Recommended Sessions for Pooling Basics Track:

Jurassic Parliament – Ann McFarlane
- Monday, March 7, 10:30-12:30pm

Pooling Basics Session #1a
- Monday, March 7, 2:30-3:30pm

Pooling Basics Session #1b
- Monday, March 7, 3:45-4:45pm

Pooling Basics Session #2a
- Tuesday, March 8, 10:30-11:30am

Pooling Basics Session #2b
- Tuesday, March 8, 11:45-12:45pm

Effective Board Governance for Pools – Sara Peterson
- Tuesday, March 8, 2:30-4:45pm

Presentation Description

Over the course of two days, solidify your pooling basics knowledge with several sessions to recap the course work you have already been through. Basics sessions will coverage Underwriting, Actuarial Science, The Life of a Claim, Financial Reporting, Auditing, and Risk Management. Complimentary sessions will cover governance and leadership roles. And, there will be plenty of time for Questions & Answers for the Pooling experts lined up to dispense their knowledge and experience.

Presentation Software
http://prezi.com/dcjl7yrankbc/?utm_campaign=share&utm_medium=copy&rc=ex0share

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Presenter

Joel Kress, AGRiP Staff  jkress@agrip.org; 603.568.4880

Joel Kress currently serves as Director of Special Projects for AGRiP. Amongst his other projects, he is updating Pooling Basics to be included in a holistic initiative known as ‘AGRiP University’. Although in its infancy, AGRiP University will wrap up all educational initiatives in the pooling sector, and standardize the educational requirements for those seeking pool management.

Previously, Mr. Kress served as Underwriting Manager for Government Entities Mutual, Inc. PCC, providing reinsurance underwriting and actuarial analytical services, as well as computer programming for the claims management information system. Previous to GEM, Mr. Kress worked for an actuarial consulting firm for 5 years. He has received two Bachelor of Science degrees (Applied Mathematics and Mathematical Education) from North Carolina State University, and a Masters degree (Business Administration) from Southern New Hampshire University. He also earned the designation Associate in Reinsurance (ARe).

Mujtaba Datoo, AON Global Risk Consulting  mujtaba.datoo@aon.com; 949-608-6332

Mujtaba Datoo is the Actuarial Practice Leader for AON Global Risk Consulting, leading the public entity practice. He has over 30 years experience providing actuarial services within the insurance and risk management fields. He has spent over 10,000 hours just in the last decade preparing actuarial reports, and thus qualifies as an expert according to the 10,000-hour rule popularized by Malcolm Gladwell in his bestselling book ‘Outliers’. Mr. Datoo has extensive experience in ratemaking, loss reserve, and funding studies for self-insured workers compensation and liability programs, particularly for pooling programs. His experience has included tenures in a commercial carrier, rating bureaus, and consulting.

He has presented before various organizations, including PRIMA, CAJPA, CASBO, PARMA, AGRiP, APTA, STRIMA, NLC, and Conference of Consulting Actuaries. A frequent speaker to Pool Boards he has presented extensively on understanding actuarial reports and its findings, financial measures and cost allocations. He is the cornerstone of the financial boot camps of the Aon Pooling Conference. He has authored several articles on actuarial topics, and a primer on understanding your actuarial report – soon to be published. Mr. Datoo attended Columbia University and holds the professional designation Associate of the Casualty Actuarial Society (ACAS) and is a Member of the American Academy of Actuaries (MAAA) and a Fellow of the Conference Consulting Actuaries (FCA).

Sheryl Brandt, Enduris  sbrandt@enduris.us; 509.838.0910

Sheryl Brandt has the privilege of partnering with over 500 special purpose districts in the State of Washington in applying risk management to their daily operations. For the past several years she has worked with Port Districts, Fire Districts, Health Districts, Convention Centers, Water and Sewer Districts, etc. focusing on property and liability losses, litigation management and risk management. She has presented risk management strategies with municipalities, districts and associations, both statewide and nationally. Ms. Brandt is a graduate of Oregon State University, active member of PRIMA and AGRiP, and is currently on AGRiP's Membership Practices Committee.

Carrie Rice, Johnson Lambert LLP  crice@johnsonlambert.com; 802.383.4820

Carolyn Rice, CPA is a Partner that has over 15 years of experience in public accounting. Carolyn primarily provides audit services to the insurance industry. She is a member of the firm’s technical committee and monitors all GASB pronouncements.

