

**STATE RISK MANAGER'S REPORT**  
**REVIEW OF REGULATORY COMPLIANCE**  
**OF**  
**CITIES INSURANCE ASSOCIATION OF WASHINGTON**  
*As of August 31, 2011*  
*Issued April 22, 2013*

**Results:**

The Cities Insurance Association of Washington is in compliance with a refunding agreement requiring the Pool collect additional payments from members for previous year claims. These payments (called a "reassessment") are to be collected over a five year period. The amount of the reassessment was based on the Pool's financial condition in the year that the assessment was calculated. The amount was determined based on the outstanding liabilities, available assets and the amount needed at year end 2010 to fund outstanding claim liabilities at regulatory levels.

Based on audited financial information CIAW's net assets, as of year ending 8/31/2011, were **(\$1,220,009)**. Our report includes one recommendation.

**Background:**

The State Risk Manager in the Office of Risk Management, a division of the Department of Enterprise Services, State of Washington, is responsible for regulatory oversight of local government joint self-insured risk pools formed under the authority of chapter 48.62 RCW. The law requires the State Risk Manager to adopt rules for risk pools to follow, adopted as Washington Administrative Code (WAC) 200-100. Those rules include standards for solvency, operations and management and require that risk pools maintain certain financial reserves in order to ensure that claims are funded.

The State Risk Manager determines whether risk pools are operating in a safe financial condition, according to the solvency regulations. The pool's compliance with those regulatory requirements is based on audited financial information provided by the Washington State Auditor's office. Pools that operate in an unsafe financial condition or in violation of statutory or regulatory requirements may cause the State Risk Manager to take administrative action.

**Areas Covered:**

We examined the Pool's compliance with regulatory standards adopted in rule by the State Risk Manager in the following areas:

1. Requirement for Annual Actuarial Study to Determine Unpaid Claims Liability
2. Financial Solvency/Required Assets
3. Presentation of Liabilities
4. Compliance with Reporting Requirements
5. Compliance with Membership Requirements
6. Financial Trends

## **Results of Review of Regulatory Compliance:**

### 1. Requirement for Annual Actuarial Study to Determine Unpaid Claims Liability

#### **Requirement: Risk pools must obtain an annual actuarial review which meets the following criteria:**

WAC 200-100-03001 requires that "(1) All joint self-insurance programs shall obtain an annual actuarial review as of fiscal year end which provides estimates of the unpaid claims measured at the expected and the seventy percent confidence level. . ."

WAC 200-100-020 (1) "Actuary" means any person who is a fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

**Result: A review of the actuarial report and subsequent revised actuarial communication of December 6, 2012, indicates that an actuary meeting the qualifications set forth above estimated the Pool's liability for both property and liability claims at both the expected and the 70% confidence level. The actuary for the Pool, Richard Fallquist, FCAS, MAAA, did not receive complete information about the Pool's stop loss policy limits when the original outstanding claim liability estimates were made. The original estimates were based on a stop loss policy which would provide unlimited coverage and paying the Pool's claims exceeding \$2.545 million. When revised, the actuarial estimates indicated the coverage would pay claims over the \$2.545 million, but only in the amount of \$2 million. Those revisions are shown by comparison in Attachment A.**

#### **Recommendation:**

**We recommend that the Pool carefully monitor insurance information provided to the Pool's actuary and used in calculating estimated claim liabilities at fiscal yearend so that the Pool continues to make progress toward its refunding plan.**

### 2. Financial Solvency/Required Assets

#### **Requirement 2.a: Risk pools must ensure claims liabilities are funded at the expected level by meeting certain standards for solvency and liquidity as follows:**

WAC 200-100-03001 states, in part ". . . (2) The governing body of the joint self-insurance program shall establish and maintain primary assets in an amount at least equal to the unpaid claims estimate at the expected level as determined by the program's actuary as of fiscal year end. . ."

WAC 200-100-020 (20) "Primary assets" means cash and investments (less any nonclaims liabilities).

