Risk Pool Regulations

WASHINGTON STATE
OFFICE OF FINANCIAL MANAGEMENT

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Local Government Self Insurance Program

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Risk Pool Regulations

- RCW 48.62
  - Exclusive source of authority for local governments to self-insure
  - Requires prior approval of every joint risk pool and every individual health benefits program
  - Provides maximum flexibility in self-insuring to the extent that programs are operated in a safe and sound manner
  - Requires the State Risk Manager to establish specific standards in Rule (WAC)
Chapter 48.62 RCW

- Became effective 1991
- Pieced together over time
- Recent changes pertain to issuance of bonds and inclusion of nonprofits (property and liability only)
- Applies to property and liability and health and welfare programs (not worker’s comp or unemployment)
- Established Two Advisory Boards (now eliminated in 2010 session) to assist State Risk Manager in adopting rules for pools to follow
- Model for Chapter 48.64-Affordable Housing Pool
What standards must risk pools follow?

- **RCW 48.62.061** provides authority to the State Risk Manager to adopt standards in Rule to ensure self-insurance programs are operated safely and soundly. Standards are to include:
  - **Solvency**, including frequency of actuarial analysis
  - **Management and Operations**
  - **Claims management**, including frequency of claims audits
  - **Contracts** between pools and private businesses, including third party administrators
Some rulemaking history

- Original rules adopted in 1992
- Property and liability and health and welfare in same WAC (82-60)
- Over ten year period, Guidelines established
  - Not effective or consistently followed
  - Pools could be, and some became, insolvent under Guidelines
  - Did not include sufficient specifics with regard to solvency and liquidity
  - Provided waivers, no requirement for written documentation
Recent Rulemaking - Property and Liability

- **WAC 82-60**
- Pertains to Property and Liability programs (health and welfare programs were removed)
- Adopted in January 2010 and drafted over two years by an active stakeholder group
- Adopted with assistance from Property and Liability Advisory Board
- Addressed both liquidity and solvency of pools (82-60-03001)
Recent Rulemaking – Health and Welfare

- **WAC 82-65**
- Pertains to Health and Welfare programs only
- Adopted September 1 and October 1, 2010 in 2 sections, with final effective date of November 1, 2010
- Adopted with assistance from Health and Welfare Advisory Board and stakeholders
- Contains standards which address solvency and liquidity for both individual and joint health and welfare programs (82-65-040)
Current Rulemaking-WAC 82-70

- To implement new Chapter 48.64 RCW - Affordable Housing Entities-Joint Self-Insurance Programs
- Combines non profit housing, tax credit partnerships, and local government housing authorities
- Separate chapter needed due to tax and other concerns
  - Non profits currently allowed to share risk with local governments (property and liability only), under 48.62, but risk sharing produces tax consequences
  - Separate solvency and member assessment requirements needed for non profits
- Rulemaking hearing likely in December
How does the State Risk Manager know if a pool is “Safe and Sound”

- Continual monitoring through annual reports to the state risk manager (required by RCW 48.62.091(4)) within 150 days of fiscal year end
- Reports located on OFM website
- Use of audited financial numbers to eliminate duplication and expense to local governments
- Pool compliance with new and consistent standards in WAC for solvency, operations, etc.
- Review of information indicates level of concern and timing of additional work necessary
- Onsite reviews and investigations by Local Government Self Insurance Program and/or contractors
What information do regulators need to determine financial solvency?

- Timely audited financial statements with good note disclosures
- Actuarial summary of outstanding liabilities
- Prior notice of financial insufficiency
- Significant changes to program which require written notification and prior approval (RCW 48.62.091(5))
- Access to:
  - Interlocal agreements signed by (all/new) members
  - Rate setting formula
  - Resolutions/meeting minutes/bylaws/agendas
Significant Changes Require Prior Approval from State Risk Manager

- **WAC 82-60-065**-Property and Liability programs
- **WAC 82-65-140**-Health and Welfare programs
  (a) Any change in the terms of the foundation agreement;
  (b) Elimination or reduction of stop loss insurance;
  (c) Acceptance of any loans or lines of credit;
  (d) Provision of services to nonmembers;
  (e) Addition of members of other entity types than those included in original application approved by state risk manager.

- Reporting prior to implementation of other changes is also required under these WAC’s
How does a board know whether the pool is “safe and sound”?

- **QUALITY OF THE INFORMATION YOU ARE RECEIVING INTERNALLY:**
  - Periodic financial reports and trends **over time**
  - Actuarial Study to determine outstanding liabilities-required every three years (Summary)
  - Adherence to board-adopted reserve policies/ratios (surplus)
  - Claims Audit Summary and Recommendations-required every three years
  - Rate Setting Formulas-must be consistent and nondiscriminatory (can’t “buy” business)
  - Availability of consultants to board (are you getting “actual” reports or interpretation?) Follow up on concerns with consultant for clarification
How do members know if the pool is “safe and sound”?

