

Unique Professionalism Considerations for Self-Insured Public Entities

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Background – What is a public entity?

- State agencies
- Municipalities
- Townships
- Counties
- School Districts
- Colleges & Universities
- Park Districts
- Transportation Authorities
- Pools & Associations of the above



How big is the space?

- 2002 Census of Governments:
- 87,525 local governments
 - 19,429 Municipal governments;
 - 16,504 Town or Township governments;
 - 3,034 County governments;
 - 13,506 School districts; and
 - 35,052 Special district governments.
- Over 1,800 are Public Risk Management Association (PRIMA) members

Coverages

- Traditional
 - Workers Compensation
 - Liability – Auto, General Liability
 - Property – Buildings, Autos
- Unique/Difficult Exposures
 - Police/Jails
 - Employment Practices
 - Construction Projects
 - Public Officials
 - Unemployment
 - Employee Benefits
 - Public spaces – golf courses, lakes, arenas,...

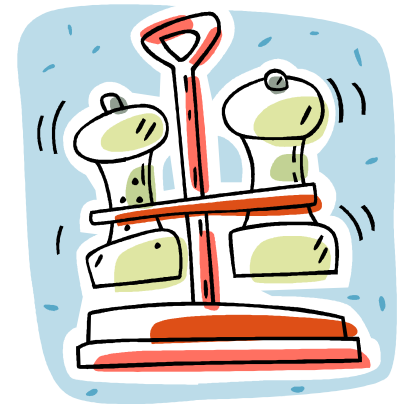


Insurance Mechanisms

- Large Deductible Self-Insurance Trusts
- Group Self-Insurance Trusts/Pools
- Single Parent Captives
- Group Captives
- Risk Retention Groups (RRGs)
- Wholly owned mutual insurance companies

Variety is the Spice of Life

- Within the space great variability exists in:
 - Internal staffing vs. outsourcing
 - Program design/sophistication
 - Geographic scope/number of members
 - Regulatory oversight





A Professionalism Perspective

The Approach

- Triage/Considerations
- Data
- Methods
- Assumptions

- Statements of Principles
- Standards of Practice
- Other Professional Standards



Considerations

- Consideration –
- Pronunciation: \kən-,si-də-'rā-shən\
 - Function: *noun*
 - **2 a** : a matter weighed or taken into account when formulating an opinion or plan
- (courtesy Merriam-Webster online)



Considerations – Statement of Principles Regarding P/C Loss & LAE Reserves

- “Understanding the **trends** and **changes** affecting the (claims) data base is a prerequisite to the application of actuarially sound reserving methods.”
- “A knowledge of changes in underwriting, **claims handling, data processing and accounting**, as well as **changes in the legal and social environment**, affecting the experience is essential to the accurate interpretation and evaluation of observed data and the choice of reserving methods.”
- “A knowledge of the general characteristics of the insurance portfolio for which reserves are to be established also is important. Such knowledge would include familiarity with **policy provisions** that may have a bearing on reserving, as well as **deductibles**, salvage and subrogation, **policy limits**, and reinsurance.”

Considerations - Statement of Principles Regarding P/C Loss & LAE Reserves

- Data Availability (w/ ASOP 23 and 43)
- Emergence Patterns
- Settlement Patterns
- Development Patterns
- Frequency & Severity
- Operational Changes
- External Influences
- Discounting (w/ ASOP 20)
- Provision for Uncertainty (w/ ASOP 20)

Considerations - Statement of Principles Regarding P/C Insurance Ratemaking

- Exposure Unit
- Loss Development/Benchmarks (w/ ASOP 36 & 43)
- Trends (w/ ASOP 13)
- Policy Provisions
- Operational Changes
- Individual Risk Rating
- Risk Margins (w/ ASOP 20)
- Expenses (w/ ASOP 29)

Considerations – Operational Changes

- What kind of changes are material?
- ASOP 36 3.5.2/ASOP 43 3.6.7 – Changing Conditions
- Public entity may be going through operational changes
 - New arena, library, fire station, 911 service
 - Change in health insurance coverage
- Risk management team may be going through changes
 - Loss of Experienced Adjuster
 - Change of Third Party Administrator (TPA)
 - Claims Handling Processes/Philosophy
 - New Claims/Risk Management System
 - Data Processing
- The extent to which I have data to support a change often determines the amount of credibility given to it

