	3,500	3,301	3,437	3,263	3,504	3,687	3,859	3,247	3,397	2,762
Gross Revenue	**$ 78,598**	**$ 79,891**	**$ 81,571**	**$ 82,994**	**$ 84,889**	**$ 86,785**	**$ 88,728**	**$ 89,951**	**$ 91,998**	**$ 93,328**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	38,381	28,536	37,459	25,325	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	200	200	200	200	200	200	200	200	200	200
Operating Expense	**$ 84,276**	**$ 76,006**	**$ 86,559**	**$ 76,112**	**$ 79,645**	**$ 81,874**	**$ 106,206**	**$ 85,676**	**$ 110,140**	**$ 92,457**
Operating Income	**$ (5,678)**	**$ 3,885**	**$ (4,988)**	**$ 6,883**	**$ 5,244**	**$ 4,911**	**$ (17,478)**	**$ 4,275**	**$ (18,142)**	**$ 871**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ (5,678)**	**$ 3,885**	**$ (4,988)**	**$ 6,883**	**$ 5,244**	**$ 4,911**	**$ (17,478)**	**$ 4,275**	**$ (18,142)**	**$ 871**
OPERATING METRICS										
Loss Ratio	49%	36%	46%	31%	32%	32%	56%	31%	54%	32%
Expense Ratio	58%	59%	60%	61%	62%	63%	63%	65%	65%	67%
Combined Ratio	**107%**	**95%**	**106%**	**92%**	**94%**	**94%**	**120%**	**95%**	**120%**	**99%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	44,322	48,206	43,218	50,101	55,345	60,256	42,778	47,053	28,911	29,782
Capital & Surplus	$ 94,322	$ 98,206	$ 93,218	$ 100,101	$ 105,345	$ 110,256	$ 92,778	$ 97,053	$ 78,911	$ 79,782

Source: MA-Lee

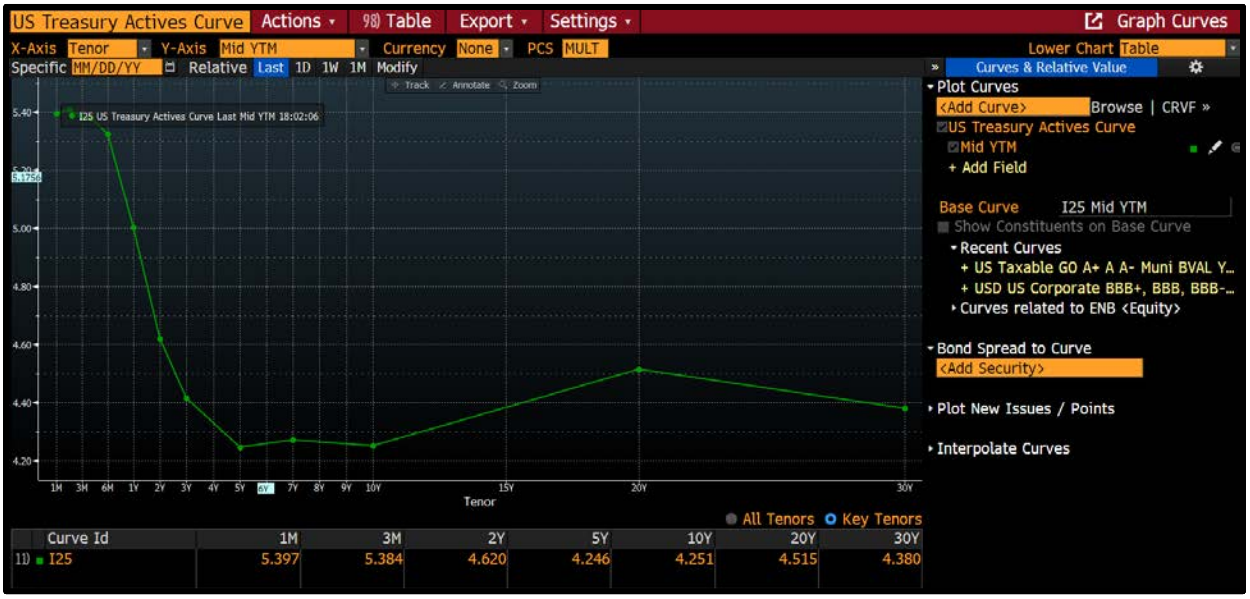
Similarly, the initial capitalization can be increased from $200 million to $300 million to assess whether a larger investment portfolio would be beneficial for the captive's financial position. The increased investment revenue results in a surplus position of $97 million at the end of ten years.

$300 Million Capital FYE Ending June, $000's	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**	**2032**	**2033**	**2034**
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 76,590**	**$ 78,134**	**$ 79,732**	**$ 81,386**	**$ 83,098**	**$ 84,869**	**$ 86,703**	**$ 88,601**	**$ 90,566**
Investment Income	13,500	13,676	14,300	14,547	15,346	16,097	16,858	16,639	17,416	17,212
Gross Revenue	**$ 88,598**	**$ 90,266**	**$ 92,434**	**$ 94,278**	**$ 96,732**	**$ 99,195**	**$ 101,728**	**$ 103,342**	**$ 106,017**	**$ 107,778**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	38,381	28,536	37,459	25,325	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	600	600	600	600	600	600	600	600	600	600
Operating Expense	**$ 84,676**	**$ 76,406**	**$ 86,959**	**$ 76,512**	**$ 80,045**	**$ 82,274**	**$ 106,606**	**$ 86,076**	**$ 110,540**	**$ 92,857**
Operating Income	**$ 3,922**	**$ 13,860**	**$ 5,475**	**$ 17,767**	**$ 16,686**	**$ 16,921**	**$ (4,878)**	**$ 17,267**	**$ (4,523)**	**$ 14,921**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ 3,922**	**$ 13,860**	**$ 5,475**	**$ 17,767**	**$ 16,686**	**$ 16,921**	**$ (4,878)**	**$ 17,267**	**$ (4,523)**	**$ 14,921**
OPERATING METRICS										
Loss Ratio	43%	32%	41%	27%	28%	28%	49%	27%	47%	28%
Expense Ratio	52%	53%	54%	54%	55%	55%	56%	57%	57%	58%
Combined Ratio	**96%**	**85%**	**94%**	**81%**	**83%**	**83%**	**105%**	**83%**	**104%**	**86%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	253,922	267,781	273,256	291,023	307,709	324,630	319,752	337,018	332,495	347,416
Capital & Surplus	$ 303,922	$ 317,781	$ 323,256	$ 341,023	$ 357,709	$ 374,630	$ 369,752	$ 387,018	$ 382,495	$ 397,416

Source: MA-Lee

A 4.00% return on investment assets is currently attainable investing in treasuries. A 4.00% asset return assumption is conservative and accounts for the possibility that interest rates will fall, which impacts both the cash yields and the reinvestment rates for the investment portfolio. Since the captive will need to hold $50 million in cash and equivalents to fund losses (retention), the estimated yield on short-term instruments is a critical part of the return assumption over the forecasting horizon. The Current Treasury Yield Curve, the Historical 10 Year Treasury Yield, and Fed Funds Futures table are supplied below:

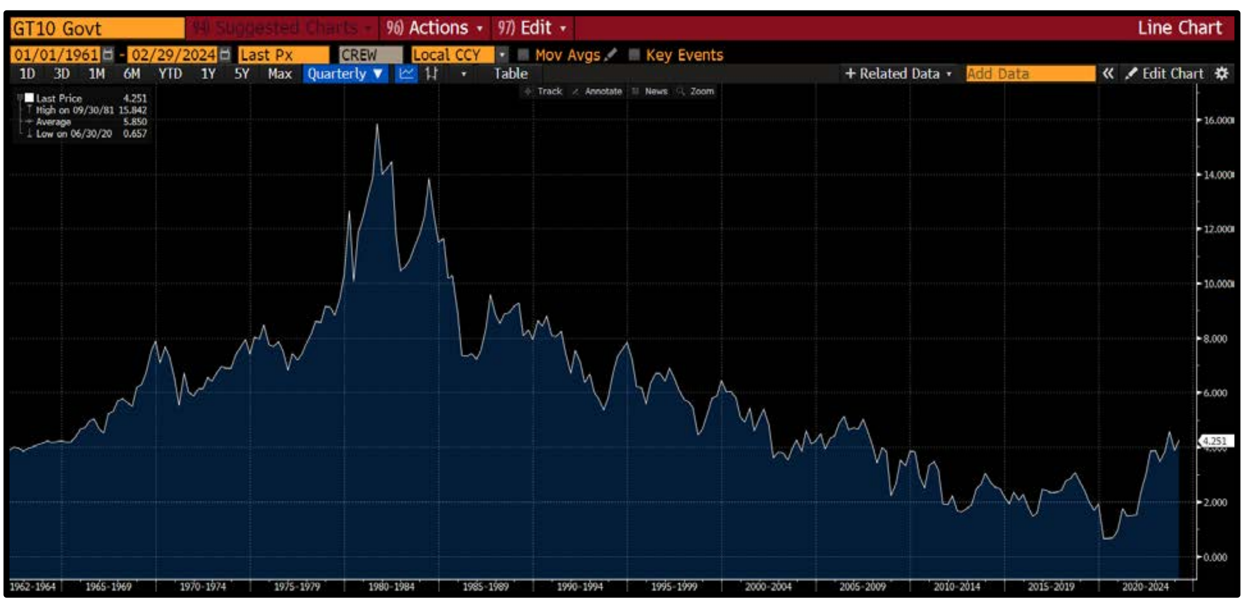
Current Treasury Yield Curve



Source: Bloomberg

Investing in the risk-free asset across the maturity curve provides greater than a 4.00% return, currently.

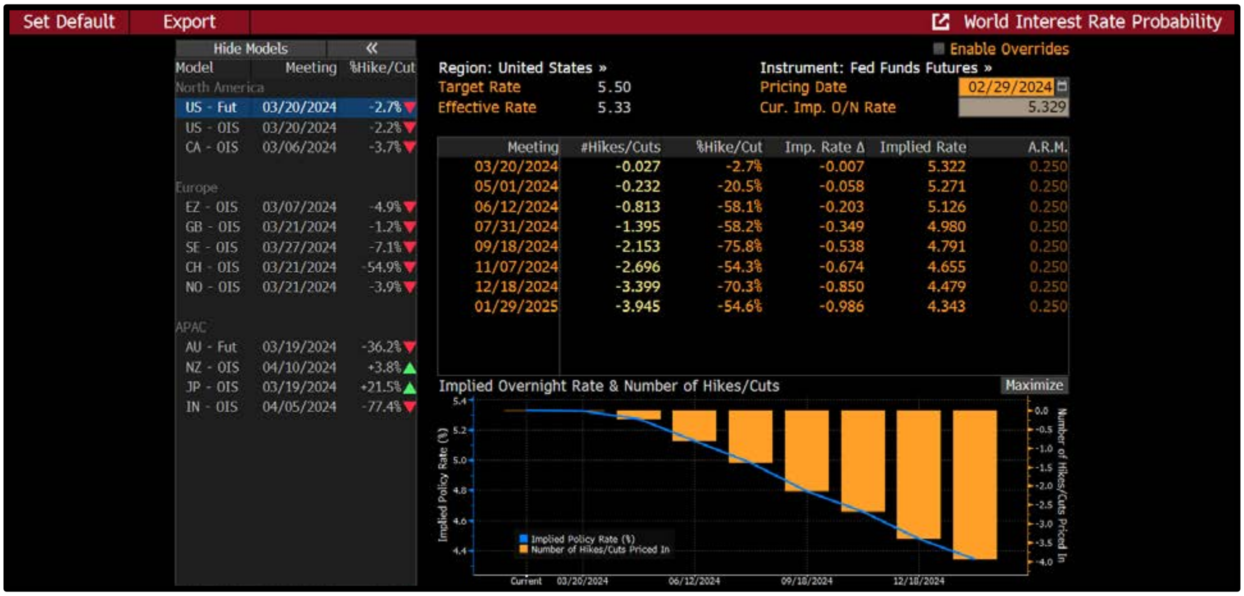
Historical 10-Year Treasury Yield



Source: Bloomberg

Interest rates as measured by the 10 Year Treasury Note are higher than those experienced in recent history, but remain well-within the historical range. The current yield on the 10 Year Note is 4.25%.