Ms. Rice joined Johnson Lambert in 2003, after having worked for two local CPA firms where she gained experience in a number of industries, including not-for-profit, manufacturing and governmental sectors. She also serves on the board of International Center for Captive Insurance Education (ICCIE). Carolyn is a graduate of the University of Vermont, is a licensed CPA in Vermont and Hawaii.
Magali Welch, CPA, CA, AIAF is a Partner that has over 20 years of experience in public accounting. Magali's main focus is providing audit services insurance industry. Her responsibilities additionally include co-chairing Johnson Lambert’s Technical Committee which has the responsibility for the firm-wide training, implementation of new standards and the technical content contained on the Johnson Lambert website. She also oversees and coordinates the firm’s webinars and newsletters.

Prior to joining Johnson Lambert in 1994, Ms. Welch was with the Montreal accounting firm of Lacroix, Vaillancourt & Associates during which time she attained her Chartered Accounting designation. She recently completed a three-year term on the AICPA Insurance Expert Panel. Ms. Welch has obtained an Associate in Accounting and Finance (AIAF) designation offered by the Insurance Institute of America. She also completed the International Financial Reporting Standards (IFRS) certification offered by the AICPA.
History of Insurance in 60 seconds
(set to the music of a popular song)

Lloyd’s of London, tea time, cargo ships, maritime;
Barn building Amish, Franklin’s Fire Mutuals;
Homesteaders take a risk, farmers’ crops take a hit;
Insurance sales men get a wrap, selling one big money trap.

Exclusions, exclusions everywhere, regulators on a tear;
Acts of God don’t you say, NFIP saves the day;
Asbestos, black lung disease, toxic dumping killing trees;
Underwriters off Scot-free, who’ll actually pay for me.

We didn’t start the (insurable) fire
It was always burning
Since the world’s been turning
We didn’t start the (insurable) fire
No, we didn’t light it
But we tried to (compensate) for it

Strip Searches, eminent domain, Miranda Rights are such a pain;
Hurricane Andrew, Northridge earthquake;
Eliot Spitzer kills finite, contingent commissions good night;
Medical and social inflation equals premium escalation;

Katrina rains down for a week, New Orleans springs a leak;
Lehman, AIG crashes, Great Recession lashes;
Investors eye Insurance profit, soft market beyond all logic;
Underwriters off Scot-free, who’ll actually pay for me;

We didn’t start the (insurable) fire
It was always burning
Since the world’s been turning
We didn’t start the (insurable) fire
No, we didn’t light it
But we tried to (compensate) for it
Pre-Conference Material

Pooling Basics – Filling the Pool

Imagine getting a letter in the mail informing you that your car insurance company has cancelled your policy. Or, tripled the premium. Naturally, you might just call another insurance company, right? Now, imagine all the insurance companies you call reject you. What do you do?

This is exactly the position that public entity risk managers in the 1980’s found themselves in when the commercial insurance marketplace had a distaste for public entity risks. So, the risk managers said, “forget them, we’re going to start our own insurance company”. This is a simple ideal, but it took hard work to successfully execute that ideal. The result outcome was the pooling sector that we all belong to today. Suffice to say, the hard work paid off...

So, what is a pool?

“A member-owned, member-governed, intergovernmental cooperative through which a group of public entities - the members - contribute to a shared fund that in turn pays claims for and provides risk management services to the participating members.”

While pools are defined as “something other than insurance” in most states, the fundamental purpose of risk pooling is not unlike conventional insurance to protect program participants against unexpected losses.

Like conventional insurance, pools typically transfer risk from one entity to another central risk sharing authority – the pool. Unlike commercial insurance, however, a pool’s primary purpose is to manage and reduce risk – not just finance it.

Some of the benefits enjoyed by pool members are:

- **Coverage**: Unlike insurance companies that are founded to make a profit and use mostly standard language contracts for the insurance coverage they provide, pools typically craft their own coverage documents. This
provides the members with the availability of coverage, terms, and limits which are best suited to address the risks of the members.

- **Services**: Risk management is typically seen as a detraction from an insurance company’s bottom line. The pooling community has committed much more labor and capital to reduce, mitigate, and prevent losses from happening. These customized risk management services are provided to meet your members’ risk management and administration needs.
- **Financial savings**: Reduced losses, lower overhead, leverage in the purchase of catastrophe insurance (or “reinsurance”), and investment income that accrues to the member-owners, all allow a pool to offer lower costs over the long run than commercial insurance.
- **Budgetary stability**: The financial advantages, together with prudent funding and member commitment, has provided greater budgetary stability to members. The commercial insurance market, however, vacillates greatly depending on a number of internal and external financial conditions.