Considerations - External Influences

- ASOP 43 3.6.6 - External Conditions
- Economic Changes
 - Local Economy leading to staff cuts
 - Adverse Development/Funding Increases often come at really bad times
 - Puts extreme pressure on funding & reserves
- Judicial Decisions
 - Unique Court of Claims?
 - Eroding
 - What activities are covered? Interstate?
 - Sovereign Immunities
 - Eroding
 - What activities are covered? Interstate?
 - Societal Changes
- External Influences/Changes in the Legal and Social Environment



Considerations – Policy Provisions

- ASOP 43 3.5.b – Nature of Claims – “circumstances that make a claim more or less likely or the cost more or less severe.”
- Policy Provisions
 - Workers Compensation
 - Integrated Disability Management Program
 - Return to Work
 - Occupational Accident/Life Insurance Policy
 - General Liability
 - Completed Operations may be emergence or manifestation triggers
 - EPLI may have “sustained pattern of behavior” language
- Deductibles, Per Occurrence and Aggregate Limits can all have subtle nuances



Other Standards – Actuarial (ASOP 21)

Responding to or Assisting Auditors

3.1 “The actuary should be appropriately responsive to the auditor’s or examiner’s reasonable requests...”

- ❑ May not be as familiar with insurance issues
- ❑ May not be as familiar with public entity issues

3.1.2 “The responding actuary should be prepared to discuss with the auditor or examiner known circumstances that, in the actuary’s professional judgment, had a significant effect on the preparation of those elements of the financial statement for which the actuary is the responding actuary.”

- ❑ May present challenges here and in ASOPs 9/41

Other Standards - Actuarial (ASOP 7)

- Cash Flows
 - Cash flow vs. accrual funding/reserving
- Different asset mix
- Constraints on asset strategy
- Material asset risk?

Other Standards - Accounting

- Statements of the Governmental Accounting Standards Board (GASB)
 - Statement No. 10
Accounting and Financial Reporting for Risk Financing and Related Insurance Issues
 - Statement No. 30
Risk Financing Omnibus--an amendment of GASB Statement No. 10
 - Statement No. 34
Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments

GASB 10

- Explicitly Permits Discounting
- Identifies Potential Need for PDR
- Requires reporting split of paid and incurred losses between current fiscal year and prior years
- Requires determination of unpaid losses at the end of each fiscal year (short & long term liabilities)
- All of this means that a simple loss reserve analysis, without cash flows, does not fully comply with GASB 10.

Other Standards - Regulatory

- State Regulatory Standards
 - One state requires reserves be held @discounted 90% confidence level
 - Many self insurance programs are permitted to only fund and reserve on a “pay as you go” basis
 - Some require SAO, some modified SAO, some nothing
 - Many WC programs have collateral requirements
 - Some have a quasi-guaranty fund protection
 - Lots of departures from NAIC regulatory approach

Data Availability – ASOP 23

- 3.1 “Data that are completely **accurate, appropriate, and comprehensive** are frequently not available. The actuary should use available data that, in the actuary’s professional judgment, allow the actuary to perform the desired analysis. However, if material data limitations are known to the actuary, the actuary should disclose those limitations and their implications.” (See further ASOP 43)

- For public entities, this is common practice.
 - 1 yr roll forward with no new data?
 - Three fiscal years of payments?
 - Legal Department does a swag of GL case reserves?

Data Availability - ASOP 43

- 3.2 “Sometimes constraints exist in the performance of an actuarial analysis, such as those due to limited data, staff, time or other resources. Where, in the actuary’s professional judgment, the actuary believes that such constraints create a significant risk that a more in-depth analysis would produce a materially different result, the actuary should notify the principal of that risk and communicate the constraints on the analysis to the principal.”
- Do not hesitate to use this in your report.

Data Quality – ASOP 23

■ 3.5 Review of Data

- “the actuary should review the data for reasonableness and consistency”
- Sometime it is not.