Fed Funds Futures

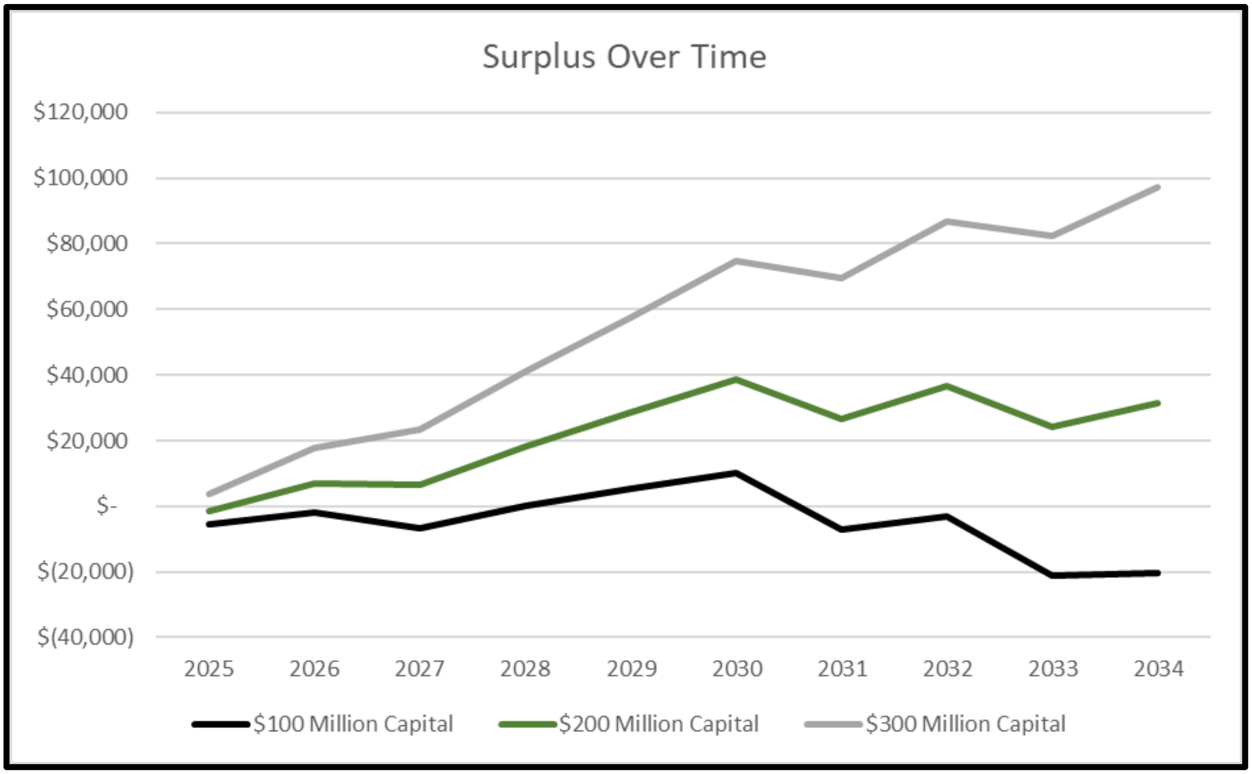


Source: Bloomberg

Fed Funds Futures signal that short-term interest rates will likely fall 1.0% over the next year. The Federal Reserve controls the short-end of the yield curve, and many financial market participants expect short-term interest rates to decline to the neutral rate in the next few years, which is estimated at 2.5%.

SURPLUS OVER TIME

It is critical to create a sustainable business model that results in the generation of capital surplus over time. A minimum initial capitalization level of $200 million is recommended since it results in a $31 million surplus at the end of the forecasting period.



Source: MA-Lee

CAPITALIZATION AND INVESTMENT ASSETS

The benefits of a larger capital base are numerous. Initially focusing on the financial aspects, the revenue generated from a larger investment portfolio could be used to pay for higher than anticipated claims costs, or to limit premium cost inflation for policyholders in order to make the program more affordable. These scenarios are presented below with $200 million and $300 million of initial capital.

HIGHER CLAIMS COSTS

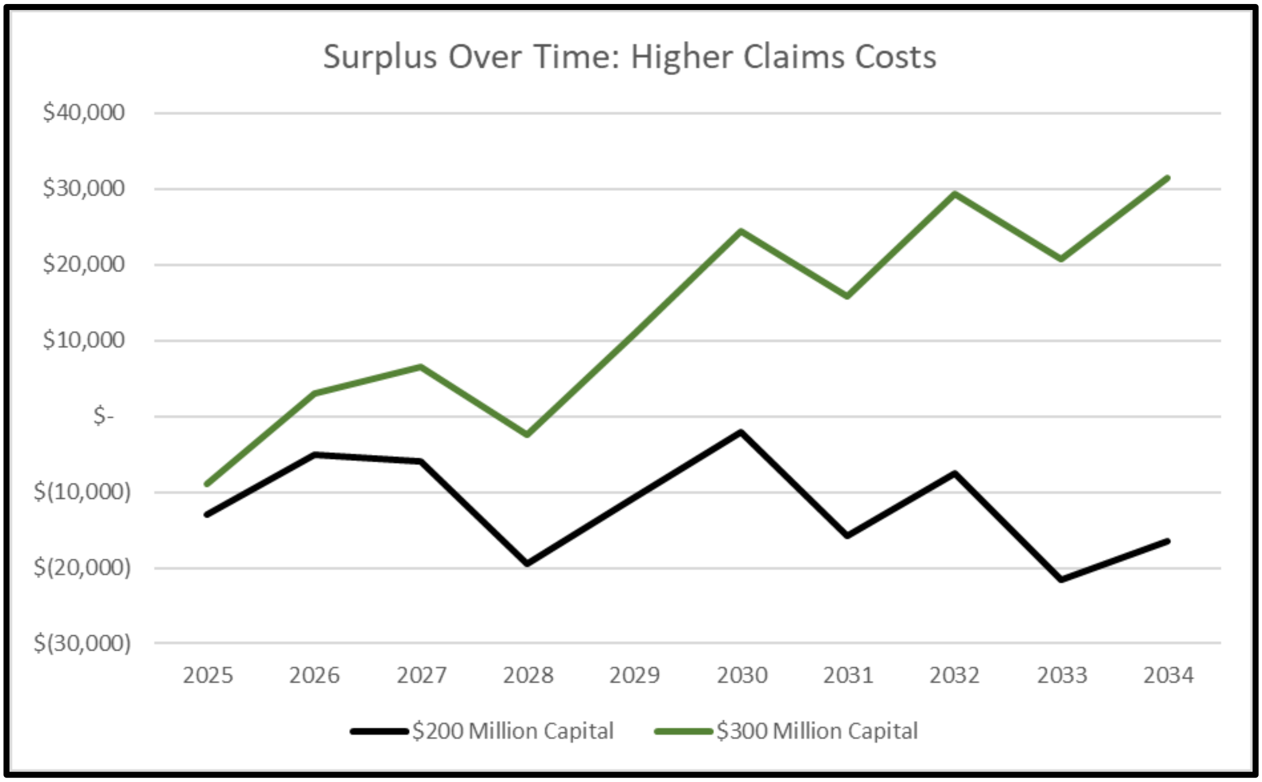
If average claims costs increased from $34 million to $38 million per year during the forecasting period, the insurance captive would require $300 million of initial capital to operate at a surplus.

Higher Claims: $200 Million FYE Ending June, $000's	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 76,590**	**$ 78,134**	**$ 79,732**	**$ 81,386**	**$ 83,098**	**$ 84,869**	**$ 86,703**	**$ 88,601**	**$ 90,566**
Investment Income	8,000	7,480	7,795	7,761	7,222	7,572	7,916	7,371	7,699	7,138
Gross Revenue	**$ 83,098**	**$ 84,070**	**$ 85,928**	**$ 87,493**	**$ 88,607**	**$ 90,670**	**$ 92,785**	**$ 94,074**	**$ 96,300**	**$ 97,703**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	50,000	28,536	37,459	50,000	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	400	400	400	400	400	400	400	400	400	400
Operating Expense	**$ 96,095**	**$ 76,206**	**$ 86,759**	**$ 100,987**	**$ 79,845**	**$ 82,074**	**$ 106,406**	**$ 85,876**	**$ 110,340**	**$ 92,657**
Operating Income	**$ (12,997)**	**$ 7,863**	**$ (831)**	**$ (13,494)**	**$ 8,762**	**$ 8,596**	**$ (13,621)**	**$ 8,199**	**$ (14,039)**	**$ 5,046**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ (12,997)**	**$ 7,863**	**$ (831)**	**$ (13,494)**	**$ 8,762**	**$ 8,596**	**$ (13,621)**	**$ 8,199**	**$ (14,039)**	**$ 5,046**
OPERATING METRICS										
Loss Ratio	60%	34%	44%	57%	31%	30%	54%	29%	52%	31%
Expense Ratio	55%	57%	57%	58%	60%	60%	61%	62%	63%	64%
Combined Ratio	**116%**	**91%**	**101%**	**115%**	**90%**	**91%**	**115%**	**91%**	**115%**	**95%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	137,003	144,867	144,036	130,542	139,304	147,900	134,279	142,478	128,439	133,485
Capital & Surplus	$ 187,003	$ 194,867	$ 194,036	$ 180,542	$ 189,304	$ 197,900	$ 184,279	$ 192,478	$ 178,439	$ 183,485

Source: MA-Lee

Higher Claims: $300 Million FYE Ending June, $000's	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 76,590**	**$ 78,134**	**$ 79,732**	**$ 81,386**	**$ 83,098**	**$ 84,869**	**$ 86,703**	**$ 88,601**	**$ 90,566**
Investment Income	12,000	11,640	12,121	12,261	11,901	12,439	12,977	12,635	13,173	12,831
Gross Revenue	**$ 87,098**	**$ 88,230**	**$ 90,255**	**$ 91,993**	**$ 93,287**	**$ 95,536**	**$ 97,847**	**$ 99,338**	**$ 101,775**	**$ 103,397**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	50,000	28,536	37,459	50,000	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	400	400	400	400	400	400	400	400	400	400
Operating Expense	**$ 96,095**	**$ 76,206**	**$ 86,759**	**$ 100,987**	**$ 79,845**	**$ 82,074**	**$ 106,406**	**$ 85,876**	**$ 110,340**	**$ 92,657**
Operating Income	**$ (8,997)**	**$ 12,023**	**$ 3,496**	**$ (8,994)**	**$ 13,441**	**$ 13,463**	**$ (8,559)**	**$ 13,463**	**$ (8,565)**	**$ 10,739**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ (8,997)**	**$ 12,023**	**$ 3,496**	**$ (8,994)**	**$ 13,441**	**$ 13,463**	**$ (8,559)**	**$ 13,463**	**$ (8,565)**	**$ 10,739**
OPERATING METRICS										
Loss Ratio	57%	32%	42%	54%	29%	29%	51%	28%	49%	29%
Expense Ratio	53%	54%	55%	55%	57%	57%	58%	59%	59%	60%
Combined Ratio	**110%**	**86%**	**96%**	**110%**	**86%**	**86%**	**109%**	**86%**	**108%**	**90%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	241,003	253,027	256,522	247,528	260,969	274,432	265,873	279,335	270,770	281,509
Capital & Surplus	$ 291,003	$ 303,027	$ 306,522	$ 297,528	$ 310,969	$ 324,432	$ 315,873	$ 329,335	$ 320,770	$ 331,509

