Pooling Basics
March 2018

Materials

- Presentation
- Guide
- Questions to ask
- Cybrary
- AGRiP Standards for Recognition
- Operations Manual
Maslow’s Hierarchy of Needs

SELF ACTUALIZATION
Morality, creativity, spontaneity, problem solving, lack of prejudice, acceptance of facts

ESTEEM
Self-esteem, confidence, achievement, respect of others, respect by others

LOVE/BELONGING
Friendship, family

SAFETY
Security of body, employment, resources, morality, family, health and property

PHYSIOLOGICAL
Breathing, food, water, sleep

Hierarchy of Pool Needs

RAINBOWS & UNICORNS
Pool has reached its full potential and is ready to evolve into the future

ESTEEM
Thriving financially and programmatically, the pool is valued by members and related stakeholders; its services are sought after

AFFINITY
Ability of a pool to connect – and maintain a connection – with its members and stakeholders

SECURITY
Baseline sustainability for the pool

FOUNDATIONAL
The basic requirements to bring a pool into existence and keep it functioning
Pool Types

Number of Pools with Line of Coverage

Why Pooling?

• Enable and empower public services
• Provide lowest long-term cost of coverage
• Change the cost curve for public entities
Why Pooling?

California Workers’ Comp Rates: Insurance vs. Pool

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Industry Rate</th>
<th>Pool Rate</th>
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<tbody>
<tr>
<td>2008</td>
<td>2.15</td>
<td>2.10</td>
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<tr>
<td>2009</td>
<td>2.25</td>
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<td>2010</td>
<td>2.32</td>
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<td>2011</td>
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<td>2.32</td>
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<tr>
<td>2012</td>
<td>2.88</td>
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<tr>
<td>2013</td>
<td>2.97</td>
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<td>2014</td>
<td>2.96</td>
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<tr>
<td>2015</td>
<td>2.81</td>
<td>2.96</td>
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<td>2016</td>
<td>2.52</td>
<td>2.81</td>
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<tr>
<td>2017</td>
<td>2.38</td>
<td>2.52</td>
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<tr>
<td>2018</td>
<td>1.80</td>
<td>2.38</td>
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</table>

Necessity to Innovation

- Formed out of crisis
- Public entity focus
- Member owned
- Member governed

March, 1986
Primary Governing Documents

• Formation document
• Bylaws
• Most include
  – Eligibility
  – Member obligations
  – Withdrawal or termination
  – Powers and duties of governing body
  – Board member and officer selection
Additional Documents

• Resolutions
• Board policies and procedures
• Member agreements
• Coverage

Governance & Legal

Governing Bodies

• Size
• Meetings
• Diversity
• Board selection procedures and qualifications
• Subcommittees
• Nature of decisions

Governance & Legal
Roles and Responsibilities

• Discussions and decision making
  – Fiduciary
  – Strategic
  – Generative

• Duty to the membership as a whole

• Independent decisions
  – Board orientation
  – Staff collaboration

Risk Pool Counsel

• Reporting to the CEO
  – Business issues

• Reporting to the Board
  – Fiduciary issues
  – Ethical issues
  – Interpretation of bylaws and agreements

• Coverage counsel may be different

• Defense counsel should be different
Imagine a state audit is being conducted of your pool (or a pool client you serve). You have an individual interview scheduled with the audit team and they ask you this question:

**How does the pool Board of Directors exert independent decision-making? What are some examples of your policies and practices that support the Board’s independent thought?**

**Small Group Discussion**

Governance & Legal
Coverage

Coverage & Claims

PROPERTY
Damage to property of the insured member
First party coverage

LIABILITY
Damage or injury to another party caused by insured member
Third party coverage

WORKERS’ COMP
On the job injuries

HEALTH  TERRORISM  POLLUTION  CYBER  LAW  EPL  CRIME
Coverage

• Pool goal: help the member as long as doing so isn’t harmful to other members
• Coverage may all be offered “in-house” or some can be brokered out (airport, cyber, crime)
• Reinsurance and self-insured retention (SIR)
• Interaction with Master Agreement, By-Laws
• Subject to contract laws or insurance laws