■ 3.7 Use of Data

- “the actuary should make a professional judgment about which of the following is applicable:
 - the data are of sufficient quality to perform the analysis;
 - the data require enhancement before the analysis can be performed,...
 - Judgmental adjustments or assumptions can be applied to the data that allow the actuary to perform the analysis.”
- How bad is too bad?
- Creativity is often required.

Data Sources – ASOP 23

- 3.2.b.1-3
- (S)elect the data with due consideration of the following:
 - 1. appropriateness for the intended purpose of the analysis, including whether the data are sufficiently current;
 - 2. reasonableness and comprehensiveness of the necessary data elements, with particular attention to internal and external consistency;
 - 3. any known, material limitations of the data;
- Most external benchmarks have strengths and weaknesses.
- Possibly the biggest source of variation between actuaries and often the weakest assumption in the entire actuarial analysis.

Data - Exposures

- When is a vehicle not a vehicle?
 - Fire truck vs. golf course maintenance vehicle
- Budget expenditures as a proxy for revenues?
- Medical malpractice on jails
- Payroll
 - Differences by department
- For small public entities, exposure data, especially for detailed or unusual elements, may be difficult to get.

Methods – Reserving & Allocation

- ASOP 43 3.6.1 “The actuary should consider methods or models for estimating unpaid claims that, in the actuary’s professional judgment, are appropriate.”
- Expected Loss/B-F Methods require adjustments
- Frequency & Severity methods need to reflect unique coverage caps and policy conditions
- Reserve allocations must be fair and equitable
- Proper incentives (reduce allocation for return to work)
- Allocation needs to be predictively sound
 - Premiums, incurred losses, case reserves may all play a role

Methods – Funding & Allocation

- Heavy Reliance on Experience Rating
 - Credibility
 - Frequency vs. Severity Layer Common
- Responsive, but Stable is Key

- Choice Between Top Down or Bottom Up
 - MUST BE fair and equitable
 - Must strike a balance between stability & responsiveness
 - Big and small members satisfied
 - Good experience and bad experience members satisfied
- Experience mod approach often used.

Assumptions - Development

- Claim reporting, settlement, average severity and loss to LAE relationship can be influenced by many things:
 - Social perceptions (city is different than company)
 - Specific court of claims
 - Risk management department
 - Loss control and prevention protocols
 - Case reserving philosophy
 - TPAs and outside law firms

Assumptions - Benchmarks

- Lots of Choices
 - ISO based data (trends, loss costs, LDFs)
 - NCCI-based data (trends, loss costs, ELPPFs)
 - Aggregates & Averages
 - Fronting Carrier/TPA specific data
 - State or industry specific carrier data
- Strengths and Weaknesses
 - State Specific?
 - Public Entity Specific?
 - Company Specific?

Assumptions – Trend (ASOP 13)

- 5.3 “The purpose of trending procedures is to estimate future expected values by analyzing historical data and other relevant information. Therefore, the actuary should apply trending procedures which appropriately reflect projected changes in such components as claim costs, claim frequencies, expenses, exposures, and premiums over the trending period.”
- Industry trends may not be appropriate.

Assumptions – Trend (ASOP 13)

- 5.4.d “The actuary should select trending procedures with appropriate consideration given to the analysis of historical insurance data. This includes, but is not limited to, evaluation of: ... d. the effect of known biases or distortions on the experience relied upon (e.g., impact of catastrophic influences, seasonality, coverage changes, nonrecurring events, and distributional changes in deductibles, types of risks, and policy limits).”
- Need to be especially aware of frequency and severity trends. Internal trends may be materially different from industry trends.

Assumptions – Trend (ASOP 13)

Economic and Social Influences

- “Many economic and social influences can have an impact on trends. In selecting the appropriate trending procedure, the actuary should consider those economic and social influences that may have an impact on trends. It is inappropriate to analyze only those factors that have an impact on trend in only one direction.”
- Deterioration of immunities and current economic conditions can both be material influences.