Source: MA-Lee



Source: MA-Lee

STATIC PREMIUMS

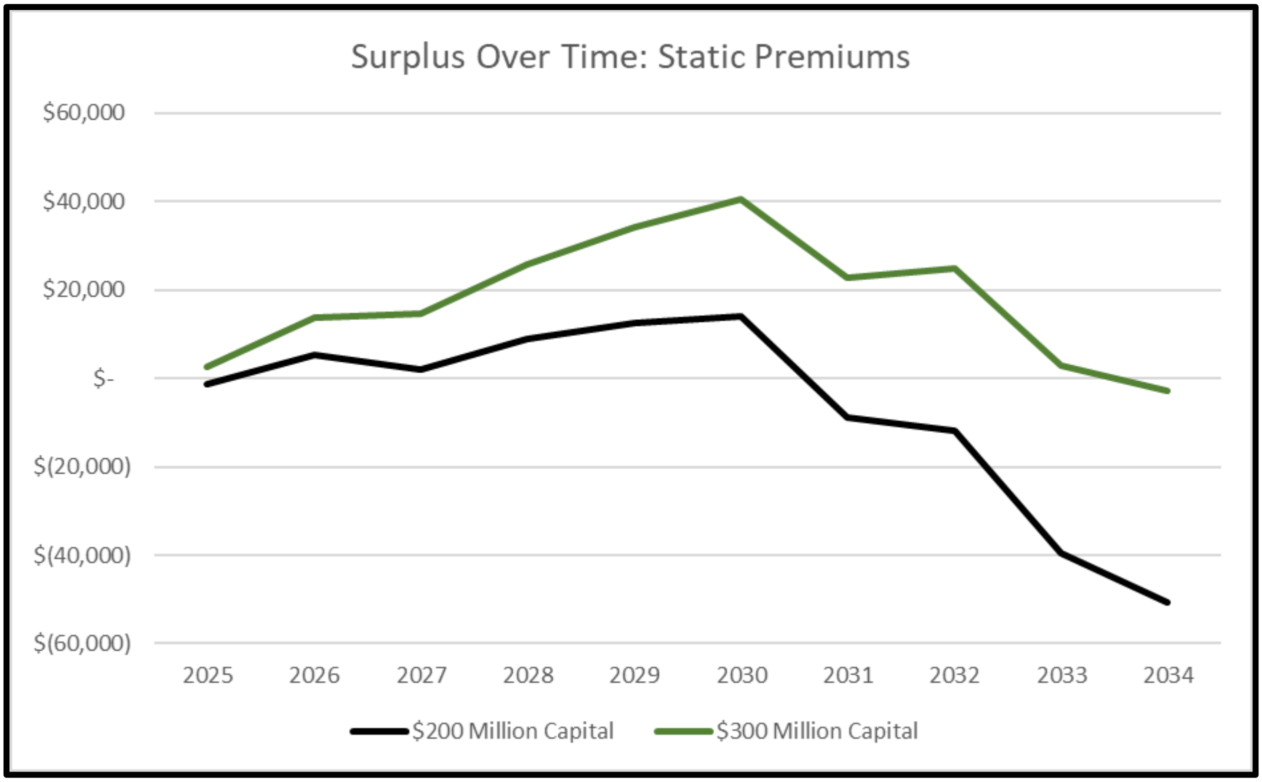
If the goal of the insurance company is to keep premium costs low for policyholders, $300 million initial capital could provide the revenue required to hold premiums flat over the forecasting period.

Static Premium: $200 Million FYE Ending June, $000's	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**
Investment Income	8,000	7,945	8,218	8,081	8,355	8,500	8,561	7,651	7,526	6,417
Gross Revenue	**$ 83,098**	**$ 83,043**	**$ 83,316**	**$ 83,179**	**$ 83,453**	**$ 83,597**	**$ 83,658**	**$ 82,749**	**$ 82,623**	**$ 81,515**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	38,381	28,536	37,459	25,325	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	400	400	400	400	400	400	400	400	400	400
Operating Expense	**$ 84,476**	**$ 76,206**	**$ 86,759**	**$ 76,312**	**$ 79,845**	**$ 82,074**	**$ 106,406**	**$ 85,876**	**$ 110,340**	**$ 92,657**
Operating Income	**$ (1,378)**	**$ 6,836**	**$ (3,443)**	**$ 6,867**	**$ 3,608**	**$ 1,524**	**$ (22,748)**	**$ (3,127)**	**$ (27,716)**	**$ (11,142)**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ (1,378)**	**$ 6,836**	**$ (3,443)**	**$ 6,867**	**$ 3,608**	**$ 1,524**	**$ (22,748)**	**$ (3,127)**	**$ (27,716)**	**$ (11,142)**
OPERATING METRICS										
Loss Ratio	46%	34%	45%	30%	32%	33%	60%	33%	61%	37%
Expense Ratio	55%	57%	59%	61%	63%	65%	67%	71%	73%	77%
Combined Ratio	**102%**	**92%**	**104%**	**92%**	**96%**	**98%**	**127%**	**104%**	**134%**	**114%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	148,622	155,458	152,015	158,882	162,490	164,013	141,265	138,138	110,422	99,280
Capital & Surplus	$ 198,622	$ 205,458	$ 202,015	$ 208,882	$ 212,490	$ 214,013	$ 191,265	$ 188,138	$ 160,422	$ 149,280

Source: MA-Lee

Static Premium: $300 Million FYE Ending June, $000's	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**	**$ 75,098**
Investment Income	12,000	12,105	12,545	12,580	13,035	13,366	13,622	12,914	13,000	12,110
Gross Revenue	**$ 87,098**	**$ 87,203**	**$ 87,643**	**$ 87,678**	**$ 88,133**	**$ 88,464**	**$ 88,720**	**$ 88,012**	**$ 88,098**	**$ 87,208**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	38,381	28,536	37,459	25,325	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	400	400	400	400	400	400	400	400	400	400
Operating Expense	**$ 84,476**	**$ 76,206**	**$ 86,759**	**$ 76,312**	**$ 79,845**	**$ 82,074**	**$ 106,406**	**$ 85,876**	**$ 110,340**	**$ 92,657**
Operating Income	**$ 2,622**	**$ 10,996**	**$ 884**	**$ 11,366**	**$ 8,287**	**$ 6,390**	**$ (17,687)**	**$ 2,137**	**$ (22,242)**	**$ (5,449)**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ 2,622**	**$ 10,996**	**$ 884**	**$ 11,366**	**$ 8,287**	**$ 6,390**	**$ (17,687)**	**$ 2,137**	**$ (22,242)**	**$ (5,449)**
OPERATING METRICS										
Loss Ratio	44%	33%	43%	29%	31%	31%	56%	31%	57%	35%
Expense Ratio	53%	55%	56%	58%	60%	62%	64%	66%	68%	72%
Combined Ratio	**97%**	**87%**	**99%**	**87%**	**91%**	**93%**	**120%**	**98%**	**125%**	**106%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	252,622	263,618	264,502	275,868	284,155	290,545	272,859	274,995	252,753	247,304
Capital & Surplus	$ 302,622	$ 313,618	$ 314,502	$ 325,868	$ 334,155	$ 340,545	$ 322,859	$ 324,995	$ 302,753	$ 297,304

Source: MA-Lee



Source: MA-Lee

The financial benefits of $300 million in initial capital are clear; specifically, cover higher-than-anticipated losses or it could lower the premium costs for policyholders. Any surplus generated from a larger investment portfolio could be used for preventative maintenance and upkeep of state properties, lowering the overall costs of maintaining state properties long-term.

In addition to the financial benefits, a larger investment portfolio also provides operational benefits. Size and stability matter when policyholders are allowed to choose their insurance provider; having a larger capital base will make the captive insurance company more appealing in a competitive marketplace. Also, given the captive insurance company's forecasted reliance on reinsurance to transfer risks, a larger capital base affords the optionality to retain risks during contract negotiations with reinsurers. This provides greater control over reinsurance costs. Although these benefits are less tangible, they are important from both a revenue generation and cost perspective.

CONCLUSION

An initial capitalization of $200 million for the insurance captive is optimal; whereas, $300 million of capital would provide more optionality.

INVESTMENT STRATEGY OVERVIEW

The investment strategy is paramount to the success of the captive's operations because it serves as the primary generator of capital surplus over time. This operating surplus provides the captive both stability and optionality, which were addressed in the preceding section. When formulating an investment strategy, it is critical to identify the investment objectives and constraints of the organization. The organization's return and unique investment requirements determine the types of investments that should be made, which serve as the foundation for the captive's strategic asset allocation.

INVESTMENT OBJECTIVES

Return Requirement: because property replacement values should continue to compound above the general rate of U.S. inflation, as measured by personal consumption expenditures (PCE), the investment portfolio should generate a nominal return of 4.0% or greater per year to accommodate higher anticipated claims costs.

U.S. inflation should settle back into a range of 2.0% to 3.0% over the near-term, and average 2.0% in the medium-term (three- to five-year investment horizon) after peaking in 2022. As recently as December 2023, Core PCE declined to a 2.9% annual growth rate. The consensus view is for continued moderation as the Federal Reserve's actions to restore price stability bear fruit, and longer-term deflationary trends such as negligible population growth and technological disintermediation persist. The risks that inflation does not return to trend are generally identified as concerns over the level of government spending and debt, faster rates of deglobalization, and higher than anticipated investments in decarbonization.