**Results: The CIAW is operating under a refunding agreement with the Office of Risk Management and, while it does not have sufficient assets to meet regulatory requirements, it is in compliance with the terms of the funding agreement as of fiscal year ending August 31, 2011.**

#### **Requirement 2.b: Risk pools must meet the above requirement to maintain primary assets and must also maintain other assets to fund claims liabilities at the 70% confidence level as follows:**

WAC 200-100-03001 states, in part, ". . . (3) The governing body of the joint self-insurance program shall establish and maintain total primary and secondary assets in an amount equal to or greater than the unpaid claim estimate at the seventy percent confidence level as determined by the program's actuary as of fiscal year end. . ."

WAC 200-100-020 (23) states that "Secondary assets" means insurance receivables, real estate or other assets (less any nonclaims liabilities) the value of which can be independently verified by the state risk manager.

**Results: The CIAW is operating under a refunding agreement with the Office of Risk Management and, while it does not have sufficient assets to meet regulatory requirements, it is in compliance with the terms of the funding agreement as of fiscal year ending August 31, 2011. Secondary assets consist of additional cash reserves, investments and other assets (property and equipment are excluded from this calculation). Also excluded were nonclaims liabilities, including prepaid contributions.**

	<b>Test 1 - Primary Asset Test</b>		<b>Test 2 - Secondary Asset Test</b>
	(WAC 200-100-03001(2))		(WAC 200-100-03001(3))
<b>(\$482,318)</b>	Primary Assets	\$1,767,807	Secondary Assets
\$2,999,146	Estimated Claim Liabilities at the expected level per actuarial estimate	\$3,171,146	Estimated Claim Liabilities at the 70% confidence level per actuarial estimate
<b>RESULT:</b>	<b>DOES NOT MEET</b>	<b>RESULT:</b>	<b>DOES NOT MEET</b>
	<i>Estimated outstanding liabilities at the expected level must be less than primary assets (cash and investments less nonclaims liabilities)</i>		<i>Estimated outstanding liabilities at the seventy percent confidence level must be less than combined primary assets and secondary assets (receivables, recoverables, real estate and other assets that can be independently verified by the State Risk Manager)</i>

(Note 1) The outstanding claim estimates used in the above regulatory tests were taken directly from the Pool's revised actuarial reports. During review, we noted that outstanding claim estimates were based on an unlimited "stop loss" insurance benefit which is applied to the Pool's portion of outstanding claim responsibilities above a threshold of \$2,545,000. See #1 for further information and recommendations.

Actuarial reports submitted as part of the annual report to the State Risk Manager are available by contacting Canfield and Associates, third party administrator for Cities Insurance Association of Washington at (509)754-2027. Contact information is also available by visiting the Pool's website at <http://ciaw.us/>.

(Note 2) The information used to calculate assets used in the Primary and Secondary Asset Tests were obtained from the audited financial statements. The audit reports are available on the State Auditor's Office website at <http://www.sao.wa.gov/EN/Pages/default.aspx>, or by telephone at (360) 902-0370.

### 3. Presentation of Liabilities

**Requirement 3: The estimated liability for unpaid claims as presented in the Pool's financial statements is supported by the actuarial report.**

**RCW 43.09.200** Local government accounting — Uniform system of accounting. The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class.

The system shall exhibit true accounts and detailed statements of funds collected, received, and expended for account of the public for any purpose whatever, and by all public officers, employees, or other persons.

The accounts shall show the receipt, use, and disposition of all public property, and the income, if any, derived therefrom; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction; all statements and reports made or required to be made, for the internal administration of the office to which they pertain; and all reports published or required to be published, for the information of the people regarding any and all details of the financial administration of public affairs.

**Result: The Pool's financial statements are based upon the Pool's actuarial report, with the exception of the application of the stop loss coverage amount as described in #1.**

### 4. Compliance with Reporting Requirements

**Requirement: The pool is required by WAC 200-100-060 to provide unaudited annual financial statements to the State Risk Manager within 150 days of fiscal year end, and audited financial statements are to be provided to the State Risk Manager within one year of the fiscal yearend date. If required by the State Risk Manager, a pool must provide quarterly reports based on its financial condition.**

**WAC 200-100-60** requires that “. . . (1) Every joint property and liability self-insurance program authorized to transact business in the state of Washington shall submit the annual report to the state risk manager.