**Formations**

Pools are organized differently in each state – a function of state law. The initial formation and its incorporating documents determine how your pool interacts with its membership and regulators, and generally does not allow for interstate membership.

Depending where you live around the country, pools might be called Joint Powers Authorities, Interlocal Agreements, Trusts, Reciprocals, Funds, Risk Retention Groups, and even Mutual Insurance Companies and Captive Insurance Companies. All of these are slightly different in organization and regulatory requirements, but generally they all function similarly to your own pool.

**Foundation Documents**

Regardless of pool formation type, you should have many of the same core legal documents. Those are the pool’s ‘Bylaws’ and its ‘Membership Agreement’, which set forth the responsibilities and relationship between the pool and each member.

Among all those governing documents, there contains provisions which should address at least the following:

- Membership eligibility criteria
- Obligations of members
- Membership termination
- Powers and duties of governing bodies
- Ownership and use and distribution of assets
- Assessments
- Professional certifications (including actuarial reviews and financial audits)
- Governance policies providing a framework for operational issue (i.e. target surplus, funding criteria, etc.)

**Regulations**

The method of pooling regulation varies from state to state. Each state has the authority to regulate municipal insurance and risk pooling, most often disparately so. Accordingly, it’s crucial to know your state’s regulations to ensure compliance and the ability to continue operations. Even largely “unregulated” pools need to understand the authority under which they operate, and be aware that, while a state may not exercise much regulatory oversight today, that convenience could change tomorrow.

**Coverage Document and Lines of Business**

In the insurance industry, organizations such as the ISO (“Insurance Services Offices”) promulgate standardized coverage language that, in theory, helps regulators with the approval process, and leads toward more consistent coverage interpretations. Nevertheless, disputes arise, and when they do, there is a huge body of court case law to fall back on.
Since most pools aren’t technically insurers, their coverage documents are not “insurance documents”; they are manuscript contracts between the pool and the member, and generally interpreted under Contract Law, rather than Insurance Law. Most pools refer to their coverage documents as the “Memorandum of Coverage”, or an “MOC”.

Whether ISO forms or manuscript contracts, MOC’s should include certain sections that allow for consistent understanding and interpretation. These include:

- **Declarations**: Also, referred to as the “DEC” page, this usually single page quickly outlines the specific coverage, limit deductibles, and endorsements that each particular member has purchased.
- **Definitions**: Identifies and clearly defines key terms for purposes of that particular coverage.
- **Coverage Agreement**: The body of the agreement that explains what the exact coverage as it is intended.
- **Conditions**: Requirements of the member in the event of a claim, such as cooperating with the investigation, and taking steps to minimize the loss.
- **Exclusions**: Clearly expressed restrictions to the intended coverage, some of which may be quite standard (such as asbestos, or losses caused by war), and some which may be specific to that pool (such as subsidence, for a pool with coastal exposure).
- **Endorsements**: Standard or manuscript, these are added to an individual member’s MOC to change, add, or detract coverage. Endorsements are negotiated and agreed upon by both the member and the pool.

In general, there are eight types of coverage pools might offer:

- Property
- Boiler & Machinery (or, Equipment Breakdown)
- Crime & Fidelity
- Liability
- Auto Liability
- Workers’ Compensation
- Health or Employee Benefits
- Unemployment Insurance

**What are the Basic Duties of a Pool Board Member?**

The legal structure of the pool and its board – whether directors or trustees – presents legal nuances in the roles and responsibilities of board members that are pool-specific. There are, however, some general characteristics that help ensure the board promotes the cooperative culture that is instrumental to a pool’s success:

- As a member of the board, your duty is to the pool – NOT to the member you represent
- You are not expected to be a technical expert, but you are expected to engage technical expertise when needed, and to always act in good faith
- You are expected to deliberate and debate with your colleagues on the board, but once action is taken, you must support that action. In other words, “The Board speaks with one voice.”
Pooling Business Model

The business model of insurance and pooling is interesting and wholly disparate from a typical business model. Below are some simple diagrams to point out the differences.

- In a typical business, raw materials are combined to create a new product, which is then sold to the consumer.