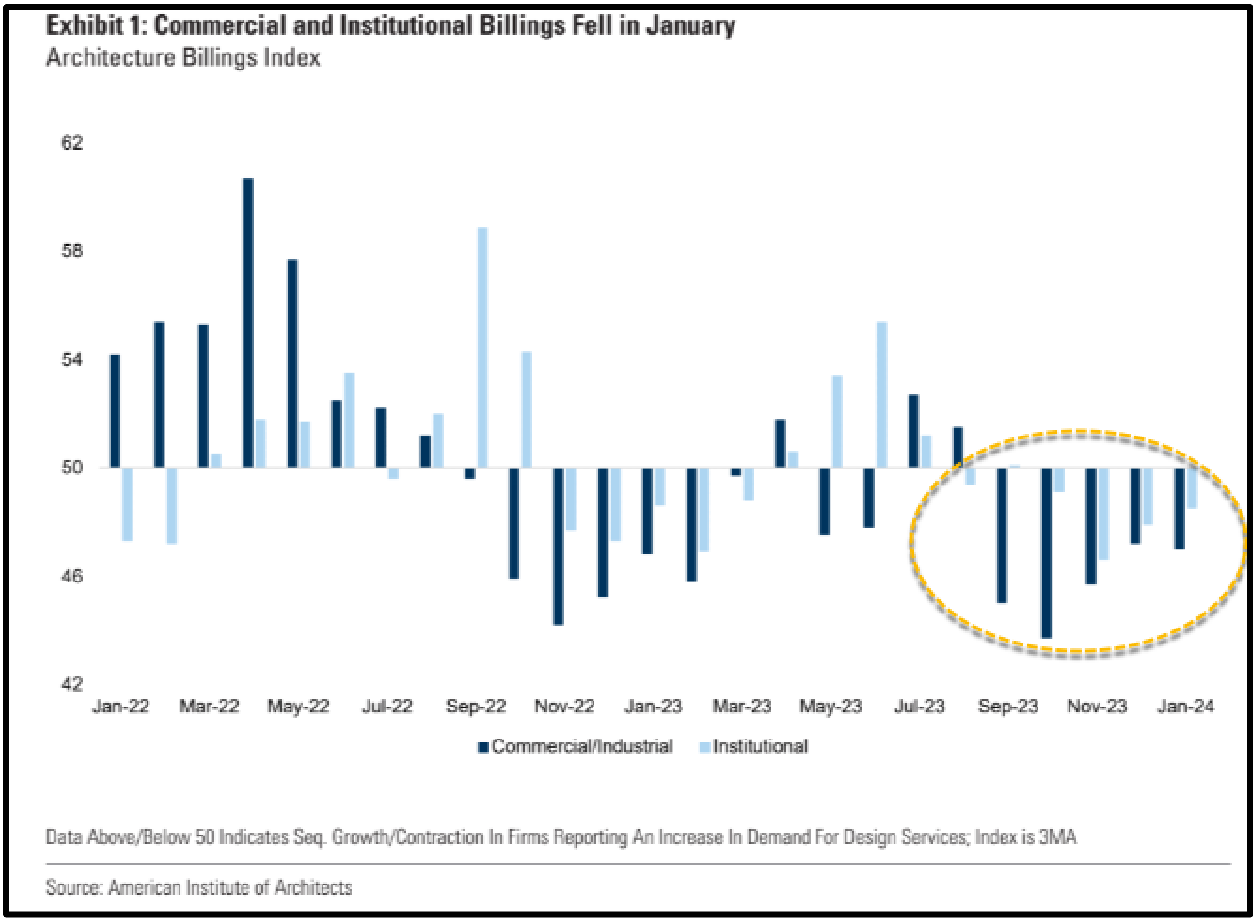
Core PCE

Source: Bloomberg

Commercial property price inflation has averaged approximately 4.0% per year as measured by the RCA CPPI National All Property Index and the NCREIF Property Index over the past five years. Prices have begun to retreat with higher interest rates, reduced demand and excess supply. These factors should continue to put downward pressure on commercial real estate (CRE) valuations, which will reduce new construction activity in several sectors. Leading indicators, such the Dodge Momentum Index and the Architecture Billings Index support this thesis, which should lead to moderating construction costs.

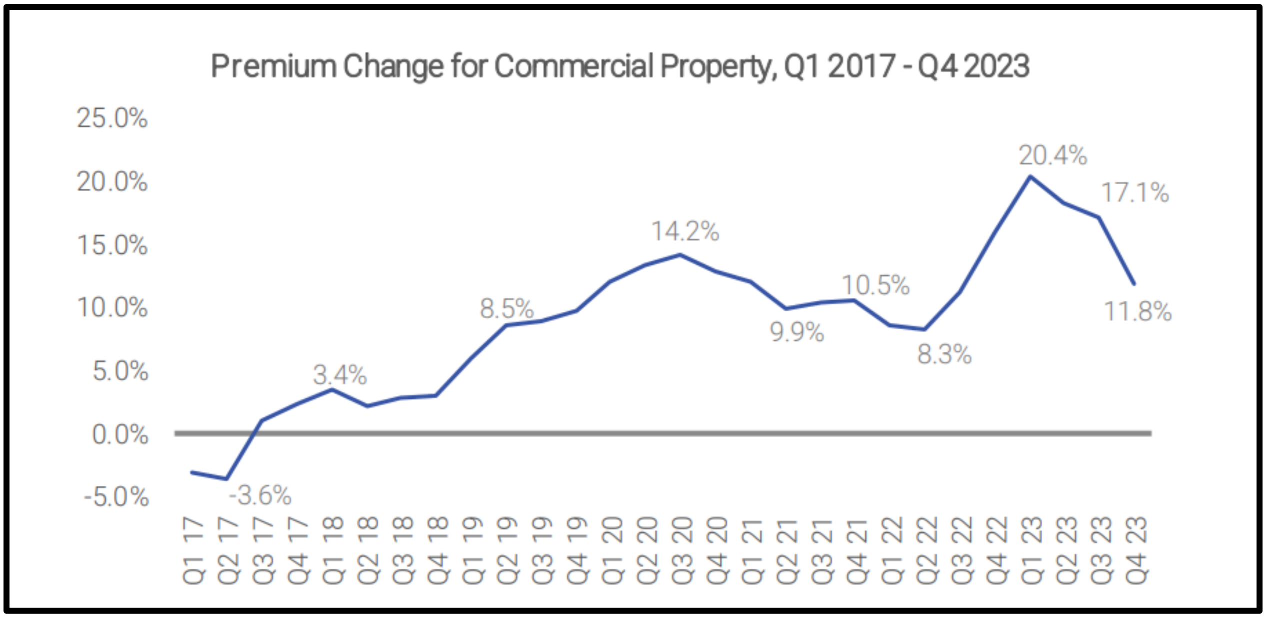
Exhibit 6: The Dodge Momentum Index Improved Marginally From Last Month

Source: Dodge Data & Analytics



Source: Goldman Sachs Research

Rate increases sought by Property & Casualty Insurers nationally have outpaced property-level inflation as claims costs have increased dramatically with disaster frequency/severity and higher construction costs. In the fourth quarter of 2023, The Council of Insurance Agents & Brokers reported premium growth of 12% for commercial property. Rate increases have averaged double-digits since 2020, and commercial property premiums have increased for twenty-five consecutive quarters during this hard market. Despite history of double-digit premium growth, prior market cycles support the likelihood that premium growth will abate as inflation slows. Hence, a 4.0% inflation assumption is prudent given the outlook for claims costs moderating in the medium-term.



Source: The Council of Insurance Agents & Brokers

In addition to establishing a 4.0% nominal return requirement to compensate for loss-cost inflation, the investment objectives should mirror the State Treasurer's investment practices. These objectives, in priority order, are to seek to ensure the preservation of capital, maintain liquidity, and optimize the return on investments.

Prioritizing safety: requires investing in asset classes with an assured return of principal and lower volatility, which limits the investable universe to investment-grade fixed income securities.

Maintaining liquidity: there should be sufficient cash and short-term liquid investments to cover the entirety of the captive insurance company's annual loss retention, which is $50 million.

Optimizing the return on investments: involves building a portfolio with the highest risk-adjusted return prospect at the time of investment, while ensuring preservation of capital and liquidity requirements are met. It also involves constant monitoring and reinvesting of investment income. Prevailing economic and market conditions, the interest rate cycle, absolute and relative yields available among fixed income sectors, and estimated returns and volatility of the underlying securities, are all analyzed to create an optimal portfolio in relation to the investment manager's forward economic and interest rate outlook. The investment manager selects the most attractive mix of fixed income sectors, issuers, duration/maturity profiles, coupons, and relative yields in order to construct a diversified portfolio with the highest risk-adjusted return prospect.

The majority of the spread, or excess return over the risk-free rate of interest, will be derived from investment in corporate bonds. To a lesser extent spread income will be generated from investment in Agency and MBS Passthrough Securities, as well as Municipal Debt. Since most of the return enhancement will come from corporate bonds, the investment manager should be highly skilled at fundamental analysis to identify the most attractive issuers and securities for inclusion in the portfolio.

INVESTMENT CONSTRAINTS

Risk Tolerance: Low, with preservation of capital as primary objective.

Investment Time Horizon: 10-year weighted average maturity, corresponding to the Arkansas State Treasury Investment Policy Statement and the captive insurance company long-term operating plan.

Liquidity Needs: $50 million.

Anticipated Cash Flows: See financials.

Tax Status: Tax exempt, non-profit company.

Legal Constraints: Pending, newly formed captive.

Regulatory Constraints: Arkansas Insurance Department will regulate and control the captive insurance company.

Investment Restrictions: Title 19 restrictions or Modified, to be determined.

STRATEGIC ASSET ALLOCATION

The primary difference between the asset allocations provided below is that the Modified Strategic Asset Allocation (SAA) has a higher permitted investment weighting for corporate bonds. The Title 19 Strategic Asset Allocation (SAA) is presented in compliance with the Arkansas State Treasury's Investment Policy Statement, which limits corporate debt exposure to 30% of assets. The Modified SAA increases the upper threshold for corporate debt to 50%, which also increases estimated returns. The estimated yield accretion from increasing corporate bond exposure from 30% to 50% is 0.27% annually, which is meaningful over a 10-year investment horizon. The Modified portfolio also accounts for premium-related cash balances, which will be held in operating cash to fund losses and support operations. This allows for greater investment in longer-duration, higher yielding assets.

Title 19 Strategic Asset Allocation

Title 19 Strategic Asset Allocation				
Asset Class	**Weight**	**Estimated Yield**	**Credit**	**Maturity**
Cash & Equivalents	25%	2.50%	AAA	0.1
Government/Agency	35%	4.35%	AAA	10.0
MBS Passthrough	5%	5.75%	AA	7.0
Corporates	30%	5.50%	BBB	10.0
Municipal	5%	5.00%	A	10.0
Total	**100%**	**4.34%**	**AA**	**7.4**

Source: MA-Lee

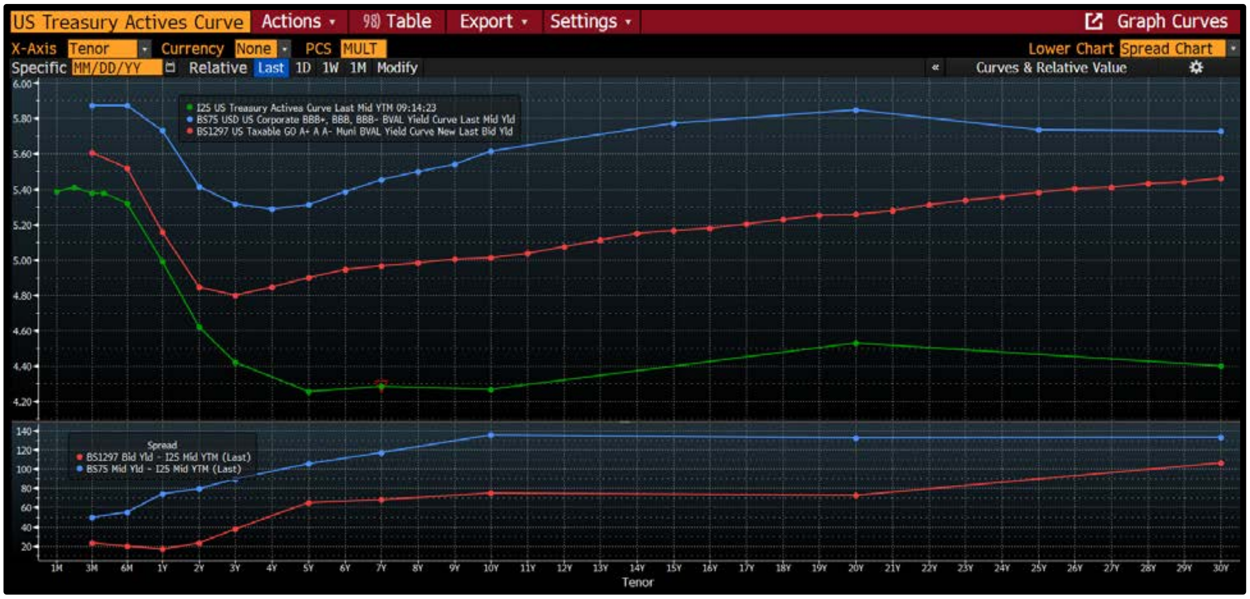
Modified Strategic Asset Allocation

Modified Strategic Asset Allocation				
Asset Class	**Weight**	**Estimated Yield**	**Credit**	**Maturity**
Cash & Equivalents	15%	2.50%	AAA	0.1
Government/Agency	25%	4.35%	AAA	10.0
MBS Passthrough	5%	5.75%	AA	7.0
Corporates	50%	5.50%	BBB	10.0
Municipal	5%	5.00%	A	10.0
Total	**100%**	**4.75%**	**A+**	**8.4**

Source: MA-Lee

The return estimates were derived from the current yield curve and spreads, with the exception of Cash & Equivalents which assumes short-term rates will fall to 2.00% with inflation over the medium-term. Because interest rates are expected to fall, the investment for the captive insurance portfolio should occur sooner rather than later to lock-in higher yielding securities.