Other Coverage Influences

• Rules and regulations
  – Statutory coverage (work comp)
  – Mandated coverage (health)
  – State rules for property, liability
  – State or federal rules (Violation of Civil Rights)
• Customized coverage
  – Regular review for changes
Coverage Document

- Can be one large document; or separate documents per line of coverage
- Schedules (vehicle, property)
- Manuscript vs. ISO (Insurance Service Office)

Coverage Document

- Declarations
- Coverage agreement
- Exclusions
- Definitions
- Conditions
- Endorsements
Overall Claims Considerations

- Reserve practices
- Adjuster caseloads and member service
- Authorities
- Litigation
- Claims administrators
- Regulations
- Systems
- Independent audits

Claims Process

1. Report the claim
2. Determine coverage
3. Investigate
4. Evaluate responsibility
5. Estimate costs or damages (set reserves)
6. Determine method to resolve
Litigation Management

• Select and manage defense/coverage counsel
• Oversee in-house performance
• Manage experts
• Alternative dispute resolution (arbitration, mediation)
• Trial

Systems

• Replacement (some pools on 3rd generation system)
• Claims data is foundation (data used by actuary, U/W, RM, Operations)
• Three questions
  – Build or buy?
  – Embedded with administrator or stand-alone?
  – How wide is the scope?
Communication

• Adjusters as advocates
• Insurance similarities/differences
• Internal collaboration between departments

What are some recent coverage discussions you’ve been involved in?

• New coverage being introduced for pool members
• Emerging risks that create coverage needs or concerns
• Considerations about coverage from the pool’s reinsurance partners
Underwriting

Goals

• Adequate contributions
• Fairly allocated
• Easy to administer
• Competitive
• Maintain membership
  – Or grow
  – Lose the “right” members, if any
Duties

- Determine acceptable risks
- Evaluate exposures
- Calculate rates
- Manage coverage language
- Procure and oversee reinsurance

Duties (continued)

- Communicate with agents and members
- Be active in complex claims
- Monitor market conditions
- Manage to state regulations
Underwriting Steps

1. Determine exposure
2. Determine rate
3. Develop experience modification
4. Prepare loss pick
5. Apply credits or surcharges
6. Ensure contribution stability

Determine Exposures

1. Population
2. Payroll
3. Budget
4. Number of students
5. Miles of rod or piping
6. Number of vehicles

What correlates to losses?
Determine Rate

Contributions and investment income must be greater than claims, reinsurance and pool expenses.

Underwriting

Develop Experience Modification

- Members with high claims pay more than members with low claims
- Easy to explain to Board, members, and agents
- Include frequency and severity
- Neutral to total contribution needs
Calculate the member’s expected losses to validate the contribution.

Apply Credits or Surcharges

• Surcharges for unusual risks
• Credits for:
  – Deductibles or alternative plans
  – Risk management activities
  – Volume discounts
  – Multiline discounts
Ensure Contribution Stability

$15 per student  
10,000 students  
1.15 experience mod (worse than expected)

$165,000  
$172,500  
$190,000  

LAST YEAR  
STANDARD CONTRIBUTION  
LOSS PICK

Rule sets for standard underwriting process  
Manage schedules, collect underwriting applications  
Track agent compensation  
Member and agent portal for easy access  
Evolution to online processes and transactions  
Bill for contributions  
Maintain coverage structure  
Produce declarations, policies, etc.
Reinsurance & Excess

- Protect against catastrophe risks
- Stabilize and smooth large losses
- Support increase of coverages and limits
- Pilot emerging coverages
- Support underwriting and claims

Simple Structure

$10,000,000 — Reinsurance #2

$1,000,000 — Reinsurance #1

$100,000 — Pool Self-Insured Retention

$1,000 — Member Deductible

Underwriting
Complex Structure

$600 million

$400m - $600m

$300m - $400m

$200m - $300m

$100m - $200m

$100m

$100m - $200m

$100m - $300m

$100m - $300m

$100m - $500m

12 reinsurance companies make up this property program

$500,000 retained

Underwriting

Details

• Treaty or facultative
  – Treaty is another word for agreement
  – Facultative is specific coverage

• Pro rata or excess of loss
  – Under pro rata sharing, pool and reinsurer share losses
  – Under excess of loss, all costs above the SIR transfer

• Reinsurance pools
  – Like a pool of pools
  – Several in AGRiP’s membership

Underwriting
Underwriting and reinsurance involve complex decisions and can seem like “black box” processes within a public entity pool operation.