(2) The annual report to the state risk manager shall require the following information to be submitted in electronic form:

- (a) Unaudited annual financial statements, including attestation, as provided to the state auditor's office;
- (b) Actuarial reserve review report on which the net claims liabilities at fiscal yearend reported in the unaudited financial statements are based;
- (c) Copies of all insurance coverage documents;
- (d) List of contracted consultants;
- (e) Details of changes in articles of incorporation, bylaws or foundation agreement;
- (f) Details of services provided by contract to nonmembers;
- (g) List of members added or terminated.

Such reports shall be submitted to the state risk manager no later than one hundred fifty days following the completion of the joint program's fiscal year.

(3) Audited financial statements shall be provided to the state risk manager within one year of the program's fiscal year end and comply with requirements for submission of audited financial statements established by the state risk manager.

(4) All joint self-insurance programs shall submit quarterly financial reports if, in the estimation of the state risk manager, the financial condition of a program warrants additional quarterly reporting requirements. . .”

**Results: The Pool met this requirement by providing audited and unaudited financial statements and documents listed above within the time required. The Pool is not required to report quarterly. The Pool received an unqualified opinion on its audited financial statements for FY 2011.**

## 5. Compliance with Membership Requirements

**Requirement: Only members of the pool who have signed the interlocal agreement may participate in the Pool's insurance program. The agreement must provide for the contingent liability of the members if assets are insufficient.**

**WAC 200-100-02005** provides that "Membership in a joint self-insurance program requires the execution of a foundation agreement. Only members may participate in risk-sharing. Only members may participate in the self-insured retention layer, and only members may participate in the joint purchase of insurance or reinsurance".

**RCW 48.62.141** requires that "Every joint self-insurance program covering liability or property risks, excluding multistate programs governed by RCW 48.62.081, shall provide for the contingent liability of participants in the program if assets of the program are insufficient to cover the program's liabilities".

**Results: The Pool is in compliance with this requirement per results of a special engagement by the Washington State Auditor's Office contracted to confirm compliance. The agreement provides that members are responsible for the contingent liabilities of the program if assets are insufficient.**

## 6. Financial Trends

**Requirement:** Risk pools are required to notify the State Risk Manager if solvency requirements are not met (WAC 200-100-03001(2)) and the State Risk Manager is required to monitor trends over time and take action when programs experience adverse trends which may require the State Risk Manager to take additional actions.

WAC 200-100-03001 states, in part “. . . (4) The state risk manager shall evaluate the operational safety and soundness of the program by monitoring changes in liquidity, claims reserves and liabilities, member equity, self-insured retention, and other financial trends over time. Programs experiencing adverse trends may cause the state risk manager to increase frequency of on-site program review and monitoring, including increased communication with the governing body and requirements for corrective plans. . .”

**Results:** Financial trends show the increases and decreases in assets, liabilities, revenues and expenses. The information below was taken directly from the audited financial statements of FY 2011. Financial trends are included in Attachment A.

