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Report to Congressional Requesters

May 1991

COAL MINE SUBSIDENCE

Several States May Not Meet Federal Insurance Program Objectives

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Resources, Community, and
Economic Development Division

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May 28, 1991

The Honorable Nick J. Rahall, II
Chairman, Subcommittee on Mining
and Natural Resources
Committee on Interior and
Insular Affairs
House of Representatives

The Honorable Frank McCloskey
House of Representatives

This report responds to your request that we examine the efficacy of the Department of the Interior's Office of Surface Mining Reclamation and Enforcement's (OSMRE) efforts to implement the federally assisted coal mine subsidence insurance program. Coal mine subsidence, a gradual settling of the earth's surface above an underground mine, can damage nearby land and property.

To help protect property owners from subsidence-related damage, the Congress passed legislation in 1984 authorizing OSMRE to make grants of up to $3 million to each state to help the states establish self-sustaining, state-administered insurance programs. Of the 21 eligible states, six—Colorado, Indiana, Kentucky, Ohio, West Virginia, and Wyoming—applied for grants. As agreed with your offices, we reviewed the efforts of these six states to develop self-sustaining insurance programs and assessed OSMRE's oversight of those efforts.

Results in Brief

After 5 years under the subsidence insurance program, two of the six states participating in the subsidence insurance program—Indiana and Ohio—may not be progressing toward self-sustainability. The difficulty experienced by these states can be traced to inadequate participation in the program by eligible property owners. If the participation rate is too low to generate sufficient premium income for the insurance reserve requirements for anticipated claims, the risk is greatly increased that a major subsidence event would threaten the fund's solvency.

While the subsidence insurance program is state-administered, federal grant money is being used to fund program operations. Accordingly, as the federal agency managing the use of the funds, OSMRE is responsible for ensuring that grants are awarded for the purpose intended and that the grant recipients are making appropriate progress toward achieving grant objectives. However, OSMRE has taken a passive role in managing these grants and has not provided the oversight necessary to ensure that program objectives are being met. OSMRE cited the relatively few federal dollars involved ($11.3 million as of September 30, 1990) and the resources needed to actively participate in state-administered programs as the reasons for its passive grants management approach.

Background

The Surface Mining Control and Reclamation Act (SMCRA) of 1977 (P.L. 95-87) established a nationwide program to regulate ongoing coal mining operations and to provide grants to states for reclaiming areas mined and abandoned before August 3, 1977. Under SMCRA, however, states could not use available grant monies to restore private property damaged by coal mine-related subsidence. Since regular property insurance policies usually do not cover damage caused by coal mine subsidence, many property owners were left with the primary financial burden. To help fill this gap, the Congress amended SMCRA in October 1984 (P.L. 98-473) to help states start their own insurance programs. The amended legislation authorized OSMRE to use SMCRA funds to provide "start-up money" in the form of grants for up to $3 million to eligible states[1] for the establishment of self-sustaining, individual state-administered insurance programs. Each state was allowed to design an insurance program to meet its particular conditions and needs. Funds used for this purpose reduced the amount of funds available to the states to correct other reclamation problems.

OSMRE's implementing regulation (30 CFR Part 887), effective February 13, 1986, defines a self-sustaining program as one that maintains an insurance rate structure designed to be "actuarially sound." Actuarial soundness, according to the regulation, "implies that funds are sufficient to cover expected losses and expenses, including a reasonable allowance for underwriting services and contingencies."

When the program was authorized, 21 states were eligible for subsidence insurance program grants. Only six states (Colorado, Indiana, Kentucky, Ohio, West Virginia, and Wyoming), however, applied for the grants. Officials in the other states gave three primary reasons for not applying for the grants. The states (1) believed they would face a limited number of subsidence situations, (2) preferred to use available grant funds for other purposes, and (3) perceived that they would be

[1] Under SMCRA a state is eligible to receive grants once OSMRE approves its state reclamation plan and the state establishes a program for administering the grant monies.

unable to establish self-sustaining insurance programs because they anticipated that few property owners would participate.[2] As of September 30, 1990, the six grants awarded in 1986 and 1987 totaled $11.3 million. These grants ranged from $375,000 to West Virginia to $3 million each to Colorado and Kentucky. Appendix I provides additional information about the federal grants and the related states' programs for the six participating states as of September 30, 1990.