- Taking a closer step towards insurance products, in the Financial Products Business Model capital is secured to make investment vehicles, which earns interest for its risk holders.

- In the Insurance Business Model premiums are collected from policyholders to pay for all accidental losses for each of those policyholders. Any profit (premiums – claim costs) belongs to the insurance company and its shareholders.

- Public entity pooling is similar to insurance, but the difference is the “profit” is returned to the policyholders (or, pool members).
Additionally, there are some interesting aspects to the business model of insurance companies and public entity pools versus the traditional business model. In most businesses, you make a product such as a widget. The cost of making that widget is known, because you have to spend almost all of the cost of making that widget before you sell it to a consumer. When you sell the widget, you add up all the costs to make it, put in a little profit, and charge the customer that price.

For insurance and pooling contracts, you charge the customer first in the form of premiums or contributions, and then years and decades later you find out how much that product costs. That unknown cost for all those years and decades is reserves, which are estimated by the claims staff and an actuary. Like all predictions, the estimates are never assumed to be entirely correct. Those unknown estimates have to be booked on our balance sheet and income statement. Fortunately (quite literally), there is a benefit to this business model. All those booked reserves sitting on your balance sheet can be invested to generate investment income. This investment income can used to either garner additional “profit” or to lower the cost of premiums/contributions.
Pooling Basics Session #1a – Underwriting and Actuarial Science

Monday, March 7, 2:30-3:30pm

Pooling and Risk Transfer

What is Risk Transfer?
Risk transfer happens when a pool’s members transfer some or all of the risk of financial loss away from themselves and to the pool. For this transfer of risk, the member pays the pool a premium/contribution. The member’s portion of retained risk is called the “Deductible”.

Pools are structured to assume this transferred risk, but they then only retain some portion of it, and further transfer another portion of it. This transferred portion can go to either another pool or to a commercial reinsurer. The pool’s retained portion of risk is called its “Self-Insured Retention” (SIR).

The amount of risk transferred by the member to the pool is determined by the coverage document (the “MOC”), which may define portions of each loss that the member has to reimburse to the pool (the “deductible”); portions the pool retains for each loss (“self-insured retention”); limits to the amount the pool will cover (coverage “limit”); and other definitions, terms, conditions, and exclusions that define whether or not the risk or claim is covered by the pool. In much the same way, pools retain some of the risk of loss exposures that are transferred to them from their members, and they in turn may transfer risk onto excess insurers or reinsurers.

Look at the coverage areas provided to your members and identify your largest exposures.

- What is a worst-case scenario for losses?
- What effect would that have per line of coverage?
- How many large losses can the surplus absorb?

What is Underwriting?
Underwriting is the process by which the pool evaluates which members to offer coverage to, and determines the premium/contributions each member should pay for the coverages offered. How well a pool does both will influence how well a pool manages its “underwriting risk,” which is the risk that losses and expenses will be greater than the contributions collected plus the investment income.

Contributions + Investment Income > Losses + Expenses
Here are some generally-accepted universal underwriting goals:

- Determine the types of risk the pool is willing to accept, by defining the types of public entities, including “demographics” like geography, size, and management structure. This is the classic diversity versus homogeneity of risk debate.
- Establish member-specific underwriting and rating criteria, which captures most of your intended market, rewarding the good risks and eliminating/minimizing the bad risks.
- Make sure that the guidelines you use are applied consistently, as unfair discrimination in how you select and price members will lead to conflict and even lawsuits within the pool.
- Know what the risk of catastrophic losses may be and how it might vary for certain members. Avoid excessive subsidization of certain members at the expense of others.

Calculating the premium or contributions of each member is a marriage between actuary and underwriter. Generally, most rating systems incorporating these steps in one form or another:

- Experience rating
- Exposure rating
- Premium allocation
- Schedule rating

Differences of Insurance and Pooling Underwriting
While insurance and pooling underwriting are similar, they do have three distinct differences. These are:

- Community rating
- Use of data analytics
- How they accept or reject risk

Underwriting Bias
It is impossible to remove bias from our lives, and this is true for underwriters. There are many biases to avoid (https://en.wikipedia.org/wiki/List_of_cognitive_biases) to become completely objective, as noble as that goal is. Related to biases is the concept of discrimination, and by state law there are certain discriminations we cannot use while underwriting (gender, race, religion, etc). But, essentially, the job of the underwriter is to find a discriminatory basis among the policyholders towards risk.