CURRENT YIELD CURVES



Source: Bloomberg

Corporate option adjusted spreads (OAS) are slightly below the historical average, but absolute yields of 5.50% or greater are very attractive currently.

EVALUATING THE INVESTMENT PROGRAMS

The revenue and surplus generated using both the Title 19 and Modified Investment Programs are compared below. Both programs result in estimated returns in excess of the captive's 4.0% return requirement. The Modified Investment Program results in greater revenue and surplus generation, and also affords more optionality if interest rates decline. The Modified SAA and Investment Program is preferred given it generates an additional $11 million in capital surplus over the evaluation period.

Title 19 SAA

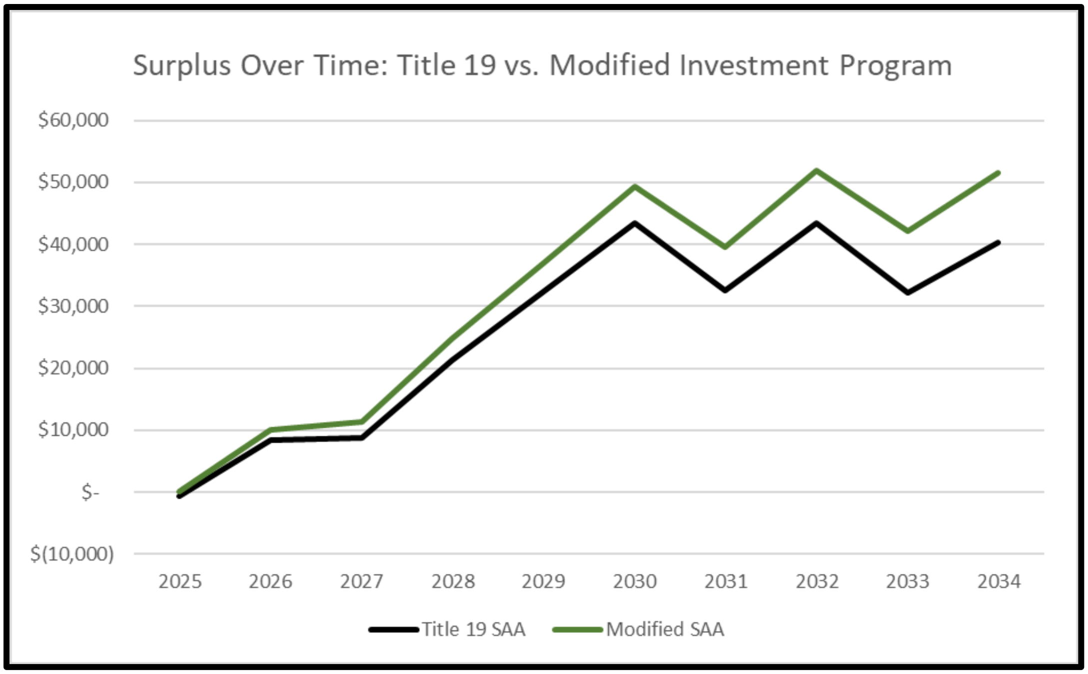
Title 19 Investment Program FYE Ending June, $000's	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 76,590**	**$ 78,134**	**$ 79,732**	**$ 81,386**	**$ 83,098**	**$ 84,869**	**$ 86,703**	**$ 88,601**	**$ 90,566**
Investment Income	8,680	8,650	9,042	9,060	9,601	10,085	10,567	10,091	10,565	10,080
Gross Revenue	**$ 83,778**	**$ 85,239**	**$ 87,175**	**$ 88,792**	**$ 90,987**	**$ 93,183**	**$ 95,437**	**$ 96,794**	**$ 99,166**	**$ 100,646**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	38,381	28,536	37,459	25,325	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	400	400	400	400	400	400	400	400	400	400
Operating Expense	**$ 84,476**	**$ 76,206**	**$ 86,759**	**$ 76,312**	**$ 79,845**	**$ 82,074**	**$ 106,406**	**$ 85,876**	**$ 110,340**	**$ 92,657**
Operating Income	**$ (698)**	**$ 9,033**	**$ 416**	**$ 12,480**	**$ 11,142**	**$ 11,109**	**$ (10,970)**	**$ 10,919**	**$ (11,174)**	**$ 7,989**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ (698)**	**$ 9,033**	**$ 416**	**$ 12,480**	**$ 11,142**	**$ 11,109**	**$ (10,970)**	**$ 10,919**	**$ (11,174)**	**$ 7,989**
OPERATING METRICS										
Loss Ratio	46%	33%	43%	29%	30%	30%	52%	28%	50%	30%
Expense Ratio	55%	56%	57%	57%	58%	59%	59%	60%	61%	62%
Combined Ratio	**101%**	**89%**	**100%**	**86%**	**88%**	**88%**	**111%**	**89%**	**111%**	**92%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	149,302	158,335	158,751	171,231	182,373	193,481	182,512	193,431	182,257	190,246
Capital & Surplus	$ 199,302	$ 208,335	$ 208,751	$ 221,231	$ 232,373	$ 243,481	$ 232,512	$ 243,431	$ 232,257	$ 240,246

Source: MA-Lee

Modified SAA

Modified Investment Program FYE Ending June, $000's	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
INCOME STATEMENT										
Insurance Premiums	**$ 75,098**	**$ 76,590**	**$ 78,134**	**$ 79,732**	**$ 81,386**	**$ 83,098**	**$ 84,869**	**$ 86,703**	**$ 88,601**	**$ 90,566**
Investment Income	9,500	9,506	9,976	10,040	10,679	11,259	11,843	11,382	11,962	11,498
Gross Revenue	**$ 84,598**	**$ 86,095**	**$ 88,109**	**$ 89,771**	**$ 92,065**	**$ 94,357**	**$ 96,712**	**$ 98,086**	**$ 100,564**	**$ 102,064**
Reinsurance Premiums	42,623	44,115	45,659	47,257	48,911	50,623	52,395	54,229	56,127	58,091
Claims & Losses	38,381	28,536	37,459	25,325	27,113	27,536	50,000	27,536	50,000	30,247
Operating Expense	3,072	3,155	3,241	3,330	3,421	3,515	3,612	3,711	3,813	3,919
Other Fees	400	400	400	400	400	400	400	400	400	400
Operating Expense	**$ 84,476**	**$ 76,206**	**$ 86,759**	**$ 76,312**	**$ 79,845**	**$ 82,074**	**$ 106,406**	**$ 85,876**	**$ 110,340**	**$ 92,657**
Operating Income	**$ 122**	**$ 9,889**	**$ 1,350**	**$ 13,460**	**$ 12,219**	**$ 12,283**	**$ (9,694)**	**$ 12,210**	**$ (9,776)**	**$ 9,407**
Interest Expense	-	-	-	-	-	-	-	-	-	-
Net Income	**$ 122**	**$ 9,889**	**$ 1,350**	**$ 13,460**	**$ 12,219**	**$ 12,283**	**$ (9,694)**	**$ 12,210**	**$ (9,776)**	**$ 9,407**
OPERATING METRICS										
Loss Ratio	45%	33%	43%	28%	29%	29%	52%	28%	50%	30%
Expense Ratio	54%	55%	56%	57%	57%	58%	58%	59%	60%	61%
Combined Ratio	**100%**	**89%**	**98%**	**85%**	**87%**	**87%**	**110%**	**88%**	**110%**	**91%**
BALANCE SHEET										
Cash	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Investments	150,122	160,011	161,361	174,821	187,040	199,323	189,629	201,839	192,063	201,470
Capital & Surplus	$ 200,122	$ 210,011	$ 211,361	$ 224,821	$ 237,040	$ 249,323	$ 239,629	$ 251,839	$ 242,063	$ 251,470

Source: MA-Lee



Source: MA-Lee

RISK-RETURN

The Modified SAA has a slightly greater risk profile, approximately 1-2% greater expected annualized volatility based upon a 5-10% higher volatility rate for investment grade corporate debt (varies depending on credit quality) and a marginal weighting of 20%. Of importance, the 50% corporate debt exposure is an upper limit, and the actual investment exposure to corporate debt at any given point in time could be less. The decision to maximize the corporate debt allocation will be based upon prevailing market conditions, and absolute and relative yield spreads at the time of investment.

CONCLUSION

The Modified SAA affords the captive the ability to generate more surplus over time, and provides a greater likelihood the captive will meet its return requirement of 4.0% should inflation and interest rates fall. The historical average OAS for investment grade corporates is approximately 120 basis points, and the additional return provided by corporates will be needed if 10-Year Treasury Note yield falls back to 3.00%.

The investment manager should be highly skilled at managing corporate bond portfolios, with an extensive background in fundamental analysis in order to mitigate risk of permanent capital loss. With interest rates expected to fall over the next year along with inflation, a reasonable strategy would be to invest as soon as possible to lock-in higher returns.

Bottom line: A minimum of $200 million in capitalization is needed. Do it right, do it once,

Conclusion

- The State of Arkansas should start its own special-purpose insurance captive that retains all the losses within the annual loss forecast, while allowing enough premium and investment income to cover all expected claims and reinsurance cost

- Three programs buying insurance within the expected losses is not an efficient or sustainable

- A state-owned insurance captive that charges the same rate per $100 of insured value is a more equitable model for all schools, big or small

- Concentrations of higher-value schools necessitates a higher limit of insurance - $2.5 billion

- Loss forecast of $40 million requires changing the approach to market, leading to a $50 million retention

- Focus on proper governance and risk management will yield additional savings and improve school quality

	Insurance Program	Insurance Company
Control	Market sets price, limited control.	Loss history sets price, greater control.
Costs	Premium costs expected to increase over time with natural disaster frequency and loss-cost inflation. Commissions and profit-requirements increase program costs.	Estimated cost savings of $10 to $12 million annually. Scale benefits entering reinsurance market; investment revenue should offset loss-cost inflation.
Values	Limits are inadequate: $500 to $700 million insured value, three separate programs.	Limits are adequate: $2.5 billion insured value.
Resources	Current staff tasked with risk management and purchasing insurance, resulting in sub-optimal outcomes.	Separate functions of risk management and purchasing insurance. Focus on the core competencies of loss prevention and managing claims.
Implementation	Zero implementation risk, "do nothing".	High implementation risk mitigated by use of expert advisors and proper governance.