Low Participation Endangers at Least Two States' Programs

The federal law and regulation have only one measurable performance criterion for assessing the efficacy of the mine subsidence insurance program—whether the state programs are self-sustaining (actuarially sound). However, there is no accepted industry standard for actuarial soundness for coal mine subsidence insurance. This is primarily because the limited data on past subsidence events make subsidence predictions, at best, an imprecise science.[3]

Nonetheless, after almost 5 years experience with the program, two of the six states that received grants—Indiana and Ohio—may not be progressing toward self-sustainability.[4] Officials in Indiana and Ohio told us that their participation rates—the ratio of participating property owners to the total number of eligible property owners in counties considered vulnerable to mine subsidence—are currently too low to generate sufficient premium income to meet the insurance reserve requirements for anticipated claims. As of September 30, 1990, the participation rates for Indiana and Ohio were 8 percent and 1 percent, respectively. (Indiana's rate increased to this level after a publicized subsidence event in 1989.) These officials pointed out that such low participation rates greatly increase the risk of having a major subsidence event threaten the state funds' solvency.

State officials in both Indiana and Ohio attribute the low participation rates in large measure to the fact that their state laws do not require

[2] Illinois and Pennsylvania currently operate state-funded insurance programs to cover private property damage caused by coal mine subsidence.

[3] Actuarial projections are usually based on relevant, recent claims experience, with adjustments to reflect expected future conditions. Since there was little experience with subsidence insurance claims prior to this program, initial projections had to be based on limited data. Up to 5 years have elapsed since the federal program was begun, and more current and useful data should now exist, provided the states have maintained adequate records. Current actuarial studies, therefore, would provide a more useful basis for establishing and maintaining a rate structure that is actuarially sound.

[4] Detailed information on the status of each state's program is presented in appendix I.

insurance companies to automatically include subsidence insurance coverage in all standard property-owner policies. With such automatic coverage, property owners in counties susceptible to abandoned mine land-related subsidence would be enrolled in the program and pay the additional annual premiums associated with the added coverage, unless they specifically waived the coverage. When automatic coverage is not a part of the program, insurance companies have the option of notifying the property owners of the availability of subsidence coverage. Under this circumstance, the property owners usually have to assume the prime responsibility for learning about and seeking subsidence insurance coverage. Legislation has been submitted in both states' legislatures to mandate automatic coverage. In neither case has the legislation been enacted.

Automatic coverage appears to have been a key factor in the performance of two of the other four participating states—West Virginia and Kentucky. As of September 30, 1990, West Virginia's participation rate was 19 percent and Kentucky's was 14 percent. Officials in both states believe their participation rate success can be attributed to the automatic coverage provision of the program. In West Virginia, for example, automatic coverage was initially part of the program but was dropped after the insurance industry expressed concerns about the administrative burden. After this feature was rescinded, however, participation by property owners dramatically decreased. When West Virginia subsequently reinstated automatic coverage, participation rates once again increased.

Although Wyoming does not require its insurance companies to offer automatic coverage, state officials told us that their participation rate increased to a level (18 percent) deemed satisfactory by the state after mortgage loan lenders routinely required property owners to obtain subsidence insurance. With such a participation rate, state officials believe that the program will be self-sustaining by 1995. They believe this will occur even though a substantial number of claims were paid to individuals who had experienced subsidence damage years before the subsidence insurance program had begun and the coverage was obtained. Under the Wyoming Attorney General's interpretation of Wyoming insurance laws, such retroactive payments are proper. We obtained Interior's opinion on whether retroactive payments as authorized by Wyoming law constituted insurance under the legislation establishing the federal subsidence insurance program. Interior found Wyoming's retroactive payments to be legally unobjectionable. Interior noted that neither SMCRA nor its legislative history provides a definition of the term insurance. It also said that insurance may encompass circumstances in which a loss occurs prior to the issuance of an insurance policy. In such cases, the insured has the burden of proving the amount of the loss and that the loss was of the type covered by the policy. On the basis of our review, we do not disagree with the state of Wyoming's and Interior's position.