- What further explanation would be helpful?
- What do you wish you better understood about your pool’s underwriting process?
- What further details about reinsurance would be helpful for you, in your role with a pool?

**SMALL GROUP DISCUSSION**

Underwriting

Financial Oversight
Actuarial Review
& Audits
### BALANCE SHEET
December 31, 2014

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
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<tbody>
<tr>
<td>Cash</td>
<td>$3,500,000</td>
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<tr>
<td>Investments</td>
<td>$75,000,000</td>
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<tr>
<td>Premiums Receivable</td>
<td>$600,000</td>
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<tr>
<td>Prepaid Expense &amp; other Assets</td>
<td>$2,000,000</td>
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<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td><strong>$81,000,000</strong></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable &amp; Accrued Expense</td>
<td>$3,000,000</td>
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<tr>
<td>Unearned Premiums</td>
<td>$5,500,000</td>
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<tr>
<td>Case Reserves (Loss &amp; LAE)</td>
<td>$25,000,000</td>
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<tr>
<td>IBNR Reserves</td>
<td>$15,000,000</td>
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<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td><strong>$48,500,000</strong></td>
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</table>

| MEMBER SURPLUS                      | $32,600,000    |
| **TOTAL LIABILITIES & SURPLUS**     | **$81,100,000**|

**Net Position**
Other

• Notes to the financial statements
• Supplemental statements

Actuarial Studies

• Rate making
  – Forward looking
• Claim reserve study
  – Current year reserves
  – Prior reserves
Reserve Studies

• IBNR: Incurred But Not Reported
  – Claims not yet reported to the pool
  – Unanticipated development on reported claims

Estimated gross reported losses & ALAE from 2007 over time in ($ millions)
Discounting

Reduce reserve estimate based upon expectation of future investment earnings

Fund Balance (Member Equity)
June 30, 2017

Confidence Levels

• Will funding be sufficient for losses
  – Best estimate standard is 55 percent
• Loss fund at $1 million and 70 percent
  – 70 percent of the time funding is sufficient
  – 30 percent of the time it is not
Surplus

• Prior losses exceed expectations by sizable margin
• Premiums set too low for current loss picks
• Reinsurance unavailable or insufficient
• Significant membership change
• Investment income below expected

How Much is Enough?

• Each pool’s risk profile is dynamic
• Opinions vary about best use of member resources
Leverage Ratios

- Change in net premiums written
  - Indicates growth in membership and underlying risks

- Net premiums written to policyholders’ surplus ratio
  - Indicates exposure to pricing errors in current book of business

Leverage Ratios (continued)

- Net liabilities to policyholders’ surplus ratio
  - Indicates exposure to errors in estimating reserves

- Net leverage ratio
  - Combination of premium-to-surplus and liabilities-to-surplus ratios
  - Indicates exposures given surplus deterioration
## Example

<table>
<thead>
<tr>
<th></th>
<th>Pool A</th>
<th>Company B</th>
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<tr>
<td>Net Written premiums</td>
<td>$50 million</td>
<td>$50 million</td>
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<tr>
<td>Surplus</td>
<td>$100 million</td>
<td>$10 million</td>
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<tr>
<td>Expected Combined Ratio</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Premium to Surplus Ratio</td>
<td>0.50</td>
<td>5.00</td>
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<tr>
<td>Pricing Error</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Loss of Surplus</td>
<td>5%</td>
<td>50%</td>
</tr>
</tbody>
</table>

**Restated Figures (same net written premium levels)**

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
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</tr>
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<tbody>
<tr>
<td>Surplus</td>
<td>$95 million</td>
<td>$5 million</td>
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<tr>
<td>Premium to Surplus Ratio</td>
<td>0.53</td>
<td>10.00</td>
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## Methods

- **Minimum funding expectations**
- **Confidence level funding**
- **Benchmark ratios and insurance industry metrics**
- **Refund or dividend policy (max funding expectations)**
- **Dynamic capital modeling**
Independent Audits

• Assurance there are no material misstatements, whether caused by errors or fraud

• Method for checking in
  – What is the purpose?
  – What is the process?
  – What is the best outcome?
  – What to do with a worrisome audit?

