Frequently Asked Questions for self-insurance requirements governing local government and nonprofit self-insurance risk pools

1. What changes are proposed to the current rules?

The proposed changes are:

- Increase the combined asset requirements for risk pools from the current 70 percent to the 80 percent confidence level.
- Identify the procedure to be followed by the state risk manager when a pool operating under the supervision of the state risk manager declines to the point that monetary reserves available to pay claims fall below the 70 percent confidence level.
- Require risk pools to provide audited financial statements to the state risk manager within eight months of fiscal year end.

2. Why are changes to the rules needed?

A change to increase funding for outstanding claim liabilities is needed because the current requirement to fund outstanding claims at the 70 percent confidence level does not adequately protect local government and non-profit members from a cash call or reassessment. Funding outstanding claim liabilities at higher confidence levels gives greater assurance that funds are available to pay claims on behalf of risk pool members.

An additional change to the rules is needed which requires pools provide audited financial statements within eight months of a risk pool's fiscal year end. This change increases transparency and allows the state risk manager, the board of directors and risk pool members to know the financial condition of the pool and to take early and immediate action before the next year begins to improve the pool's financial condition. The current requirement to provide audited financial statements within a year of fiscal year end does not allow enough time for planning and corrective action in the coming year, since the next year is already beginning when audited financial statements are provided.

An additional change describes the conditions under which a risk pool may continue to operate at the 70 percent confidence level under supervisory watch while working with the risk manager to improve its financial condition to meet the 80 percent confidence level requirement. This change creates an awareness of a pool's declining financial position and creates an opportunity for the pool and the regulators to work toward financial soundness before the issuance of a cease and desist order becomes necessary.

Other changes are needed to clarify the two separate assets tests that pools are required to meet, and to clarify the work that might be done by an independent actuary at the direction of the state risk manager to verify that the pool meets the requirements of these two tests.

3. How is membership in a risk pool different from purchasing an insurance policy?

When nonprofits and local governments purchase an insurance policy from a commercial insurance carrier, they make a one-time payment for the policy, and the insurer pays claims that are covered by the policy. The insurer does not ask for additional money.

Unlike the purchase of insurance, risk pool members jointly self-insure claims by paying an annual premium (or contribution) to a risk pool. Members also agree to provide extra money to the pool at any time, which is known as a cash call. If prior year claims exceed the money collected, members must respond to a cash call, even if they are no longer members of the pool. For this reason, it is important that risk pools fund their outstanding claim liabilities to reduce the likelihood of a cash call to members.

4. Will the proposed change to increase funding to the 80 percent confidence level increase rates for nonprofits?

No. The Non Profit Insurance Program (NPIP) is already funding outstanding claims at the 95 percent confidence level, according to NPIP's last submitted financial and actuarial reports for fiscal year end 2013 (available upon request). No increase to members should occur as a result of these proposed changes to the rules.

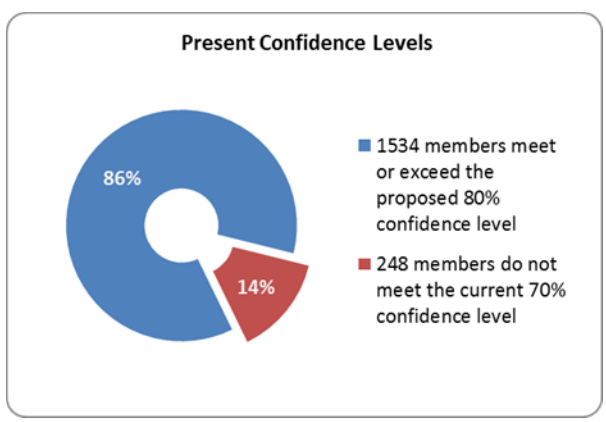
5. Will the proposed change to increase funding to the 80 percent confidence level increase rates for members of any risk pools?

No. Rates will not increase for those pools that maintain a confidence level above the proposed 80 percent confidence level. Fourteen of the fifteen risk pools are already funding in excess of the 80 percent confidence level and no increase is expected as a result of the proposed change. (The remaining pool, Cities Insurance Association of Washington, does not currently meet the 70 percent confidence level requirement and is operating under an agreement with the state risk manager to meet current confidence level funding requirements in 2015).

6. Why did early drafts of the proposed rules include a requirement for nonprofit risk pools to fund outstanding claims at 90 percent instead of 80 percent confidence level?