As of September 30, 1990, 41 (totaling $661,516) of the 47 claims (totaling $674,834) paid under Wyoming's program were for damages that had occurred in Rock Springs, Wyoming, in 1985, more than a year before the state insurance program was established. Previously uninsured property owners became eligible for prior damage payments by paying a $100 enrollment fee in addition to the premium.

Although Colorado does not require insurance companies to automatically offer coal mine subsidence protection to property owners, its participation rate increased to 14 percent over a 3-year period. State officials attribute the high participation rate to the fact that the state has used a public relations firm to inform property owners of the protection and focused its promotional efforts on the five counties where subsidence is of greatest concern. State officials are confident that the program is currently self-sustaining. The state is approaching performance levels judged by independent consultants and actuaries to produce a self-sustaining program with 95-percent confidence.

In addition to a lack of an automatic coverage provision, Indiana property owner participation was burdened by two other factors. First, Indiana officials acknowledged that their initial efforts to publicize the program were not adequate to ensure property owner awareness. They said the state held 1-day seminars for the insurance industry in 1986 and 1987 (which were poorly attended), advertised sparingly through the news media, and arranged with some banks and utility companies to distribute brochures to their customers. Second, Indiana requires insurance companies to bear the cost of investigating subsidence claims. Such investigations are sometimes costly, particularly if core drilling or other types of expensive investigative techniques are needed to evaluate the claim. According to an Indiana official, the cost of one comprehensive investigation can negate the total revenues obtained by insurance companies from premium income and can serve as a disincentive for the companies to enroll participants.

Program awareness and participation became important concerns in October 1989 when a subsidence event occurred in southwest Indiana.

Many of the property owners in this area had not known that subsidence insurance was available. In addition, some of the individuals who did have coverage had problems receiving damage payments under their policies because Indiana had not developed claims processing procedures.

OSMRE Has Assumed a Passive Role in Managing Subsidence Insurance Grants

OSMRE's Financial Assistance Manual contains the policies and procedures OSMRE is to follow in administering its financial assistance programs, including the subsidence insurance program. Among other requirements, OSMRE must (1) review state grant applications and ensure that the states have plans that would reasonably lead to successful achievement of grant program objectives; (2) monitor state progress toward achieving those objectives, including required progress reports; and (3) if necessary, encourage corrective action or terminate a grant when, in OSMRE's judgment, insufficient progress is being made.

Early in the subsidence insurance program, however, OSMRE determined that it would play a passive role in reviewing grant applications and monitoring program progress. This decision was based on the relatively few dollars[5] involved and OSMRE's interpretation of the degree of effort needed for more active participation in state-administered programs. This interpretation was most clearly expressed by the OSMRE Director in March 1990 congressional correspondence, where he stated

> "while [OSMRE] provided money to create the program, the overall success of that program remains the State's responsibility. Criteria for evaluating the success of this program and potential for the program to become self-sustaining rest with the State agency and not OSM [Office of Surface Mining Reclamation and Enforcement]."

In the context of this interpretation, OSMRE headquarters did not provide its field offices—which were generally responsible for approving the states' grant applications and monitoring program progress—with any advance written guidance on how these processes should be conducted. Without advance guidance, the field office personnel said they had little basis to assess grant applications and determine whether the states had proposed programs that would become self-sustaining. Consequently, the field office personnel said they gave the states considerable latitude in designing their programs and only cursorily reviewed the applications.