Assumptions – Discount (ASOP 20)

- 5.3.1 Data Sources—The actuary should use the entity’s own historical payment data to project the timing of payments, to the extent that credible data are available.
- 5.4 “the appropriate selected interest rates are a function of the context”
- Make sure benchmark payment patterns are reasonable (don’t overstate discount)
- Conservative interest rate (make sure you understand whether funds supporting reserves produce investment income)

Assumptions - Discount

- 5.5 “The actuary should be aware of the historical relationship between reserve discounting and risk margins and include appropriate risk margins.
- Discounting a reserve diminishes the risk margin implicit in a full-value reserve by the difference between the full-value and the discounted reserve.
- The discounting process itself introduces additional uncertainties.
- The actuary should be aware that a discounted reserve is an inadequate estimate of economic value unless appropriate risk margins are included.”

Assumptions – Expenses (ASOP 29)

- Many programs can develop expense provisions ground-up (Salaries, overhead, etc.)
- Many programs, especially those that fund and reserve at high levels of statistical confidence, can accumulate significant retained earnings, but may not have a way to release them.
- Accrual for prepaid LAE is often a material issue.
- Some states (e.g., NY) self-insurance programs need to accrue for statutory assessments.

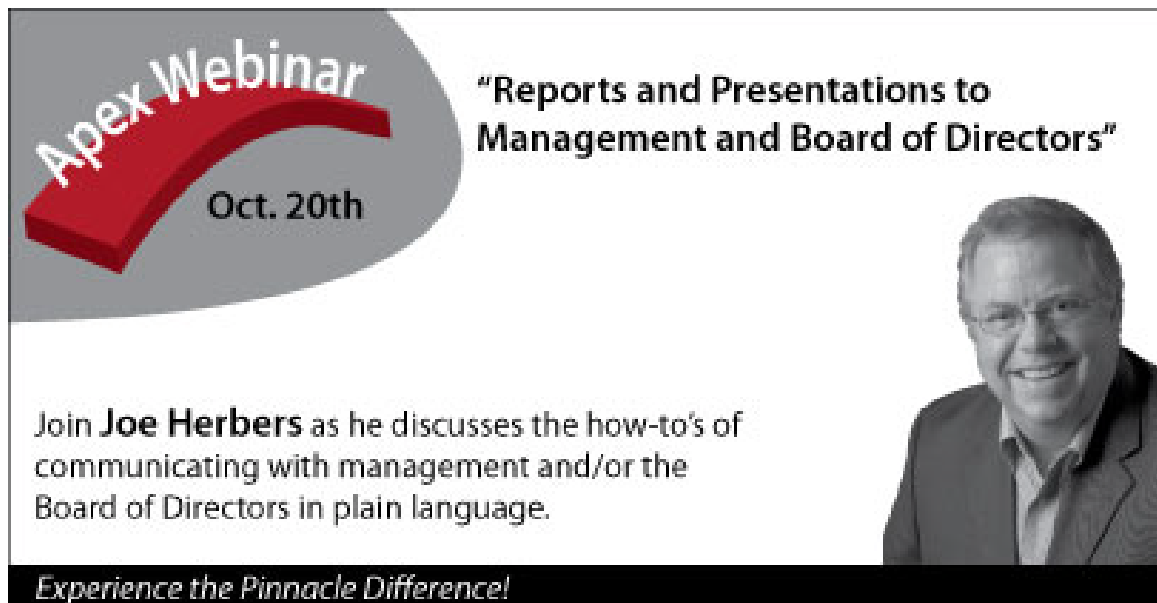
Documentation

- ASOP 9 5.2, ASOP 41 3.3.3
 - “an actuarial report should identify the data, assumptions, and methods used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary’s work.”
- ASOP 41 3.1.2
 - “taking into account intended audience”
- ASOP 41 3.1.9
 - “when methods or assumptions are prescribed by law, regulation, or another profession’s requirements, the actuary should disclose that his or her work has been performed in compliance with such requirements”

Conclusion

- Public entity self-insurance programs require:
 - Careful consideration of unique risk factors
 - Making the most of often imperfect data and benchmarks
 - Methods adjusted to suit situation
 - Appropriate assumptions
 - Clear communication with risk management staff, service providers, and auditors
 - Documentation, documentation, documentation


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