Because nonprofits do not have the same taxing, bonding and other financial mechanisms available as do local governments, the WRAC stakeholder group discussed requiring nonprofits to fund claims at the 90 percent confidence level.

The concern was expressed by governmental risk pool staff members that nonprofit members would have more difficulty responding to a cash call of the membership than would local government members of a risk pool if pool funds were insufficient to pay claims.



Note, data is based on most recent actuarial and financial reports provided by each risk pool

After some discussion, the agency determined that the funding requirements would remain the same for nonprofits as for governmental risk pools (at the 80 percent confidence level). The change was made in the draft rules sent to members on January 15, 2013.

7. Why is it necessary to require audited financial statements from pools within eight months of fiscal year end? Is it possible for the State Auditor to meet this requirement?

The current requirement to provide audited financial statements within one year of fiscal year end does not provide timely financial information for the state risk manager, the board of directors and risk pool members to be proactive in making immediate changes to improve the pools financial condition because the next year has already begun.

Also, most pools require members to give at least one year's notice prior to leaving a pool, so members concerned about a pool's financial condition would have information earlier and could give notice prior to the next year instead of remaining in the pool for an additional year. The State Auditor's Office has indicated it has sufficient capacity to complete financial statement audits of risk pools within eight months of each pool's fiscal year end, provided pools submit timely and accurate financial statements ready for audit.

8. The nonprofit pool is already spending $50,000 a year for actuarial services. Won't the costs increase if they have to be done at increasingly high confidence levels?

No, the costs for actuarial reports for the Non Profit Insurance Program are not expected to increase because the actuarial reports for the Non Profit Insurance Program already include an expansive chart estimating outstanding claim liabilities from 1 to 99 percent confidence level. (The reports are available upon request.)

Multiple confidence level estimates are included in actuarial reports because the information is used by risk pool boards and management in determining current funding levels and future financial targets. Actuaries generally have the information readily available because it is done with computer modeling programs.

9. Aren't these rule changes contrary to the intent of the legislation that was passed ten years ago that created the ability for governments and non-profits to self-insure?

No. RCW 48.62.061 is specific in its direction to the state risk manager to adopt rules that include standards for solvency, management and operations of risk pools formed under RCW 48.62. The Non Profit Insurance Program is a risk pool formed under RCW 48.62.

10. Why wasn't the request to limit notice requirements to a one-year notice when members leave a pool included in the proposed rules as requested?

The state risk manager has specific statutory authority to set standards in rule for contracts between self-insurance programs and private businesses, including standards for contracts between third-party administrators and programs ([RCW 48.62.061(3)](RCW 48.62.061(3))).

Risk pools are formed by interlocal agreement and are not private businesses. The state risk manager does not have authority to stipulate the length of a notice requirement contained in the interlocal agreements between members.

11. Why doesn't the state risk manager recognize a model that puts the risk back to the insurance companies through stop-loss and aggregate stop-loss protection?

Stop-loss and aggregate stop-loss models only put ***some*** of the risk back to the insurance companies.

Risk pools can transfer as much, or as little, risk back to the insurance company as the pool chooses. Risk pools have maximum flexibility to purchase any amount of insurance, and to choose any claim deductible amount to self-insure, as long as the pool funds those deductibles by meeting two asset tests.

The asset tests help to keep the pool's claim liabilities funded so member claims can be paid and reduce the risk that members will be asked for additional money later. Risk pools also use some money to purchase joint insurance policies to cover claims above the chosen deductibles. In this regard, all risk pools operate similarly.

If the risk pool purchases an aggregate stop loss policy, claim deductible amounts covered by that policy are also not required to be funded. Those amounts covered by aggregate stop loss insurance are excluded from the annual financial statements, are not included in the actuarial estimates of the pool's outstanding claims liabilities, and do not require funding under the current or proposed confidence level funding requirements. Amounts covered by any insurance policy do not require funding and are not included in the outstanding claim liabilities of any of the risk pools.

While some risk pools purchase an aggregate stop loss policy, the policy does not transfer all risk back to the insurance company, does not cap losses and does not eliminate risk to members. The policies we have seen pay approximately $2 million in benefits toward claim deductibles once the pool has paid out a specified amount in claim deductibles (called the "attachment point").