[5] Of the over $1.4 billion in grants to states under SMCRA, the insurance program for the six states totals $11.3 million, or less than 1 percent.

For example, in 1986, when reviewing the grant applications of Indiana and Ohio, field officials accepted state views—at face value—that their programs would be self-sustaining. They did not determine the basis for the states' views or ensure that they were supported by actuarial analyses. Both of these states have had trouble meeting the program objectives. While not required by OSMRE as a condition of grant approval, Indiana has now recognized—4 years into the grant period—the need to perform an actuarial analysis to help determine if its program can be self-sustaining. The state has contracted with a public accounting firm to perform the study, which is to be completed by December 31, 1991. Likewise, the Ohio insurance industry completed an actuarial study in March 1991, and advised the state that its program can be self-sustaining if the program insurance coverage is made mandatory. Ohio officials told us they plan to continue their efforts to obtain legislative changes requiring mandatory coverage.

When the programs were initially approved, the lack of casualty experience under a subsidence program made an assessment of actuarial soundness a difficult proposition. Sound actuarial practices dictate under these circumstances, however, that thorough monitoring of early program experience be conducted to determine whether initial program designs are actuarially sound or whether program changes need to be made.

OSMRE field offices told us, however, that they did not believe they were responsible for actively monitoring state progress or requiring the states to modify program operations to better achieve the self-sustaining objective. While the field offices received semiannual progress reports from the states and sometimes noted the need for corrective actions, they did not take steps to ensure that the actions were taken. For example, in an August 1988 field oversight report, OSMRE said Indiana's Department of Insurance did not give the program a high enough priority. As a result, the program was behind schedule and marketing efforts were insufficient to establish self-sustainability. Field office personnel discussed these and other issues (i.e., the need for the state to require insurers to automatically include subsidence coverage in homeowners' insurance policies) with Indiana officials in 1987 and 1988, but did not follow up to ensure that corrective actions were taken.

OSMRE officials recently told us that they believe a more proactive management approach is appropriate. They agreed that it is OSMRE's responsibility to establish criteria to measure self-sustainability and to provide the oversight necessary to determine whether this program objective is met.

Conclusions

We do not believe OSMRE's passive grant management approach for this program is consistent with its grant management requirements. These requirements and sound actuarial practices require that progress toward achieving a program objective—in this case the achievement of a self-sustaining insurance program—be effectively monitored. At a minimum, OSMRE should assess whether the state programs stand a reasonable probability of achieving actuarial soundness and whether the states are making reasonable progress toward achieving this objective.

Recommendations to the Secretary of the Interior

To ensure that states implement coal mine subsidence insurance programs that have a reasonable probability of achieving self-sustainability, we recommend that the Secretary of the Interior direct the OSMRE Director to follow the requirements of OSMRE's Financial Assistance Manual as it manages this grant program. As part of OSMRE's enhanced oversight, the Director should monitor the states' progress toward achieving self-sustaining programs; encourage those actions that will enhance their prospects of achieving self-sustainability; and, as a last resort, terminate a state's grant if it becomes clear that a self-sustaining program is not obtainable. In particular, the Director should encourage states to automatically include subsidence insurance coverage in all property owner policies and inform mortgage lenders of the availability of the insurance.

Scope and Methodology

During our review, we examined (1) the proposed and final rules published by OSMRE to establish the grant program and to provide guidance to the states and OSMRE's field offices for administering the program and (2) the states' grant applications and related semiannual progress reports, as well as OSMRE field office oversight reports. We also reviewed the applicable laws and OMB Circulars, as well as the relevant legal opinions. We also obtained information from the states and OSMRE offices about states' grants and insurance programs for our analysis. As agreed with your offices, we did not independently verify the sources or accuracy of this information. We interviewed OSMRE and state officials to determine how the programs were developed and managed, and how progress toward achieving the legislative objective was being monitored. We later requested state officials to provide us with current information about their specific programs, and retained the advice of practicing actuaries and consultants to assess potential program needs.