It is hard to envision an insurance program in today's market that could compete with a well-capitalized captive insurance company. The insured values at risk, disaster severities, and added layers of costs of dealing with for-profit companies make it nearly impossible to get a good deal. Meanwhile the institutional risk-transfer market has advanced and made self-insuring more economical and accessible. The cost of doing nothing could be as little as $250 million ($10 million perpetuity discounted at 4.0%), or it could be in excess of $2 billion in a severe weather event.

Moving to a Proof of Concept:

A proof-of-concept phase would be the next logical step. This would be the process of taking the concept of a state-owned insurance captive from theory and into practice. In order for this to happen, it is critical that all of the following steps occur in sequential order to ensure that minimal expense is incurred while building the captive and prior to final capitalization of the insurance company. The table below demonstrates how an effective board of directors acting a team would launch the captive insurance company:

April	Select the implementation team & establish the Board of Directors :				
	↓			↓	
	Risk Finance			**Risk Control**	
	Reinsurance Broker	Captive Manager	Investment Advisor	Risk Management	Claims
May	Evaluation of Property Schedule	Actuarial Study	Formulate Investment Policy Statement	Begin Onboarding ASBA	Audit Open Claims
June	Recommend Structure - Evaluation of Policy-level Coverages/Terms & Conditions				
July	Begin Reinsurance Procurement Process	Captive Formation	Finalize Investment Policy Statement, build Model Portfolio	Report on Corrective Actions Taken	Report on Open Claims
August	Report on Actions Taken				
September	**Capitalize the Captive Insurance Company -** Formalize Future Strategy				
October	**Launch Captive, Absorb Current Programs**				

The study has laid the groundwork to move to a proof-of-concept phase, allowing the state to see the concept into practice only if the implementation efforts lead to desirable results. Through this process, the implementation risk is reduced to zero. If the concept is unproven, no further action will be taken, However, after months of study, the probability of success is very high.

Glossary

Aggregate limits - insurance contract provision limiting the maximum liability of an insurer for a series of losses in a given time period.

Aggregate retention - maximum amount the insured can pay as deductibles over a specified period, typically 1 year.

Capacity - refers to the largest amount of insurance or reinsurance available from a company or the market in general.

Captive Insurance Company - an insurance company that has as its primary purpose the financing of the risks of its owners or participants.

Catastrophic Limits - amount of coverage that applies to all losses at all locations during each separate 12-month period of this policy; this is limited to the expiration or anniversary date.

Corporate Governance - set of rules, practices, and processes used to direct and control an organization. Boards of directors are the primary force determining corporate governance.

Expected Loss Amount - the estimated loss frequency multiplied by estimated loss severity and summed for all exposures

Facultative Reinsurance – a form of reinsurance whereby each exposure the ceding company wishes to reinsure is offered to the reinsurer and is contained in a single transaction.

Funded Risk Pool - multiple subjects of insurance insured or reinsured by a single insurer where, to avoid risk concentration and improve risk distribution, different combinations of exposures, perils, and hazards will be underwritten

Investment income - the income of a company derived from its investments as opposed to its operations.

Loss Forecast - predicting future losses through an analysis of past losses.

Loss Prevention - risk management technique that seeks to reduce the possibility that a loss will occur and reduce the severity of those that do occur through safety and risk management information and services.

Parametric Insurance - agreement under which the insurer agrees to pay the insured an agreed amount upon the occurrence of a specified event, such as an earthquake or hurricane of specified intensity

Policy Limits - the maximum amount an insurance policy or reinsurance agreement can be called upon to pay for a specified coverage.

Policyholder Surplus - the difference between an insurer's admitted assets and liabilities — that is, its net worth.

Premium Surplus - the amount by which an insurer's assets exceed its liabilities.

Probable Maximum Loss - represents the worst amount of loss that is likely to happen, as opposed to the worst possible result that could happen.

Reinsurance - arrangement whereby an insurer transfers all or part of a risk to another insurer to provide protection against the risk of the first insurance.

Retention - portion of any potential damages will need to be paid for by the policyholder. Damages in excess of this retained portion would then be covered by the insurance policy.

Sideways insurance – provisional transfer of risk if certain conditions are met.

Special-Purpose Captive - a captive insurance company created for a specific need that does not meet the definition of any other type of captive insurance company.

Statement of Values - report that an insured submits to an insurer. This report outlines the property insured, its type (i.e. building, equipment, or stock), the value of each piece of property, and the method used to calculate that value.

Third Party Administrator - a company that provides operational services such as claims processing under contract to another company.

Treaty Agreement - agreement between an insurer and a reinsurer stating the types or classes of businesses that the reinsurer will accept from the insurer.

Appendix

Exhibit 1

ARKANSAS INSURANCE DEPARTMENT
Risk Management Division
1 Commerce Way, Suite 504
Little Rock, Arkansas 72202-2087
Phone: (501) 371-2690 Fax: (501) 371-2842
Email: insurance.risk.management@arkansas.gov
Website: www.insurance.arkansas.gov

APSIT PROPERTY INSURANCE PROGRAM

(2023-2024 Coverage Highlights)*

1. ☐ Repair or replacement cost coverage $500 Million per occurrence for all buildings at each described location unless scheduled otherwise.
2. ☐ Repair or replacement cost coverage for contents at each described location subject to the policy limits and sub-limits.
3. Deductible:
    - District per occurrence deductible applies to losses within the APSIT $6 Million annual aggregate retention (program self-insured layer).
    - $250,000 per occurrence for Wind/Hail if the annual aggregate is exceeded.
    - $100,000 per occurrence for All Other Perils if the annual aggregate is exceeded.
4. ☐ Extra expense coverage - $25,000,000 per occurrence. (*Shared limit*); Complies with 4.03.1.
5. ☐ Building ordinance and law - $25,000,000 per occurrence. (*Shared limit*); Complies with 4.03.2.
6. ☐ Personal Property Transit coverage - $3,000,000 per occurrence; Complies with 4.03.3.
7. ☐ Newly acquired building and contents coverage - $10,000,000 limit – 90 day to report; Complies with 4.03.5/6.
8. ☐ Boiler and Machinery - $250,000,000 per breakdown. $10,000 deductible; Complies with 4.03.7.
9. ☐ Debris Removal - $25,000,000 per occurrence for reasonable and necessary expense for insured buildings.
10. ☐ Service Interruption – off-premise power outage $2,500,000 per occurrence, subject to food spoilage sub-limit $1,000,000 per occurrence
11. ☐ Builders Risk coverage using District labor - $5,000,000 limit. Project must be scheduled.
12. ☐ Coverage for owned utility service is available per scheduled agreed value.
13. ☐ Mobile Equipment coverage on actual cash value basis. $1,000 per occurrence deductible. No Cost.
14. ☐ All mobile equipment assets exceeding $100,000 original cost must be scheduled with AID-RM.
15. ☐ Flood coverage - $100,000,000 annual aggregate with the following limitation:
    - **No coverage in special flood hazard areas (Flood Zone A).**
    - Deductibles: $10,000 per occurrence per school district.
16. ☐ Earth Movement coverage - $100,000,000 annual aggregate limit; except $50,000,000 annual aggregate limit in New Madrid counties. (Shared Limit).
    - Deductibles: Zone 2 - $100,000 per occurrence
      Zone 3 - $25,000 per occurrence
      Zone 4/5 - $5,000 per occurrence
17. ☐ No coverage for sewer lift stations, bridges, boardwalks, trails and other infrastructure unless scheduled.

AID RISK ADVISOR	SCHOOL DISTRICT CONTACT	DATE

**Limits and deductibles are subject to change upon renewal. This Coverage Highlights document does not convey or provide insurance coverage. Refer to the insurance policy for terms and conditions.*

Exhibit 2

ARKANSAS INSURANCE DEPARTMENT
Risk Management Division
1 Commerce Way, Suite 504
Little Rock, Arkansas 72202-2087
Phone: (501) 371-2690 Fax: (501) 371-2842
Email: *insurance.risk.management@arkansas.gov*
Website: *www.insurance.arkansas.gov*

AMAIT PROPERTY INSURANCE PROGRAM

(2023-2024 Coverage Highlights)*

1. ☐ Replacement Cost Coverage $500 Million per occurrence limit described locations unless otherwise specified and scheduled.
2. ☐ Replacement Cost Coverage for contents at described locations subject to the policy limits and sub-limits. Contents limits do not include any of the collectibles, one-of-a-kind or rare assets, whether scheduled or not.
3. ☐ Newly acquired building and contents coverage - $25,000,000 - 90 day limit to report.
4. ☐ Contents in transit coverage - $5,000,000 per occurrence for contents, except $250,000 per occurrence for Fine Arts.
5. ☐ Off-Premises power service interruption – Property Damage and Business Interruption combined - $5,000,000;
   - Subject to $1,000,000 limit per occurrence for food spoilage.
6. ☐ Building ordinance and law - Increased cost of construction - $5,000,000 per occurrence.
7. ☐ Boiler and Machinery - $250,000,000 per occurrence. $10,000 retention per occurrence.
8. ☐ Extra expense coverage - $1,000,000 per participating agency with a $50,000,000 per occurrence limit.
9. ☐ Flood coverage (Shared Limits)
   - $100,000,000 annual aggregate except:
   - $ 40,000,000 annual aggregate Zones B and X-shaded except;
   - $ 10,000,000 annual aggregate in special flood hazard areas (All Flood Zone A designations).
   - ❖ Deductibles:
   - $100,000 per agency per occurrence for all other designated zones.
   - Special Flood Hazard Areas (All Flood Zone A designations) - $500,000 for Building Losses **and** $500,000 for Content Losses per agency per location per occurrence as defined.

   Consideration of purchasing Flood Insurance from National Flood Insurance Program (NFIP) is recommended, in (Flood Zone A).

10. ☐ Earth Movement coverage – (Shared Limits)
    - $200,000,000 annual aggregate limit – All Zones Except:
    - $100,000,000 annual aggregate limit – Zones 2 & 3.
    - Deductible: 5% of the combined value of property at location where damage or loss occurs or $25,000 per location whichever is greater.

Optional Coverages Available upon request:

11. ☐ Time Element coverage is available upon request for special revenue and other revenue sources:
    a. Loss of Rents Coverage
    b. Business Interruption Coverage
    c. Tuition and Fees Coverage
12. ☐ Inland Marine coverage available upon request per agency subject to the **agency provided schedule on file** with stated limits:
    a. Museum Collections - $10,000,000 per occurrence.
    b. Mobile Equipment - $50,000,000 per occurrence.
    c. Farm Equipment - $50,000,000 per occurrence.

AID RISK ADVISOR	STATE AGENCY CONTACT	DATE

***Limits and deductibles are subject to change upon renewal.**
This Coverage Highlight document does NOT convey or provide insurance coverage. Refer to the insurance policy for terms and conditions.