If the claim deductibles exceed the aggregate stop loss benefit amount, the responsibility to pay any additional claim deductibles returns to the pool. The aggregate stop loss benefit acts as an extra layer of insurance, but it is not unlimited.

Risk pools are required to maintain funds to pay **only** their own outstanding claim liabilities, which consist of the self-insured claim deductibles. Risk pools are **not** required to fund any claim, or portion of a claim, covered by excess insurance, reinsurance or stop loss insurance. In this way, any risk pool using any kind of insurance is treated equally as long as it meets the requirements to fund the claim liabilities which are the responsibility of the pool by meeting the asset tests contained in the rules.

12. Why does this proposed change allow more discretion to the state risk manager, including the use of a cease and desist order? It doesn't appear to allow recourse, mediation or resolution by some third party.

RCW 48.62.091(3) already provides authority to the state risk manager to issue a cease and desist order when the risk manager determines that a joint self-insurance program covering property or liability risks is in violation of the statute or is operating in an unsafe financial condition.

The proposed change to WAC 200-100-03001(4) allows risk pools to avoid the issuance of a cease and desist order when working closely with the state risk manager under supervisory watch to improve its financial condition. This early intervention and corrective action which occurs when a pool's financial condition begins to decline will reduce the need for issuance of a cease and desist order after the pool is already operating in poor financial condition, putting members at risk of a cash call. The proposed change does not provide any additional powers to the risk manager from those already provided by statute.

The Administrative Procedures Act (RCW 34.05) and WAC 200-100-210 already include a process to seek an administrative hearing after issuance of a cease and desist order (see below).

> *WAC 200-100-210 Standards for operations—Appeals of cease and desist orders.*
>
> *Within ten days after a joint self-insurance program covering property or liability risks has been served with a cease and desist order under RCW 48.62.091(3), the entity may request an administrative hearing. The hearing provided may be held in such a place as is designated by the state risk manager and shall be conducted in accordance with chapter 34.05 RCW and chapter 10-08 WAC*.

13. Why weren't all risk pools included in the development of the proposed rules?

All risk pools were included in the development of the proposed rules through the Washington Risk Pool Advisory Council as follows:

- The Washington State Risk Pool Advisory Council (WRAC) met seven times. A formation document was sent out in advance of the first meeting to provide information about this informal advisory group. Each of the fifteen risk pools was given a seat on the WRAC.
- The formation document sent to risk pools stated that the purpose of the WRAC was to provide an avenue of communication between the risk pools and the state risk manager about regulatory concerns.
- Meeting invitations were sent out several weeks in advance of each meeting. Members were solicited for agenda items of interest and final agendas were also provided.
- The meetings were held on the following dates:
  - Tuesday, November 1, 2011
  - Thursday, December 8, 2011
  - Thursday, February 9, 2012
  - Thursday, May 10, 2012
  - Thursday, October 4, 2012
  - Thursday, December 13, 2012
  - Thursday, May 16, 2013
- Early drafts of possible changes were written by the group collectively. After meeting discussions, a proposed draft was sent to members on May 1, 2012. After three additional meetings and further discussion, another draft was sent to members on

January 15, 2013. This draft incorporated ideas by the Non Profit Insurance Program (NPIP) to reduce a proposed ninety confidence level reserve requirement to 80 percent as requested by NPIP. One stakeholder petitioned the Department of Enterprise services to adopt this version of the rules drafted collectively by the WRAC. The petitioner said that the rules were necessary to ensure the financial safety of risk pools. After review by the state risk manager and agency management, a decision was made to move forward with rulemaking.

- The Department of Enterprise Services followed the notification process required by statute. Notifications were published by the Code Reviser, formal hearings were held and written comments were taken. An additional comment period and hearing is being held to ensure all interested stakeholders have an opportunity to participate in the rulemaking process.

14. Why is it that, unlike the Property Advisory Board process, the Washington Risk Pool Advisory Council (WRAC) process never established meeting rules, procedures or process – especially for consensus taking needs?

The former Property and Liability Advisory Board was created in statute, was advisory in nature and was not a governing or decision-making board. When the Legislature eliminated many boards and commissions several years ago, that board was also eliminated.

When that board was eliminated, the state risk manager formed the WRAC to provide an avenue of communication between the state risk manager and the risk pools formed under RCW 48.62.