As agreed with your staff, we did not obtain official agency comments on a draft of this report. However, we discussed the factual information obtained during our review with agency officials, and have incorporated their views where appropriate. We conducted our review between April 1990 and April 1991 in accordance with generally accepted government auditing standards.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Secretary of the Interior and other interested parties and make copies available to others upon request.

This work was performed under the direction of James Duffus III, Director for Natural Resources Management Issues, who can be reached at (202) 275-7756. Other major contributors are listed in appendix II.

Keith O. Fultz / for

J. Dexter Peach
Assistant Comptroller General

Contents

Abbreviations

GAO	General Accounting Office
OSMRE	Office of Surface Mining Reclamation and Enforcement
SMCRA	Surface Mining Control and Reclamation Act

States' Coal Mine Subsidence Programs

OSMRE has awarded grants to six states to establish self-sustaining coal mine subsidence insurance programs. Although program features vary among the states, the basic subsidence insurance program works in the following manner. Policyholders generally pay their insurance companies an additional annual premium or fee for subsidence coverage. This additional premium ranges from $15 to $80. The amount of insurance coverage offered in the six states ranges from $50,000 to $150,000. The insurance companies turn over all or part of the additional premium to the states. In some states the insurance companies keep a portion of the premium to cover their selling expenses, while in others the state reimburses them for these expenses. When subsidence damage claims are submitted by property owners and approved, the claims are paid with state program funds either directly by the states or by the insurance companies, which are then reimbursed by the states. In providing grants to help states establish subsidence insurance programs, the federal government assumes no liability for paying any claims.

The grants were awarded in 1986 and 1987 for amounts ranging from $375,000 to $3 million. Additional information about the grants and the states' programs are provided in this appendix.

Table I.1: Status of Federal Grants for the Six States Participating in OSMRE's Coal Mine Subsidence Insurance Program as of September 30, 1990

State	Grant period	Grant amount	Funds received
Colorado	July 1986 to May 1989	$3,000,000	$3,000,000[a]
Indiana	Sept. 1986 to June 1994	2,782,485	306,795
Kentucky	July 1986 to June 1990[b]	3,000,000	818,052
Ohio	Feb. 1986 to Feb. 1991[c]	1,000,000	337,433
West Virginia	Oct. 1987 to Sept. 1991[d]	375,000	366,560
Wyoming	Nov. 1986 to Oct. 1994	1,152,291	820,667
Total		**$11,309,776**	**$5,649,507**

Notes:

[a]Colorado established a trust fund with grant monies. The interest earned by the trust is used to pay claims and to assist in paying program administration costs.

[b]Kentucky's grant was terminated as of June 30, 1990, following the state's determination that a self-sustaining status had been reached.

[c]On December 27, 1990, Ohio's grant was extended by 2 years to January 1993.

[d]West Virginia's initial grant period, through September 1988, has been extended three times. On January 29, 1991, the grant was extended by 4 years to September 1995, and increased by $700,000.

Table I.2: Self-Sustaining Information for the Six States' Coal Mine Subsidence Insurance Programs as of September 30, 1990

State	Reserves available to pay claims	Claims pending	State opinion regarding self-sustaining status
Colorado	$2,858,539	$0	Self-sustaining[a]
Indiana	568,595[b]	Not available[c]	Not determinable[d,e]
Kentucky	3,900,000	197,000	Achieved in June 1990[a]
Ohio	434,500	432,500	Not at present time[d,e]
West Virginia	6,904,856	1,582,342	Not determinable[a,f,g]
Wyoming	464,504	0	To be achieved in 1995[d]

[a]OSMRE's March 15, 1991, letter to GAO states that its field office had determined that the state has met the self-sustaining program requirement.

[b]Reserves available represent the difference between the sources and uses of funds reported by Indiana.

[c]Claims-pending information is not available until the completion of an actuarial study.