If you have two schools that you are underwriting, and one school is thought to be twice as risky as the other. Intuitively, you should charge the first school twice as much contribution as the second, right? But, what basis are you making that determination of “twice the risk”, absent any loss data. If the first school had twice as many students, then you could make a rational argument that it would be twice as risky. But, if you were to assess the risk level against a protected class (for instance, the first school is All Boys and the second school is All Girls), then that is illegal.

So, underwriters need to make as objective selectors to risk as possible. One common bias is ‘Ingroup Bias’, which is the tendency to give preferential treatment to others they perceive to be members of their own group. So, back to the school example, perhaps even with twice as many students the first school gets the same premium as the second school, merely because it resides in the same town as the underwriter lives.

Actuarial Science
Actuaries play a vital role in the operation and success of pools by providing analysis crucial to the financial viability of pools. Quite simply, when a pool offers its product – indemnification coverage – it cannot know for sure what its final cost for the product – the claims it will pay, and when it will pay them – will be. That is where actuaries come in. Actuaries are trained in tried and proven statistical methods of making future “guesses” as accurate as possible.

The pool’s actuary should also be involved in establishing the funding requirements for the upcoming year, or the “rates” the pool will charge members. This involves projections of future losses, based on past experience and whether
other changes are occurring (such as changes in coverages, the litigation environment, or benefits levels in workers' compensation) and adding other costs, such as administrative expenses and reinsurance costs.

Actuaries use mathematics, statistics, economics, and finance to analyze the financial consequences of risk. In this case, the risks analyzed are related to the coverages or “risks covered” by pools.

**Funding Studies**
So, how do you fund for a loss that has yet to occur? Or, in business terms, how do you price a product you are selling today, when you don’t know the ultimate production costs for many years (or even decades)?

An actuary conducts a loss projection analysis, which is an estimate of the retained losses that will occur during a specific time period in the future, based on the coverage provided by the pool to its members. In order to project the losses for the coming period, an actuary will review the historical losses and exposures associated with previous periods. He or she will also ask for input from management on what might be different next year, in terms of changing membership or coverages, for example.

An actuary will first estimate the ultimate losses for each of the previous periods based on several actuarial methods. The incurred and paid loss development methods are the most common and basic methods used.

**Reserve Studies**
An actuarial reserve analysis estimates a pool’s outstanding liabilities resulting from the risk transfer contracts they have written in the past. One unique characteristic of risk transfer products is that the products are priced before the policy is written, but the final cost may not be known for sometimes decades later. For property risks, it may only be five years – your building burns down, you build another one. But, for workers’ compensation, an injured worker might have a lifetime of benefits.

The liabilities to be funded consist of two components:

1. Case reserves are the reserve amounts shown on the loss run. They are typically estimated by a claim adjuster, lawyer, or other insurance professional. They represent the amount of money estimated for future payments related to a particular claim.
2. IBNR reserves can be thought of as composed of two further parts – Pure IBNR reserves and reserves for development on known claims.
   - Pure IBNR reserves are the estimated amount needed for claims that have happened but have not been reported to the pool yet.
   - Reserves for development on known claims are estimated additional amounts needed to ultimately settle known claims in addition to the current case reserves.
Pooling Basics Session #1b – The Life of a Claim

Monday, March 7, 3:45-4:45pm

What are the basic types of claims?

Property – Often referred to as 1st party coverage. Damage to property of the insured/member.

Liability – Often referred to as 3rd party coverage. Damage or injury to another party.

Workers’ Compensation – On the job injury.

Other unique types of claims: Crime, Cyber Liability

Claims Management Process

Six key steps in handling a claim.

- Reporting the claim
- Determining coverage
- Investigation
- Determining liability
- Determining damages
- Settlement/Trial
  - Closing the claim file

