

## Association Sponsorship of Pools – Emery response to a member, August 2013:

In follow-up to our recent conversation, let me follow-up with information and insights related to Association Sponsorship of pools.

I do know that some 35 State Municipal Leagues “sponsor” pools; I believe there are a few less county associations that do so, and fewer still School Associations. But, out of 50 states, this suggests it is pretty common. What is uncommon is the nature of that “sponsorship.” It ranges from a simple endorsement with no other inter-connectedness, to quite comprehensive interfaces...and everything in between.

You asked about differences in the governing responsibilities between an Association Board and a Pool Board, and I believe this is technically a legal question that is answerable only in the context of a the federal and/or state regulations that the organizations are formed under, and the agreements that the members sign on to for each. Both are, in essence, membership organizations, although the economics of the organizations are fundamentally different. Assets in both would be returnable to members upon dissolution, but are likely considered to be within the control of the respective governing boards during operations.

The financial ties between the two take several forms:

1. Required membership in the Association, which is not uncommon, and is certainly a legitimate requirement unless it is precluded by regulation or rule within that particular state. One might argue that Association membership is a legitimate risk management investment, and therefore an underwriting tool for the pool. As long as this is not precluded regulatorily, it is supportable. Anecdotally, I believe the state of Ct. precluded this tie-in when it passed its pooling legislation, based on lobbying by local agents. In NH, the issue was raised in regulatory hearings involving the NGLGC, and the findings were that the tie-in not be allowed. However, there had never been any regulation or rule disallowing it in the past, and the finding is in dispute. I believe the membership requirement is likely more common, than not.
2. Contractual or operating agreements, which provide that some or all of the staffing and administration of the pool be provided through the Association. Generally, the pools reimburse the Associations for direct and indirect expense, and there is certainly some art in the allocation of indirect expense, as is always the case when a number of products and services are operated under one roof. Again, there is nothing inherently wrong with this, but if not well-defined and communicated, and acted upon openly by the governing bodies, after due consideration to the best interests of the members, it can lead to conflict.
3. Licensing or “institutional value” payments or fees are sometime explicitly paid, in recognition of the goodwill provided by the Association; the relationships they facilitate; and the general contribution to good governance principals which is where the two service organizations missions clearly overlap. The same caveat about transparency applies here, and is coupled with careful legal assessment to assure that the non-dues income paid by the pool to the Association does not threaten the tax exempt status of the Association.

An example of a clearly defined sponsorship agreement at TASB was in the Resource Center, and I have attached it, here, for your information.

Unfortunately, as a practical matter, Association/Pool dynamics have played a large role in a number of conflicts, over the years. My own view is that this derives from a combination of the very different financial underpinnings of each organization, and specific examples of poor leadership and/or governance. Let me offer a few examples.

- The Kentucky League of Cities was criticized in a State Audit for improper use of public funds, in light of excessive spending by Association employees that was facilitated by the availability of the funds generated by the pool. Once disclosed, and after very public leadership changes, the Association and Pool have continued forward in a mutually beneficial relationship, with separate but overlapping boards. Jon Steiner, the Executive Director at KLC, and formerly a pooling executive at NHLGC, might be someone you would want to talk to for excellent perspective.
- The Kentucky School Boards Association also sponsored and ran a pool, KSBIT, which has recently been shut down due to underfunding. The issues are complex, and the explanation of the pool's failure subject to many interpretations. But, the facts are: the pool got into financial trouble while being managed by the Association, largely due to inadequate rates. The regulators intervened, and asked the pool servicing arm of KLC – KLCIS – to take over and try to turn the pool around several years ago, but a string of bad losses, on top of years of underfunding, a competitive environment, and recently discovered under-reserving, led the Association to conclude that it would shut down the program, which would trigger assessments to fund the liabilities. There are some who are of the opinion that the Association was ill-equipped to apply the “tough love” sometimes needed to properly fund a pool. I am not advocating that opinion, but not it to recognize that it is a concern and it is why some Associations have not gotten involved in pooling.
- In the NH case, the separate boards of the Association, the Health Trust, and the P&C Trust made independent decisions (in the early '90's) to integrate into one board – the Local Government Center – under the belief that this would better serve its constituents, over the long run. One board member at the time disagreed, felt there was some sort of inherent conflict for the Health Trust in this integrated arrangement, and spent the next 10 years generating distrust about the LGC, which operated in a very lightly regulated environment. Again, at the time of the decision to integrate, there was no prohibition, but this became one of the attack points in the case, which continues, as you know, today. One related issue in this case that is worth mentioning is the notion that funding from one member of one organization cannot be used to enrich another member of another organization: in this case, Health Trust monies should not have been used to support the WC Fund, because the members weren't the same. The same might be argued about pools and associations, whose members are not exactly the same. I reject this argument. What matters is that the decisions that lead to cross-support (or reject such support) of one product or service by another – or one organization by another - be well informed, be motivated by interests consistent with that of the members as a whole, and over the long run, and be made by duly appointed or elected governing boards. Boards are there to make just such decisions; in fact, it is their fiduciary duty to do so.
- The Tennessee Municipal League and its sponsored pool has been dealing with allegations of improper use of pool members' funds related to the launch of a bond bank. Here is a link to some information: [http://www.tml1.org/page/TMBF+Audit+Minutes+--+\(Oct+21,+2010\)/224](http://www.tml1.org/page/TMBF+Audit+Minutes+--+(Oct+21,+2010)/224).

I note these situations because they point out that Association/Pool relationships do create challenges. (I haven't mentioned the many internal/operational challenges that some have experienced around conflicts between Association ED's and Pool Executives; this is another category unto itself.) My own opinion is that there is and can be real value in the collaboration, and those organizations which see that value clearly and want their members to benefit from it should also see the importance of lots of open communication, transparency in all financial and related party transactions, and good governance practices.