[d]OSMRE's March 15, 1991, letter to GAO stated that OSMRE field office directors would make the final determination of self-sufficiency after close interaction with the states.

[e]State officials believe that legislative changes proposing automatic coverage may make achievement of self-sustaining status possible.

[f]OSMRE's March 15, 1991, letter to GAO states that its field office had determined the state's program was self-sustaining in June 1986, before the grant was made.

[g]State officials said that a major event could potentially place a large drain on the funds.

Table I.3: Sources of State Insurance Funds From Grant Start to September 30, 1990

State	Grant Drawdowns	Premium income	Interest earned	Other income	Total
Colorado	$3,000,000	$0[a]	$466,523	$34,510	**$3,501,033**
Indiana	306,795	774,623	23,021	0	**1,104,439**
Kentucky	818,052	3,515,204	415,205	0	**4,748,461**
Ohio	337,433	440,200[b]	49,081	200,000[c]	**1,026,714**
West Virginia	366,560	4,702,418[d]	750,000	0	**5,818,978**[e]
Wyoming	820,667	272,089	49,194	78,162	**1,220,112**

[a]Payments made by subscribers are considered administrative fees instead of premium income, and are shown as other income.

[b]Premium income is net of commissions paid.

[c]Other income represents amounts from the state's general fund (to be repaid).

[d]Premium income amount is total for the grant period through December 1990.

[e]Total includes some estimates by state.

Table I.4: Uses of State Insurance Funds From Grant Start to September 30, 1990

State	Promotional expenses	Investigation expenses	Administration and other expenses	Claims payments	Total
Colorado	$123,582	$2,490	$522,462	$0	**$648,534**[a]
Indiana	68,124	0	254,158	213,562	**535,844**
Kentucky	57,011	206,230	371,049	184,962	**819,252**[a]
Ohio	44,407	101,747	566,105	173,807	**886,066**
West Virginia	0[b]	244,611	0	460,616	**705,227**
Wyoming	18,791	9,735	32,509	674,834	**735,869**

[a]Totals include some state estimates.

[b]Promotional expenses were less than $200.

Table I.5: Comparison of Participation Rates With Different Insurance Coverage Methods as of September 30, 1990

State	State coverage method	Participation: Number eligible	Participation: Number enrolled	Rate of participation
Colorado	Voluntary	7,450	1,054	14%
Indiana	Voluntary	297,540	24,225	8%[a]
Kentucky	Automatic	308,392	42,888	14%
Ohio	Voluntary[b]	1,149,004	11,656	1%
West Virginia	Automatic	544,000	104,511	19%
Wyoming	Voluntary	5,000	904	18%

[a]Legislation has been proposed for automatic coverage. Participation rate was low—1 percent in 1988—prior to a subsidence event in 1989. The rate subsequently increased to 4 percent in 1989 and 8 percent in 1990.

[b]Legislation has been proposed for automatic coverage.

Table I.6: Extent of Program Coverage by Counties in the Six States as of September 30, 1990

State	Number of counties in state	Number of counties affected by coal mine subsidence	Number of counties participating in program
Colorado	63	25	5
Indiana	92	26	26
Kentucky	120	56	34
Ohio	88	37	37
West Virginia	55	55	55
Wyoming	23	6	3

Table I.7: Status of Claims for the Six States as of September 30, 1990

	Number of claims			Value of claims	
State	**Filed**	**Paid**	**Pending**	**Paid**	**Pending**
Colorado	0[a]	0	0	$0	$0
Indiana	34	7	6	213,562	Not determined[b]
Kentucky	191	7	4	184,962	197,000
Ohio	75	25	30	173,807	432,500
West Virginia[c]	799	126	162	2,073,536	1,582,342
Wyoming	51	47	0	674,834	0

[a]Two requests for investigations were made but did not meet claims criteria.

[b]State insurance officials reported that estimates could not be provided until an actuarial study is completed.

[c]Includes numbers and amounts prior to the start of the grant period.

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