What sorts of conversations is your pool (or your pooling client) having about funding adequacy?

• Are you working on a surplus target? Using what method?

• What are the pros/cons you see of having significant surplus?

• What surplus challenges do you have?
Purpose & Structure

- Rationale and implementation varies
  - Number and status
  - Provider networks
  - Collective bargaining
- Structure, governance, size
- Risk retention
Financials

Number of Pools with Line of Coverage

- Risk retention
- Higher contributions
- Faster claim payments
- Not the same IBNR
- Ratios and modeling

HEALTH TRUST FINANCIALS

ASSETS
Cash $9,660,000
Investments 32,911,000
Premiums 237,400,200
Prepaid Expense & other Assets 3,509,000
TOTAL ASSETS $283,480,200

LIABILITIES
Accounts Payable & Accrued Expense $2,705,100
Unearned Premiums 62,700
Claims 202,338,400
Reserves 21,873,400
TOTAL LIABILITIES $236,979,600

MEMBER SURPLUS $46,500,600
TOTAL LIABILITIES & SURPLUS $283,480,200
Membership

- Who owns the equity?
- Covered lives
- Service expectations
- Limited opportunity to influence key costs

Key Relationships

- Provider networks
- Pharmacy networks and benefit managers
- Case management
- Wellness
- Claims, repricing, etc.
**Cost Drivers**

- Aging population
- Underlying health and disease
- Technology
- Rx spend
- Provider consolidation

**Health Pool Expenditures**

- Hospitals and Docs
- Rx
- Other

**Regulation**

- Federal Agencies
- State Agencies
- Private Organizations

"Because of the tremendous breadth of the subject, it is impossible to cover every regulatory program that relates to healthcare."
Health Promotion

- Assessments and biometrics
- Goal setting
- Coaching
- Education
- Special purpose clinics
- Onsite healthcare
- Incentives

Stop Loss

Impact of Increasing Costs

8% Cost Trend
52% Increase

Stop Loss Paid
Retained Risk
Risk Management

What is Risk?

• Uncertainty that impacts objectives
• Good and bad
What is Risk Management?

Treatment of uncertainty
1. Mitigate negative outcomes
2. Enhance positive outcomes

The pool and its members want every child to be safe and every police officer to go home in the same condition as at the start of shift.

Goals

Reduce losses - lower costs for the pool and members
Protect staff and assets of members
Add value to distinguish the pool from competition
Culture of pooling - it's the right thing to do
Enterprise Risk Management

A holistic view of how uncertainty impacts a public entity’s objectives.

Process

Understand Culture

Assess
- Identification
- Analysis
- Evaluation

Treat

Communicate and Consult

Monitor and Review
Understand Culture

- Organizational objectives
- Interest of internal and external influencers

Assess

- Identification
- Analysis
- Evaluation
Treat

1. Assign owner
2. Current enhancement strategies
3. New enhancement strategies
4. Resources
5. Early warning signs and performance measures
6. Communication plan

Communicate

- Inform influencers
- Use existing communication resources
- Consider new communication methods
Monitor & Review

- Check back with risk owners
- Review early warning indicators and performance measures
- Best practices
- Audits
Data

• Claim data to pinpoint root causes
• Pilot projects and best practices tested in control groups
• Predictive modeling to identify the next loss
• Mobile apps deliver service
Member Services

Purpose

• Relationship management
• Marketing and growth
• Communications
• Not every pool has member services department
  – Services performed by several staff
  – Pools may fulfill with association relationship
Purpose

• Relationship management
• Marketing and growth
• Communications
• Not every pool has member services department
  – Services performed by several staff
  – Pools may fulfill with association relationship
What is the most valuable or meaningful member service your pool provides to your membership?

**Small Group Discussion**

*Member Services*

We **energize** the power of pooling.