Nine Stories

<table>
<thead>
<tr>
<th>Claim Severity</th>
<th>PROPERTY</th>
<th>LIABILITY</th>
<th>Workers’ Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incidental [CNP]</td>
<td>Vehicle struck snow bank, and the damage was under the deductible.</td>
<td>Third party damages vehicle from striking a pot hole. No liability.</td>
<td>Teacher struck by falling book on leg. Reported incident but no medical treatment.</td>
</tr>
<tr>
<td>Standard [&lt; $10,000]</td>
<td>Snow load collapses school shed roof.</td>
<td>Injured party tripped over defect in landing, and the pool member had prior notice of defect. Soft tissue back injury resolved.</td>
<td>Laceration to index finger while slicing veggies for lunch. Required stitches. Clinical visit to treat, and then remove stitches.</td>
</tr>
<tr>
<td>Catastrophic</td>
<td>Small fire on top floor of historic town building with extensive water damage on lower floors due to sprinklers and fire fighting activity. Historical elements of building increase repair costs.</td>
<td>A firefighter drove a fire truck to an emergency call, stopped and exited the truck. The unmanned fire truck rolled down the street, veered left into a driveway, struck the homeowner and plowed into the front living room of the house.</td>
<td>Employee suffered hernia while lifting heavy equipment. Required two surgeries to repair. After second surgery, employee developed life-threatening infection, requiring inpatient treatment, and referral to rehabilitation facility.</td>
</tr>
</tbody>
</table>
**Reporting the Claim**

Key components:
- Timely reporting
- Adequate information (who, what, when, where, how or why)
- Prevent further loss or damage

**Determining Coverage**

Key components:
- What type of a claim (property, liability, crime, cyber, workers compensation, etc.)
- Review coverage document(s), reinsurance/excess
- Review schedule (property)
- If no coverage or limited coverage, deny claim or investigate under a reservation of rights

**Investigation**

Key components:
- Contact all parties involved, get statements
- Obtain all documentation, police reports, incident reports, medical reports
- Phone vs. face to face

**Determining Liability**

Key components:
- Negligence (at fault party/parties)
- Comparative negligence (laws differ from state to state)
- Workers Comp (state’s definition of the employer’s responsibility to an employee for injuries that arise in the course of employment)
- Subrogation (property claims)

**Determining Damages**

Key Components:
- Obtain and evaluate all invoices, bills, documents
- Reasonableness
- Property (actual cash value vs. replacement cost)
- General damages (pain and suffering, mental or emotional distress)
- Special damages (medical bills, treatment, cost to repair)

**Settlement/Trial**

- Settlement authority levels
- Negotiate settlement directly with member/claimant/attorney
- Obtain Proof of Loss (property) or Release of Claim
- Mediation/Arbitration
- Trial
- Work Comp claims tend to remain open for longer periods of time
- Payment of claim/closing file
<table>
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<tr>
<td><strong>Incidental [CNP]</strong></td>
<td>Vehicle struck snow bank, and the damage was under the deductible. $0</td>
<td>Third party damages vehicle from striking a pot hole. No liability. $0</td>
<td>Teacher struck by falling book on leg. Reported incident but no medical treatment. $0</td>
</tr>
<tr>
<td><strong>Standard [&lt; $10,000]</strong></td>
<td>Snow load collapses school shed roof. $9,657</td>
<td>Injured party tripped over defect in landing, and the pool member had prior notice of defect. Soft tissue back injury resolved. $4,524</td>
<td>Laceration to index finger while slicing veggies for lunch. Required stitches. Clinical visit to treat, and then remove stitches. $1,230</td>
</tr>
<tr>
<td><strong>Catastrophic</strong></td>
<td>Small fire on top floor of historic town building with extensive water damage on lower floors due to sprinklers and fire fighting activity. Historical elements of building increase repair costs. $10,958,301</td>
<td>A firefighter drove a fire truck to an emergency call, stopped and exited the truck. The unmanned fire truck rolled down the street, veered left into a driveway, struck the homeowner and plowed into the front living room of the house. $850,602</td>
<td>Employee suffered hemia while lifting heavy equipment. Required two surgeries to repair. After second surgery, employee developed life-threatening infection, requiring inpatient treatment, and referral to rehabilitation facility. $1,208,402</td>
</tr>
</tbody>
</table>

**Other considerations:**
Reserve practices

Board of Directors responsibilities in claims

Litigation – pros and cons, cost (financially/emotionally/reputational)

Independent claims audits
Balance Sheet and Income Statement Basics

An important part of any organization is its financial health. Two key components of assessing and reporting financial health are balance sheets and income statements. We will explain the basics of each and how they interrelate.