The WRAC is also advisory only, and is not a governing or decision-making board. The WRAC was formed because the statute directs the state risk manager to set rules for solvency, management, and operations of risk pools. The risk manager also felt it was important to continue to meet with the risk pools in an informal, idea-sharing group to discuss matters of regulatory concern. A formation document was sent to all of the risk pools prior to the first meeting explaining the purpose of this informal group, along with an invitation to each pool to occupy a seat on the WRAC.

15. Why did DES only consider proposed rule-making changes that were submitted by a single member of the committee and disregarded all other proposals submitted by other members of the committee?

DES did not only consider the proposed changes submitted by a single member. All of the input submitted by any member was fully considered.

The state risk manager received input from most risk pools. Meetings began in November of 2011. After several meetings, the first draft of the proposed rules was sent to stakeholders on May 1, 2012. After considering additional feedback, a second draft incorporated some new ideas and was sent to stakeholders on January 15, 2013. One stakeholder petitioned the agency to adopt these rules. The agency is required by statute to consider citizen petitions. After consideration, the agency determined it would move forward with the rulemaking process. No other petitions were submitted by stakeholders.

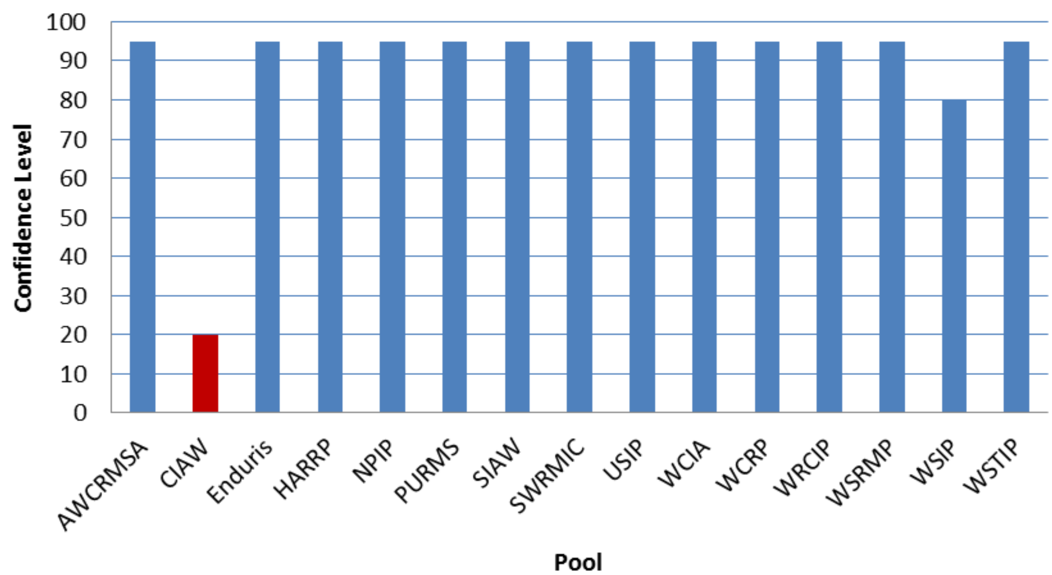
16. Why wasn't a problem statement identified by the representatives from DES or members of the committee? Additionally, no minutes were taken for the meetings and members of the committee were left to wonder what decisions had been made.

While a formal problem statement is not required to engage in rule-writing, the current rules required updating. The Washington Risk Pool Advisory Council (WRAC) is an informal, idea-sharing stakeholder group formed by the state risk manager to communicate with the risk pools formed under RCW 48.62 about regulatory concerns. It is not a governing or decision-making board. As such, no official meeting minutes have been taken to date.

We appreciate the recent request made by a WRAC member to add the subject of meeting minutes to the agenda for the January 23, 2014 meeting. This item, along with the above suggestion concerning problem statements, will be added to the agenda for discussion at the upcoming meeting.

17. What confidence level are the risk pools operating at now?

Based on the most recent actuarial reports and financial statements, nearly all pools are operating at roughly a 95 percent confidence level.



Note: data is based on most recent actuarial and financial reports provided by each risk pool.

18. What statutory authority do you have to regulate self-insurance risk pools for entities that aren't using public funds?

State law grants the state risk manager the authority to regulate self-insurance risk pools under RCW 48.62.036 and RCW 48.62.061. These statutes specifically include non-profit entities.