Exhibit 3

ASBA Property Program

- Established February 1, 1984
- 177 Members - 170 public school districts, 2 open enrollment charter schools, 5 education cooperatives
- Total Insured Value - $16,036,657,876
- Loss Limit - $700,000,000 distributed over 11 layers, utilizing 35 carriers
- Coverage - Broad Manuscript Form - Blanket Replacement Coverage, includes Earthquake and Flood
- ASBA Self-Insured Retention/Deductible - $1,250,000, $3,000,000 Aggregate
- ASBA Wind/Hail Deductible - 2% per building, $1,000,000 minimum, $5,000,000 maximum
- School District Deductible Options - $5,000 - $250,000

2

Exhibit 4

Billion-dollar disasters in 2023

Last year, the U.S. experienced 28 separate billion-dollar weather and climate disasters. This surpasses 2020 — which had 22 events — for the highest number of billion-dollar disasters in the U.S. on record.

“The U.S. was hit with more billion-dollar disasters in 2023 than any other year on record, highlighting the increasing risks from our changing climate,” said NOAA NCEI Director Deke Arndt. “Record heat waves, drought, wildfires and floods are a sobering reminder of the consequences of the long-term warming trend we’re seeing across our country. These findings underscore the need for the data products and services provided by NOAA, like this annual report, to help create a more informed and climate-ready nation.”

The 28 events from 2023 include:

- 17 severe weather/hail events.
- 4 flooding events.
- 2 tropical cyclones (Idalia in Florida and Typhoon Mawar in Guam).
- 2 tornado outbreaks.
- 1 winter storm/cold wave event.
- 1 wildfire event (Maui Island of Hawaii).
- 1 drought and heat wave event.

The total cost for these 28 disasters was $92.9 billion, but that may rise by several billion dollars when the costs of the December 16-18, 2023, East Coast storm and flooding event are fully accounted for.

Exhibit 5

Asset Appraisal Date:
09/01/2015

BUILDING APPRAISAL REPORT
STATE MASTER POLICY ADMINISTERED BY
RISK MANAGEMENT DIVISION, ARKANSAS INSURANCE DEPARTMENT

Loss Control Inspection Date:
02/01/2012

43-04 - Cabot School District
43-04 - High School - 401 N. Lincoln
43-04 - Academics
HIGH SCHOOL MAIN BUILDING
401 N. Lincoln 13
Cabot 72023

Latitude: N 34 58' 20" Longitude: W 92 0' 39"

Building Appraisal	Square Footage	Cost Per Unit(sqFT)	Cost To Rebuild
	176,351	$227.31	$40,086,345.81
	0	$0.00	$0.00
	0	$0.00	$0.00
	0	$0.00	$0.00
PORCH	13,162	$68.18	$897,385.16
OUTDOOR STAIRWELLS	2,816	$113.68	$320,122.88
	0	$0.00	$0.00
	0	$0.00	$0.00
			$0.00
Total	176,351.00		$41,303,853.85

Leased	Building Insured	TC	PC	EZ	ET	FZ	CT	BC
	X	430	03	4	16	X	4	E

Values Insured	
Replacement Cost-Building	$41,303,853.85
Agreed Amount-Building	$0.00
Contents	$8,261,201.08
Total Insured	$49,565,054.93

Asset ID	43-04: 2899
Number of Levels	2
Year Built	2006
Date of Total Renovation	
Date of Addition	

Construction Code	
CSP1	0%
CSP2	0%
CSP3	0%
CSP4	100%
CSP5	0%
CSP6	0%

Roof Covering	
Metal	100%
Wood	0%
Concrete	0%
Composition	0%
Built-Up	0%
Other	

Electrical	
None	
Without Conduit	
With Conduit	X
Unknown	

Exposure to Other Structures	CSP 1-2	CSP 3-6
0'-50'		
51'-100'	X	X
Over 100'		

Alarms and Emergency Equipment	
Air Duct-Central Station	X
Air Duct-Local	
Ansul System	
Auxillary Lights	X
Battery Smoke	
Burglar-Central Station	
Burglar-Local	
Emergency Generator	
Fire Doors-Automated	X
Fire Extinguisher	X
Fire Pump	
Gaseous Fire Suppression	
Hardwire Smoke Central Station	X
Hardwire Smoke-Local	
Heat- Local	
Heat- Central Station	1
Pull Station-Local	
Pull Station-Central Station	X
Sprinklers	100%
Sprinklers - Attic	0%
Standpipe System	

Security Hours
7A - 5P, M-F

Occupancy Hours
7A - 5P, M-F

Appraisal Descriptions and Comments

HIGH SCHOL (484), SEC. 18-9, CLASS C, 3.5, ACOUSTIC, PB, TILE, ADD (1) PASS. ELEV. ADD 100% WET SYSTEM, W/C HVAC, 14' HT. MOD., 90% LOC.

(1) MECHANICAL.

Exhibit 6

AR Code § 25-35-101 (2020)

This chapter may be cited as the "Arkansas Multi-Agency Insurance Trust Fund Act".

AR Code § 25-35-102 (2020)

For the purposes of this chapter:

(1) "Annual aggregate deductible" means the maximum amount payable annually from the Arkansas Multi-Agency Insurance Trust Fund for covered losses;

(2) "Insurance Commissioner" means the Insurance Commissioner of the State Insurance Department or the commissioner's successor;

(3) "Risk manager" means the Administrator of the Risk Management Division of the State Insurance Department;

(4) "State agency" means any state agency, board, bureau, commission, council, department, institution, or other similar entity; and

(5) "Trust fund" means the Arkansas Multi-Agency Insurance Trust Fund.

AR Code § 25-35-103 (2020)

(a) There is established on the books of the Treasurer of State, the Auditor of State, and the Chief Fiscal Officer of the State, a separate fund to be known as the "Arkansas Multi-Agency Insurance Trust Fund".

(b) No money shall be appropriated from the trust fund for any purpose except to pay:

(1) Insurance and reinsurance premiums;

(2) Loss adjustment expenses;

(3) Related educational and training expenses;

(4) Insured claims falling below the annual aggregate deductible level;

(5) Expenses including actuarial, consultant, and service contract fees; and

(6) Cybersecurity risk insurance premiums and expenses.

(c)

(1) The assets of the trust fund may be invested and reinvested as the Insurance Commissioner may determine.

(2) All income derived through investment of the trust fund as established under this chapter shall be credited as investment income to the trust fund.

(3) For the purposes of investment, trust fund moneys invested and interest earned thereon shall be administered as trust funds.

(4) All moneys deposited to the trust fund shall not be subject to any deduction, tax, levy, or any other type of assessment.

(d) All moneys received by the risk manager, including, but not limited to, the premiums collected and any insured loss or loss expenses paid by insurance or reinsurance companies shall be deposited in the trust fund created in this section.

AR Code § 25-35-104 (2020)

(a) The following agencies shall participate in the Arkansas Multi-Agency Insurance Trust Fund:

(1) State agencies participating in the State Master Property Policy as of June 30, 2003;

(2) The Division of Correction;

(3) The Division of Community Correction; and

(4) State agencies participating in the Arkansas State Master Vehicle Policy as of June 30, 2003.

(b) Upon approval by the State Risk Manager, other state agencies may participate in the trust fund.

AR Code § 25-35-105 (2020)

(a) The Arkansas Multi-Agency Insurance Trust Fund shall be administered by the Insurance Commissioner.

(b) At the discretion of the commissioner, the risk manager may:

(1) Enter into contracts;

(2) Purchase insurance and reinsurance in accordance with the Arkansas Procurement Law, § 19-11-201 et seq.;

(3) Adjust, settle, and pay or deny claims with notice to a claimant;

(4) Pay expenses and costs;

(5) Study the risks of all participating state agencies and their properties;

(6) Promulgate the form for insurance and reinsurance policies and other forms;

(7) Issue certificates of coverage to state agencies for any risks covered by the trust fund;

(8) Make recommendations about risk management and risk reduction strategies to participating state agencies;

(9) Review participating state agency building construction, major remodeling plans, program plans, and make recommendations to the participating state agency about needed changes to address risk considerations;

(10) Utilize underwriting discretion and authority to deny coverage of any risk deemed to adversely affect the financial stability of the trust fund;

(11) Establish values for participating state agency buildings and structures to be insured;

(12) Attend state agency planning and management meetings;

(13) Review any proposed legislation and communicate with members of the General Assembly and legislative committees about the liability or risk management issues connected with any legislation; and

(14) Solicit any needed information about state agency plans, state agency programs, or state agency risks necessary to perform the responsibilities under this chapter.

(c)

(1) The risk manager may expend moneys from the trust fund to procure and provide coverage to all participating state agencies and their indemnified employees except those agencies or employees specifically exempted by statute or elsewhere in this chapter.

(2) The risk manager shall apportion the costs of coverage under subdivision (c)(1) of this section consistent with this chapter.

AR Code § 25-35-106 (2020)

(a)

(1) Premiums shall be charged to each agency based on the rates established by the risk manager that include all costs associated with the operation of the Arkansas Multi-Agency Insurance Trust Fund, based upon sound rating techniques.

(2) The risk manager shall provide premium billings to participating state agencies for each renewal and for participating agency changes occurring during the policy year.

(3) If any participating state agency fails to pay its premium charges within thirty (30) days after the due date, the risk manager shall notify the delinquent state agency that coverage will be cancelled due to nonpayment of premium unless the delinquent payment is made within thirty (30) days of the notice.

(4) Funds appropriated or otherwise made available to participating state agencies for payment of premium shall not be reduced as a result of any shortfall of projected revenues.

(b) The risk manager will provide each agency with a renewal schedule of coverage and an endorsement for each participating state agency change occurring during the policy year.

AR Code § 25-35-107 (2020)

The risk manager shall establish:

(1) Appropriate policies and procedures governing the payment of losses from the Arkansas Multi-Agency Insurance Trust Fund, including notice or proof of loss by any participating state agency; and

(2) Policies and procedures governing disputes that may arise between the risk manager and any person having charge over the property in question concerning the extent of loss or damage.

AR Code § 25-35-108 (2020)

Notwithstanding any other provision of law, any report, recommendation, survey, schedule, list, or data compiled, or action taken or not taken by or at the request of the risk manager to identify, evaluate, or plan the safety enhancement or risk reduction of any potential accident sites or other hazards related to any entity covered by the Arkansas Multi-Agency Insurance Trust Fund may not be admitted into evidence in any court or used for any other purposes in any action for damages arising from any occurrence at a location mentioned or addressed in the reports, recommendation, survey, schedule, list, or data.

Exhibit 7

RULE AND REGULATION 73
CONCERNING THE LICENSING AND REGULATION OF
CAPTIVE INSURANCE COMPANIES

Section

§ 1. Purpose and Scope.

A. The purpose of this Rule and Regulation is to establish financial and reporting requirements that the Commissioner of Insurance ("Commissioner") deems necessary for the regulation of captive insurance companies. Reference hereinunder to "company" shall mean captive insurance company or companies, unless otherwise specified.

B. This Rule and Regulation applies to captive insurance companies as that term is defined by Ark. Code Ann. § 23-63-1601(8). The provisions of the Arkansas Insurance Code do not apply to captive insurance companies except as specifically provided in Title 23, Chapter 63, Subchapter 16, of the Arkansas Code Annotated.

§ 2. Authority

This Rule is issued under the authority vested in the Commissioner by Ark. Code Ann. §§ 23-63-1615 and 25-15-203 – 204.

§ 3. Annual reporting requirements.