- Open Public Meetings Act (RCW 42.30) WAC 82-60-02011
- Communication with Members required by WAC’s
  - 82-60-02009-Annual Membership Report
  - 82-60-02013
    - Notification to members 10 days in advance of meeting
    - Publication of meeting meetings on web
    - Agendas for special & regular meetings provided to members in advance
  - 82-60-02019-Notification 30 days in advance of vote on changes to bylaws or interlocal/foundation agreement with proposed changes included
- Transparent, audited and timely financial statements with board follow up on any issues
Elections – WAC 82-60-02023

- The governing body of every joint self-insurance program shall be elected by a majority of the members.
- Notification prior to elections
- No secret voting (RCW 42.30.060(2))
- Maintain voting records for follow up SRM review and SAO audits
- No similar requirement at this time for health and welfare programs
Other “Partners”

• Office of Insurance Commissioner (OIC)
  • Regulates insurance providers
  • Exemption provided by the legislature for joint self-insurance programs when Chapter 48.62 RCW was enacted
  • Most other states OIC examines and regulates self-insurers
  • California-150 risk pools/CAJPA credentials risk pools

• State Auditors Office (SAO)
  • Conducts financial and accountability audits
  • Reporting, not regulatory, agency
Users of the Financial Statements

- Who is ultimately responsible for financial statements?
  - The board of directors
- Users of the Financial Statements
  - OFM/State Risk Manager
  - Legislature
  - Other state agencies
  - Pool Members
- Sufficient disclosure required in notes
  - Type of insurance policies (occurrence, claims made or paid, stop loss), limits, protections, significant exclusions
  - Actuarial projections of liabilities
  - OFM schedule of expenses (new)-use of taxpayer monies
  - Explanation of significant operational/policy changes/or events
  - Related Parties-Conflict of Interest
A word about transparent, timely and audited annual financial statements

- Pools audited by SAO for accountability & opinion issued on financial reports.
  - SAO has given option to pools to use qualified independent financial auditors
  - SAO has indicated they do not always receive timely pool reports
  - Reports available on SAO website-resources for pool boards

- QUALITY of financial information is like fruit:
  - If it’s too old it shouldn’t be used or ingested– OR USED FOR DECISION MAKING.
  - There is a reason that OIC requires audited financials within six months
  - Timely and transparent financial statements instill confidence in partners, public officials and potential members
Information not provided by financial statements

- Financial solvency vs. financial position
- Trends over time
- Accuracy of rate setting (until late in the game)
- Accuracy of previous information provided to board (until even later in game)
- Compliance with operation/management standards
Financial Position and Solvency

- Solvency occurs when there are more assets than liabilities
- Solvency does not address equity (surplus)
- Financial position is an indicator of trends
  - Decreasing equity
  - Increasing liabilities
  - Rate of changes
  - Reduction of liquid assets (cash) and minimum cash flow
- Example: SAO Financial Statement audit addresses solvency, Accountability audit addresses financial position
- Warning of future insolvency if trend continues
How much money is required by regulation?

- WAC 82-60-03001 – Property and Liability Programs
  - Requires liquid assets (cash) reserves at the expected level as determined by an actuary, minus outstanding payables
  - Requires additional, less liquid assets that can be verified by the State Risk Manager at the 70% confidence level, minus outstanding payables
    - Investment (Longer term) per member statutory requirements
    - A receivable independently confirmed by insurer
  - Outstanding payables includes all other liabilities-a pool could not borrow itself out of debt
Reserve requirements for health and welfare programs

- Joint Self-Insured Medical Programs (82-65-040)
  - 16 weeks of program expenses
  - Stop loss policy with attachment point at 125% or less of expected claims
    OR
  - Reserves in the amount of liability determined by an actuary
  - Stop loss policy recommended
- Vision and Dental
  - Eight weeks of program expenses
  - Additional contingent reserves approved by board policy
Quality of Assets

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<td>Receivables:</td>
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Total Net Assets: $3,000,000 equity. . . Right????
What can you do with equity??

**Choices:**
- Allows “smoothing” of rates to members
- Disbursements to members (not recommended unless trend continues)
- Investments do not languish in reserve accounts, but instead earn income for the pool and ensure solvency
- Once a liability is incurred, it is the members responsibility if the pool is not adequately funded

**If no equity:**
- Reassessments likely
- The liability is then reported on the member’s balance sheet, affecting the members’ solvency
- Rates Increase or Services Decrease
- Membership Decreases
- Downward Spiral Begins
Rate Setting

How?
- Select your target, and move backwards to set rates
- Adjust annually according to actuarial reports, but keep enough equity to absorb impact and reduce rate spikes
- Boards must wear “pool hats” when they take action
- Maintain membership
  - Past costs are already incurred
  - If reserved adequately, changes in members can be addressed by cutting current costs
  - If not reserved, you will need a reassessment of membership
- Local governments are adverse to reassessment
- Could result in insolvency of local government members
Other things to remember. . .

- Regulations are MINIMUM standards
- Best practices are historically proven standards by which successful pools operate
Boards should:

- Rely on actual contact with consultants:
  - Financial auditors
  - Claims auditors, if necessary
  - Actuaries, certainly!
- Tie loss control to industry and pool claims history
- Monitor fluctuations in claims liabilities
- Require full disclosure of commissions and compensation received by contractors from other sources
- Board contracts directly with consultants to avoid conflict of interest per WAC
- Set standards for determining whether deliverables were received from contracts and monitor performance