19. Why does DES want to increase reserves instead of leaving money in the hands of members to pay for services?

When a claim is reported to the pool, it becomes an unpaid liability of the pool and its members until it is settled. The unpaid liability is funded by the membership through the annual premium, or contribution, each member pays to the pool. By collecting enough money to pay the claims that will occur during the coming year (which are estimated by an actuary), the pool can fund its outstanding liabilities with little risk to the membership of receiving a cash call later for prior year claims.

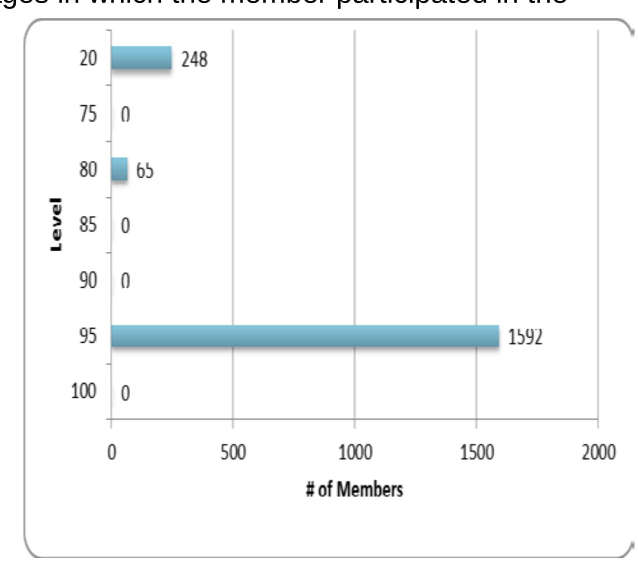
Since not all claims will be settled at year end, the pool will maintain these funds, usually in short term investments, to pay the remaining claims when they are settled. Funding outstanding liabilities is a fiscally sound practice because the pool does not rely on frequent cash calls to the membership when claims are settled.

If annual premium payments collected from members are too low, frequent cash calls will occur. While low annual premiums are attractive to members who want to use these funds locally, funding of outstanding claims protects the members from unexpected cash calls later and allows risk pools to establish predictable and stable annual rates for members. When risk pools fund outstanding unpaid claims, pool members have less financial risk of an unexpected cash call and can budget funds for schools, sidewalks, parks, and services.

20. Why is it necessary to increase reserves to the 80 percent confidence level?

All risk pools follow a model in which some portion of the liability for outstanding claims is jointly self-insured and paid from a pool of funds established by members. If monies are insufficient to fund unpaid claims in the self-insured layer, members must provide additional monies in response to a cash call from the pool. Even if a member leaves a pool, it can still be required to provide funds for past year shortages in which the member participated in the pool.

Claims Reserves Confidence Level	Number years when shortfalls for claims happen	Funding Adequacy Determination
55%	45	Inadequate
70%	30	Marginally Adequate
95%	5	Conservative



Note, data is based on most recent actuarial and financial reports provided by each risk pool

Actuaries working with risk pools recommend funding outstanding claims at minimum confidence levels between eighty and ninety percent. When outstanding claim liabilities for risk pools are funded at the 80 percent confidence level, if the pool terminated or members left, there is a high likelihood that the risk pool will be able to pay the remaining claims that have occurred without a cash call to members. Most local governments and nonprofits no longer have available funding to respond to a cash call.

21. Why do the rules require funding of outstanding claims in order to be considered solvent? Solvency, in accounting terms, means you have enough money to pay the bills.

RCW 48.62.061(1) requires that the state risk manager adopt rules for solvency. Solvency is used differently in insurance accounting. Pools collect money from members through an annual premium payment intended to pay the claims that will occur during the coming year. At year end, not all claims will have been settled, and some monies remain to pay those claims. Since all members are subject to a cash call to provide additional funds to the risk pool, maintaining funds to pay outstanding claims protects the members from an unexpected cash call later.

If pools operate with just enough money to pay current bills and do not fund outstanding unpaid claims, pools place a significant reliance on obtaining additional funding through cash calls to the membership. In this scenario, the claims are unfunded and the pool operates on a cash basis, with frequent cash infusions from members, or unpredictable rate spikes later to pay for prior year claims. Collecting and maintaining sufficient funding to pay outstanding claims allows the pool to maintain predictable annual rates for members without reliance on a cash call to the membership. Collecting and maintaining sufficient funding to pay outstanding claims up front also helps local government and nonprofit members in annual budgeting because their insurance costs are stable.