A. An association captive insurance company and an industrial insured group doing business in this State shall quarterly and annually submit to the Commissioner a report of its financial condition, verified by oath of two of its executive officers. The report shall be that required by Ark. Code Ann. Section 23-63-216(a).

B. A pure captive insurance company, sponsored captive insurance company, industrial insured captive insurance company or producer reinsurance captive insurance company doing business in this State shall annually submit to the Commissioner a report of its financial condition, verified by oath of two of its executive officers. The report shall be that prescribed by the Commissioner as "Captive Annual Statement."

§ 4. Annual audit.

A. All companies shall have an annual audit by an independent certified public accountant, authorized by the Commissioner, and shall file such audited financial report with the Commissioner on or before June 30 for the year ending December 31 immediately preceding. The annual audit shall be on the same accounting basis as the annual statement.

B. The annual audit report shall be considered part of the company's annual report of financial condition except with respect to the date by which it must be filed with the Commissioner.

C. The annual audit shall consist of the following:

(1) Opinion of Independent Certified Public Accountant

(a) Financial statements furnished pursuant to this section shall be examined by independent certified public accountants in accordance with generally accepted auditing standards as determined by the American Institute of Certified Public Accountants.

(b) The opinion of the independent certified public accountant shall cover all years presented.

(c) The opinion shall be addressed to the company on stationery of the accountant showing the address of issuance, shall bear original manual signatures and shall be dated.

(2) Report of Evaluation of Internal Controls

(a) This report shall include an evaluation of the internal controls of the company relating to the methods and procedures used in the securing of assets and the reliability of the financial records, including but not limited to, such controls as the system of authorization and approval and the separation of duties.

(b) The review shall be conducted in accordance with generally accepted auditing standards and the report shall be filed with the Commissioner.

(3) Accountant's Letter

The accountant shall furnish the company, for inclusion in the filing of the audited annual report, a letter stating:

(a) That he is independent with respect to the company and conforms to the standards of his profession as contained in the Code of Professional Ethics and pronouncements of the American Institute of Certified Public Accountants and pronouncements of the Financial Accounting Standards Board.

(b) The general background and experience of the staff engaged in the audit, including their experience in auditing insurance companies.

(c) That the accountant understands that the audited annual report and his opinions thereon will be filed in compliance with this regulation with the Department.

(d) That the accountant consents to the requirements of section 7 of this regulation and that the accountant consents and agrees to make available for review by the Commissioner or his appointed agent, the work papers as defined in section 7(C) of this regulation.

(e) That the accountant is properly licensed by an appropriate state licensing authority and that he is a member in good standing in the American Institute of Certified Public Accountants.

(4) Financial Statements

(a) The financial statements required shall be as follows:

(1) Balance sheet,

(2) Statement of gain or loss from operations,

(3) Statement of changes in financial position, if appropriate,

(4) Statement of cash flow,

(5) Statement of changes in capital paid up, gross paid in and contributed surplus and unassigned funds (surplus), and

(6) Notes to financial statements.

(b) The notes to financial statements shall be those required by the accounting principles used in the annual statement, and shall include:

(1) A reconciliation of differences, if any, between the audited financial report and the statement or form filed with the Commissioner.

(2) A summary of ownership and relationship of the company and all affiliated corporations or companies insured by the captive.

(3) A narrative explanation of all material transactions with the company.

For purposes of this provision, no transaction shall be deemed material unless it involves three percent (3%) or more of a company's admitted assets as of the December 31 next preceding.

(5) Certification of Loss Reserves and Loss Expense Reserves

(a) The annual audit shall include an opinion as to the adequacy of the company's loss reserves and loss expense reserves.

(b) The individual who certifies as to the adequacy of reserves shall be approved by the Commissioner and shall be a Fellow of the Casualty Actuarial Society or a member in good standing of the American Academy of Actuaries.

(c) Certification shall be in such form as the Commissioner deems appropriate.

§ 5. Designation of independent certified public accountant.

Companies, after becoming subject to this regulation, shall within ninety days report to the Commissioner in writing, the name and address of the independent certified public accountant retained to conduct the annual audit set forth in this regulation. Any independent certified public accountant retained by a company to conduct its annual audit shall make application to the Commissioner for authority to act as an independent certified public accountant for captive insurance companies on the "Application for Authorization as an Independent Certified Public Accountant for Captive Insurance Company", which is adopted as part of this Rule and Regulation.

§ 6. Notification of adverse financial condition.

A company shall require the certified public accountant to immediately notify in writing an officer and all members of the Board of Directors of the company of any determination by the independent certified public accountant that the company has materially misstated its financial condition in its report to the Commissioner. The company shall furnish such notification to the Commissioner within five working days of receipt thereof.

§ 7. Availability and maintenance of working papers of the independent certified public accountant.

A. Each company shall require the independent certified public accountant to make available for review by the Commissioner or his appointed agent, the work papers prepared in the conduct of the audit of the company. The company shall require that the accountant retain the audit work papers for a period of not less than five years after the period reported upon.

B. The aforementioned review by the Commissioner shall be considered investigations and all working papers obtained during the course of such investigations shall be confidential. The company shall require that the independent certified public accountant provide photocopies of any of the working papers that the Department considers relevant. The Department may retain such working papers.

C. "Work Papers" or "working papers" as referred to in this section include, but are not necessarily limited to, schedules, analyses, reconciliations, abstracts, memoranda, narratives, flow charts, copies of company records or other documents prepared or obtained by the accountant and his employees in the conduct of their audit of the company.

§ 8. Organizational examination.

In addition to the processing of the application, an organizational investigation or examination may be performed before an applicant is licensed. Such investigation or examination shall consist of a general survey of the company's corporate records, including charter, bylaws and minute books; verification of capital and surplus; verification of principal place of business; determination of assets and liabilities; and a review of such other factors as the Commissioner deems necessary.

§ 9. Reinsurance.

Any captive insurance company authorized to do business in this State may take credit for reserves on risks ceded to a reinsurer subject to the following limitations:

(A) No credit shall be allowed for reinsurance where the reinsurance contract does not result in the complete transfer of the risk or liability to the reinsurer.

(B) No credit shall be allowed, as an asset or a deduction from liability, to any ceding insurer for reinsurance unless the reinsurance is payable by the assuming insurer on the basis of the liability of the ceding insurer under the contract reinsured without diminution because of the insolvency of the ceding insurer.

Reinsurance under this section shall be effected through a written agreement of reinsurance setting forth the terms, provisions and conditions governing such reinsurance.

The Commissioner in his discretion may require that complete copies of all reinsurance treaties and contracts be filed and/or approved by him.

§ 10. Alternative investments of assets.

A producer reinsurance captive insurance company which determines that bonds, notes, warrants or other securities of reasonable quality or liquidity, as determined by the company's management, and with the approval of the Commissioner, do not exist for purposes of compliance with Ark. Code Ann. § 23-63-1614(i), shall be permitted to invest such assets in any amount necessary to comply with the provisions of Ark. Code Ann. § 23-63-1614(i), in certificates of deposit of any bank organized under the laws of the United States whose home state is the State of Arkansas or any federally insured bank or savings institution organized and supervised under the laws of the State of Arkansas.

§ 11. Insurance managers and intermediaries.

No person shall act as an insurance manager or reinsurance intermediary for captive business in or from within this State without the authorization of the Commissioner. Application for such authorization must be on a form prescribed by the Commissioner. Any person who engages in the insurance or reinsurance business as a producer, agent, or broker for a captive insurance company shall be licensed as such pursuant to Chapter 64 of Title 23 of the Arkansas Code Annotated and shall be authorized as such by the Commissioner.

§ 12. Directors.

A. Every company shall report to the Commissioner within thirty days after any change in its executive officers or directors, including in its report a biographical affidavit of any new executive officer or director.

B. No director, officer, or employee of a company shall, except on behalf of the company, accept, or be the beneficiary of, any fee, brokerage, gift, or other emolument because of any investment, loan, deposit, purchase, sale, payment or exchange made by or for the company, but such person may receive reasonable compensation for necessary services rendered to the company in his or her usual private, professional or business capacity.

C. Any profit or gain received by or on behalf of any person in violation of this section shall inure to and be recoverable by the company.

§ 13. Conflict of interest.

A. Each company chartered in this State is required to adopt a conflict of interest statement for officers, directors and key employees. Such statement shall disclose that the individual has no outside commitments, personal or otherwise, that would divert him from his duty to further the interests of the company he represents but this shall not preclude such person from being a director or officer in more than one insurance company.

B. Each officer, director, and key employee shall file such disclosure with the Board of Directors yearly.

§ 14. Acquisition of control of or merger with domestic company.

The acquisition of control of or merger of any company with a domestic insurance company shall be conducted pursuant to Ark. Code Ann. Section 23-69-142, *et seq.*

§ 15. Rescission of captive license.

A. The Commissioner may, subject to the provisions of this section, by order rescind the license of the company:

(1) if the company has not commenced business according to its plan of operation within two years of being licensed; or

(2) if the company ceases to carry on insurance business in or from within Arkansas; or

(3) at the request of the company; or

(4) for any reason provided in Ark. Code Ann. § 23-63-1609.

B. Before the Commissioner rescinds the license of a company under (A)(1) or (2) of this subsection, the Commissioner shall give the company notice in writing of the grounds on which he proposes to cancel the license, and shall afford the company an opportunity to make objection in writing within the period of thirty days after receipt of notice. The Commissioner shall take into consideration any objection received by him within that period and, if he decides to cancel the license, cause the order of cancellation to be served on the company.

§ 16. Change of business.

A. Any change in the nature of the captive business from that stated in the company's plan of operation filed with the Commissioner upon application shall require prior approval from the Commissioner.

B. Any change in any other information filed with the application must be filed with the Commissioner but does not require prior approval.

§ 17. Adoption of Application and Forms.

A. A proposed captive insurance company shall make application to the Commissioner for authority to conduct insurance business on the "Captive Insurance Company Application", which is adopted as part of this Rule and Regulation. The application and its accompanying forms and attachments are intended to be used by the applicant in the preparation of the statements and information required by the Act and this Rule and Regulation. The applicant may use the application, forms and attachments as blank forms that are to be filled in by the applicant or as a guide in the preparation of the statements and information required by the Act.

B. Two complete copies of the application including forms, attachments, exhibits and all other papers and documents filed as a part thereof, accompanied by the appropriate filing fee, shall be filed with the Commissioner of the State of Arkansas by personal delivery or mail addressed to:

Insurance Commissioner of the State of Arkansas
1200 West Third Street
Little Rock, AR 72201-1904
Attention: Legal Division

At least one of the copies shall be manually signed in the manner prescribed on the application. Unsigned copies shall be conformed. If the signature of any person is affixed pursuant to a power of attorney or other similar authority, a copy of such power of attorney or other authority shall also be filed with the statement.

§ 18. Application Fees.

A. The fees required for filing an application for authority to conduct insurance business are as follows:

(1) Filing and review of each application……………………………………………….$200

(2) License, when issued………………………………………………………………..$300

(3) Annual License Renewal…………………………………………………………..$300

(4) Actuary review of application………………………………Equal to cost to the Department

B. All fees imposed pursuant to this Rule and Regulation shall be due and payable to the "State Insurance Department Trust Fund" and shall be payable by company check, personal, certified or cashier's checks, cash or money orders.

§ 19. Effective Date. The effective date shall be February 11, 2002.

MIKE PICKENS
INSURANCE COMMISSIONER

_Signed February 11, 2002_____________
DATE