A Balance Sheet (BS) is a statement of a company’s financial position at a particular moment in time. This financial report shows the two sides of a company’s financial situation: what it owns and what it owes. What the company owns, called its "assets," is always equal to the combined value of what the company owes, called its "liabilities," and the value of its shareholders’ equity.

\[
\text{Assets} = \text{Liabilities} + \text{Shareholder Equity}
\]

This is why it is called a "balance sheet", as the two sides must be equal. You may also hear this as "the left equaling the right." If the company were to dissolve, then its debts would be paid, and any assets that remained would be distributed to the shareholders as their equity. Bankruptcy occurs in situations where shareholder equity is zero, and the company owes more liabilities than it owns assets.

An Income Statement (IS) shows the revenues from business operations, expenses of operating the business, and the resulting net profit (or loss) of a company over a specific period of time. We usually see this reported quarterly and annually.

BS and IS as they apply to Pools

The pool’s balance sheet look very similar, except there are two topics we are going to spend some more time on later in this course: Investment and Reserves. These are unique items to pools and insurance companies. Pools and insurance companies are required to retain huge amount of capital as reserves for future claim payments (Case Reserves are for known future payments and IBNR Reserves are for unknown future payments). This extra capital sits in an investment portfolio for years and year, so ‘Investments’ is a large ticket item for pools and insurance companies to monitor.

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>As of 12/31/14</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>3,500,000</td>
</tr>
<tr>
<td>Investments</td>
<td>75,000,000</td>
</tr>
<tr>
<td>Premiums Receivable</td>
<td>600,000</td>
</tr>
<tr>
<td>Prepaid Expense &amp; other Asset</td>
<td>2,000,000</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>81,100,000</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable &amp; Accrued Expenses</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Unearned Premiums</td>
<td>5,500,000</td>
</tr>
<tr>
<td>Case Reserves (Loss &amp; LAE)</td>
<td>25,000,000</td>
</tr>
<tr>
<td><strong>IBNR Reserves</strong></td>
<td>15,000,000</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>48,500,000</td>
</tr>
<tr>
<td><strong>Members Surplus</strong></td>
<td>32,600,000</td>
</tr>
<tr>
<td><strong>Total Liabilities and Surplus</strong></td>
<td>81,100,000</td>
</tr>
</tbody>
</table>
Second, the pool’s income statement is usually called “Statement of Operations and Changes in Member Surplus.” There are some subtle differences, such as revenue is primarily premiums or contributions, but again, we have these two unique elements called "Investment Income” and “Claims and LAE" (which includes Case and IBNR reserves).

Investment Income, listed on the income statements, is income that an organization receives as a result of using the revenue they generate to invest in various investment vehicles to generate additional income. So, pools have to keep all this money in both case and IBNR reserves for years and even decades, but in the meantime they are earning money on that money.

<table>
<thead>
<tr>
<th>Statement of Operations and Changes in Mbr Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Revenues</strong></td>
</tr>
<tr>
<td>Gross Premiums Earned</td>
</tr>
<tr>
<td>Reinsurance Premiums Ceded</td>
</tr>
<tr>
<td>Other Income</td>
</tr>
<tr>
<td>Total Operating Revenues</td>
</tr>
<tr>
<td><strong>Non-Operating Revenues</strong></td>
</tr>
<tr>
<td>Investment Income</td>
</tr>
<tr>
<td>Change in Investment Fair Value</td>
</tr>
<tr>
<td>Total Non-Operating Revenues</td>
</tr>
<tr>
<td>Total Revenues</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
</tr>
<tr>
<td>Claims and LAE</td>
</tr>
<tr>
<td>Reinsured Recovered, net</td>
</tr>
<tr>
<td>Other Administrative Expenses</td>
</tr>
<tr>
<td>Interest Expense</td>
</tr>
<tr>
<td>Total Expenses</td>
</tr>
<tr>
<td>Net Change in Member Surplus</td>
</tr>
<tr>
<td>Member Surplus - Beginning</td>
</tr>
<tr>
<td>Member Surplus - End</td>
</tr>
</tbody>
</table>

**Reinsurance**

Reinsurance is essentially “insurance for insurance companies,” or, in our case, “insurance for pools”. The pool’s coverage document defines coverage, and the reinsurer “follows the form” of the pool’s coverage document. Typically, control of the claim remains with the pool as well, and the reinsurer “follows the fortunes” of the pool in terms of how the claim is resolved.

The benefits of reinsurance are:
- Your ability to control the interpretation and application of the coverage document issued to the member
- Making your own coverage decisions
- Adjusting your own claims
Excess Insurance

Coverage above, or in “excess,” of what your pool provides. The insurance seller writes the policy as an addition to the pool’s coverage, determines its own coverage and controls the claims.