**Attachment A-Cities Insurance Association of Washington Trends in Assets, Liabilities and Membership**

	2011 <sup>1</sup>	2011	2010	2009	2008	2007	2006	2005	2004
ASSETS	(revised	Audited f/s	Audited f/s	Audited f/s	Audited f/s	Audited f/s	Audited f/s	Audited f/s	Audited f/s
Current Assets:	after audit)								
Cash and Equivalents	\$27,513	\$27,513	\$2,097,614	\$466,203	\$832,482	\$393,460	\$649,795	\$1,331,282	\$3,374,306
Investments					\$0	\$763,123	\$763,122	\$1,034,153	\$190,000
Prepaid Insurance					\$0			\$1,960,650	\$1,666,156
Receivables				\$856,675	\$1,947,711	\$4,196,686	\$2,491,356	\$2,457,022	\$2,458,265
Member Contributions	\$49,117	\$49,117	\$267,268						
Accrued Deductibles	\$198,154	\$198,154	\$260,312						
Stop Loss Recoverable	\$1,214,075	\$1,214,075	\$13,339						
Other Receivables (Supplemental Assessment)	\$197,171	\$197,171	\$197,243						
<b>TOTAL CURRENT ASSETS</b>	<b>\$1,686,030</b>	<b>\$1,686,030</b>	<b>\$2,835,776</b>	<b>\$1,322,878</b>	<b>\$2,780,193</b>	<b>\$5,353,269</b>	<b>\$3,904,273</b>	<b>\$6,783,107</b>	<b>\$7,688,727</b>
Noncurrent Assets:									
Other Receivables (Supplemental Assessment)	\$591,608	\$591,608	\$788,971						
Equipment Purchased (Net of Accumulated Depreciation)	\$158,330	\$158,330	\$207,686	\$217,042	\$109,528				
Records Purchased (Net of Accumulated Depreciation)	\$25,000	\$25,000	\$37,500	\$50,000	\$62,500	\$75,000	\$87,500	\$100,000	\$112,500
<b>TOTAL NONCURRENT ASSETS</b>	<b>\$774,938</b>	<b>\$774,938</b>	<b>\$1,034,157</b>	<b>\$267,042</b>	<b>\$172,028</b>	<b>\$75,000</b>	<b>\$87,500</b>	<b>\$100,000</b>	<b>\$112,500</b>
<b>TOTAL ASSETS</b>	<b>\$2,460,968</b>	<b>\$2,460,968</b>	<b>\$3,869,933</b>	<b>\$1,589,920</b>	<b>\$2,952,221</b>	<b>\$5,428,269</b>	<b>\$3,991,773</b>	<b>\$6,883,107</b>	<b>\$7,801,227</b>
LIABILITIES									
Current Liabilities:									
Unpaid/Open Claims Liability	\$1,867,327	\$1,743,009	\$1,769,770	\$4,860,887	\$7,428,339	\$4,864,482	\$2,475,194	\$2,221,657	\$2,180,331
IBNR Reserves	\$1,131,819	\$952,026	\$710,080						
Unallocated Loss Adjustment Expenses				\$239,362	\$371,417				
Unearned Member Contributions	\$402,195	\$402,195	\$2,137,262						
Note Payable (Vehicle-Trailer Loan)	\$12,658	\$12,658	\$10,657						
Unearned Lease Revenue	\$8,000	\$8,000	\$8,000						
Reimbursement due SIAW			\$315,000						
Deferred Revenue								\$2,208,799	\$3,121,703
Accounts Payable	\$45,663	\$45,663				\$0	\$440,273	\$546,400	\$392,457
<b>TOTAL CURRENT LIABILITIES</b>	<b>\$3,467,662</b>	<b>\$3,163,551</b>	<b>\$4,950,769</b>	<b>\$5,100,249</b>	<b>\$7,799,756</b>	<b>\$4,864,482</b>	<b>\$2,915,467</b>	<b>\$4,976,856</b>	<b>\$5,694,491</b>
Noncurrent Liabilities:									
Unearned Lease Revenue	\$16,000	\$16,000	\$24,000						
Note Payable (Vehicle/Trailer Loan)	\$25,315	\$25,315	\$37,838						
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>\$41,315</b>	<b>\$41,315</b>	<b>\$61,838</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>TOTAL LIABILITIES</b>	<b>\$3,508,977</b>	<b>\$3,204,866</b>	<b>\$5,012,607</b>	<b>\$5,100,249</b>	<b>\$7,799,756</b>	<b>\$4,864,482</b>	<b>\$2,915,467</b>	<b>\$4,976,856</b>	<b>\$5,694,491</b>
<b>NET ASSETS</b>	<b>(\$1,048,009)</b>	<b>(\$743,898)</b>	<b>(\$1,142,674)</b>	<b>(\$3,510,329)</b>	<b>(\$4,847,535)</b>	<b>\$563,787</b>	<b>\$1,076,306</b>	<b>\$1,906,251</b>	<b>\$2,106,736</b>
Restricted to meet 70% confidence level	\$172,000	\$466,289	\$405,856	\$0	\$0	\$0	\$0	\$0	\$0
<b>TOTAL NET ASSETS</b>	<b>(\$1,220,009)</b>	<b>(\$1,210,187)</b>	<b>(\$1,548,530)</b>	<b>(\$3,510,329)</b>	<b>(\$4,847,535)</b>	<b>\$563,787</b>	<b>\$1,076,306</b>	<b>\$1,906,251</b>	<b>\$2,106,736</b>
<b>Members</b>	<b>91</b>	<b>91</b>	<b>89</b>	<b>90</b>	<b>97</b>	<b>99</b>	<b>111</b>	<b>120</b>	<b>120</b>
Other members	159	159	168	168	160	157	160	172	158
Tribal Associate Members								63	63
Total	250	250	257	258	257	256	271	355	341
<b>Average Equity Per Member (See Note)</b>	<b>(\$4,880)</b>	<b>(\$4,840)</b>	<b>(\$6,025)</b>	<b>(\$13,605)</b>	<b>(\$18,862)</b>	<b>\$2,202</b>	<b>\$3,971</b>	<b>\$5,369</b>	<b>\$6,178</b>