The benefits of excess insurance are:

- It may be easier to obtain, including available cheaper and higher limits
- It requires less expert/broker or staff involvement
- Coverage and payments are available regardless of the underlying coverage of the pool

<table>
<thead>
<tr>
<th>Statement of Operations and Changes in Mbr Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 2014</td>
</tr>
<tr>
<td>Operating Revenues</td>
</tr>
<tr>
<td>Gross Premiums Earned</td>
</tr>
<tr>
<td>Reinsurance Premiums Ceded</td>
</tr>
<tr>
<td>Other Income</td>
</tr>
<tr>
<td>Total Operating Revenues</td>
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<td>Member Surplus - End</td>
</tr>
</tbody>
</table>
Risk Management in the Pooling Context
"Risk management" is a core function – some would say THE core function – of pools. Most definitions of risk management involve the process of the identification, assessment, and treatment of risk, where "risk" is uncertainty and usually viewed as negative, as in the possibility of loss, damage, or harm.

You will hear references to a number of programs, activities or functions, all of which are forms of risk management. Some of the more common include:

- **Loss prevention**: Referring to efforts to keep bad outcomes from happening in the first place, often through better training of employees to avoid injury to themselves or others; adoption and enforcement of good policies for public officials to follow; wellness programs to improve employee health; and use of preventive maintenance programs for properties and public infrastructure.

- **Loss control**: Referring to efforts to reduce the size of any loss that does occur, through prompt reporting, proactive claim management, and post incident or accident review.

- **Safety**: Most commonly associated with employee on-the-job injury prevention, but also applicable to creating and assuring safe environments for the public, or safe operation of vehicles or equipment.

- **Training**: A growing area of activity for pools, especially using new technology for efficiency, and often to include compliance issues.

One of the most important, yet challenging, aspects of risk management is determining how much to invest in risk management programs and services (i.e. measuring their effectiveness). How do you know if the specific investments actually had an impact on the loss costs? Maybe the reduction would have happened no matter what. Maybe it is just good luck.

Creating a Culture of Risk Management

*Performance improvement protocols*: To encourage the right behavior – and for the benefit of the rest of the membership – pools adopt programs that require members to make changes in order to stay in the pool, and even refuse renewal, if necessary. This might also take the form of incentivized pricing for those members of the pools that adhere to strict safety practices or recommended changes to existing policies.

*Case studies*: Sharing the positive results of one member with others, and leveraging pilot programs across the whole pool membership, is a natural way for pools to improve their risk management culture.

*Data analysis*: Pools now have 20 to 40 years of data, and tools to better analyze the data, to understand what works, and what doesn't, that can help the pool engage its members in the value of risk management.

The Future of Public Entity Pooling

What does the future hold? That’s a tough question, but AGRiP has taken the steps to ensure we start thinking about the future in a disciplined way. Through our Resident Futurist Rebecca Ryan, we can briefly talk about four segments of the future that will affect pooling (and, not insignificantly, the rest of our lives, as well).

**Generational Shifts**

As the Baby Boomer generation moves towards retirement, the original founders of the pooling movement will be taking all their institutional knowledge with this when they leave the pool. Additionally, a nationwide shortage of Generation X’ers to replace them will lead an employee’s market for employment. Pools will have to remain competitive to retain the best staffing, and continue to innovate to interest younger workers.
Technology
There is no doubt that technology has and will continue to change our lives and our business models. But, how so? Who could have predicted 20 years ago how the Internet and social media would fundamentally change business models centuries old? So, what is next? No one can say for certain, but it’s a good bet to go ask your intern what he or she thinks...

Leadership Changes
As the pooling staff turns over in favor of a younger, more technologically minded employee, pool management needs to continue to engage not only them, but the pool member representatives, as well. On-site meetings, mailed flyers, and physical locations are no longer important. New managers must integrate new methods to engage new employees and constituencies. New managers must harness the power of information and disseminate it to everyone seamlessly and constantly.

Catastrophic Weather
Irregardless of who caused it, there is little doubt that weather patterns are changing from historical data. Patterns are becoming more erratic and severe, and catastrophic weather is plaguing areas where previously there was none. As pools grapple with these enormous loss events, risk managers and underwriters have to re-double their efforts and re-think what was previously improbable. More generally, pools need to lead the charge of influencing public entities to re-think their infrastructure, maintained properties, and social services.