<sup>1</sup> Additional information was taken from the Pool's fiscal year end 8/31/2011 revised actuarial report provided during this review.

**Conclusion:** We appreciate the cooperation and assistance of the Cities Insurance Association of Washington and staff of Canfield and Associates, the Pool's third party administrator, during this process. Recommendations were made in a separate letter to management as a result of this review.

**About Cities Insurance Association of Washington:**

The Cities Insurance Association of Washington was formed through an interlocal agreement among several cities in 1988. The interlocal agreement allows the joint purchase of insurance, joint self-insuring, joint hiring or contracting for risk management services and claims administration. As of the end of fiscal year 2011, the Pool had approximately 250 members, which included cities, towns, fire districts and other special purpose districts. The Pool is regulated by the state Office of Risk Management with the Department of Enterprise Services.

An elected, nine-member Board governs the Pool. Directors are elected from member districts. The Pool does not have any employees of its own; it contracts with a private firm for claims administration and risk management services. The Pool operates on an annual budget of approximately \$9 million.

**About State Risk Manager Regulatory Compliance Reviews:**

RCW 48.62 provides authority for local governments to join or form a self-insurance program together with other entities, to jointly purchase insurance or reinsurance with other entities, and to contract for or hire personnel to provide risk management, claims and other administrative services. The State Risk Manager in the Office of Risk Management, Department of Enterprise Services, is authorized by RCW 48.62 to adopt rules for self-insurance programs formed under this chapter to follow. The rules contain standards for operations and management, claims administration, solvency, including frequency of actuarial studies and claims audits, and standards for contracts between self-insurance programs and private businesses.

In order to ensure compliance with these standards, which are adopted as Washington Administrative Code (WAC) 200-100, the Local Government Self-Insurance Program, under the direction of the State Risk Manager, conducts periodic reviews of joint self-insurance programs and, when necessary, provides for further investigation of those programs that are not operating in a safe and sound financial manner as required. The State Risk Manager may take certain administrative actions, including the issuance of a cease and desist order, when a program operates in violation of chapter 48.62 RCW or does not operate in a financially safe manner.

Each local government member of a joint self-insurance program is responsible for providing monies to the pool to pay claims for the years in which they were a member of the pool. Even if a member leaves a pool, a reassessment, or “cash call”, can occur in later years, requiring local government members to provide additional monies for past funding deficiencies for years in which they were a member. For this reason, the Local Government Self-Insurance program takes proactive measures to monitor the financial health of local government risk pools and to communicate the results of monitoring and periodic compliance reviews before adverse financial trends affect the pool and its local government members. Frequent reviews of compliance with the State Risk Manager’s rules are undertaken and the results are reported, in writing, to the board of directors and management of the pool.

Questions about this report should be addressed to the Local Government Self Insurance Program or the State Risk Manager, located at the Department of Enterprise Services, by telephone at 360-407-8153, or at [shannon.stuber@des.wa.gov](mailto:shannon.stuber@des.wa.gov) . The Department of Enterprise Services is located at 1500 Jefferson Street, PO Box 41466, Olympia, WA 98504-1466.