Table of Contents

Contacts 2

Introduction to Public Entity Risk Pooling 2

History 2

Benefits 2

Pool Structure 3

Definition 3

State Law and Regulations 3

Pool Governance 4

Governing Body 4

Legal Counsel 5

Coverage 6

Components of a Coverage Document 6

Claims 7

Typical Steps in Managing a Claim 7

Litigation 9

Other Important Claim Considerations 9

Underwriting 11

Role in Coverages and Reinsurance 11

Market Conditions and Member Relationships 11

Typical Underwriting Steps 11

Use of Investment Income 13

Health Pool Underwriting 13

Reinsurance 14

Differences in Reinsurance and Excess Insurance 14

Reinsurance Markets 15

Reinsurance Structures 15

Deductible and Retention 15

Pro Rata and Excess of Loss 16

Treaty and Facultative 16

Reinsurance Pools 16

Financial Oversight 17

Capital Adequacy 17

Release of Capital 18

Investments 18

Balance Sheet 18

Income Statement 18

Actuarial Review **19**
Loss Projection Analysis 19
Reserve Analysis 19
Confidence Level 20
Discounting 20
Independent Financial Audit **21**
Other Audits 21
Risk Management **22**
Protects the Pool and Members 22
Risk Management Examples 23
Member Service Examples 24
Technology and Communications **25**
Technology Considerations 25
Communication Considerations 25
Additional Resources **26**

Contacts

info@agrip.org
855.292.8800

Ann Gergen
Executive Director
agergen@agrip.org
855.292.8871

Claire Torza
Program Manager
ctorza@agrip.org
855.292.8874

Wendy Parker
Managing Director
wparker@agrip.org
855.292.8872

Ceara Milligan
Marketing Specialist
cmilligan@agrip.org
855.292.8877

Lizette Sierra
Member Data Specialist
lsierra@agrip.org
855.292.8876

Melissa Feltz
Engagement Manager
mfeltz@agrip.org
855.356.0231

Stacey Spears
Events Specialist
sspears@agrip.org
855.292.8879

Introduction to Public Entity Risk Pooling

Public entity risk pools use creative programs and services to make public entities safer, reduce property and liability claims, save taxpayer dollars, and ensure the ability of tens of thousands of public entities to stay focused on the services they provide to their communities.

Over time, public entity risk pooling has evolved from necessity to innovation, while providing financial stability and safeguarding public resources.

Throughout this evolution, public entity risk pooling has distinguished itself from traditional insurance. Public entity pools are member-owned, member-driven organizations. All of a pool's time and resources are dedicated solely to serving the unique and collective needs of public entities.

History

In the 1980s, the commercial insurance market had a collective distaste for insuring public entities, because on the whole public entities engage in some pretty risky activities — law enforcement, jails, playgrounds and more.



Not only were public entities sometimes unable to get insurance, but coverage available was limited and expensive.

In response to this crisis, public entities sought legislative approval to band together and self-insure their collective risks. Public entity risk pooling was born as a result.

Benefits

Public entity pooling meets the needs of local governments and schools with dynamic, member-centric programs and services based upon deep understanding of public entity activities and risks. Pooling offers many benefits for public entity members.

Coverage Specific to Public Sector Activities

Public entity pools typically craft their own coverage documents to provide members with the coverage, terms and limits that are best suited to address unique local government and school risks.

Cost Savings and Stability

Cost savings for pool members are largely achieved through reducing the number and cost of claims. Pools also function for a public purpose, not a profit margin, and employ economies of scale. Therefore, there is generally lower overhead and no profit target being generated by a pool.

Most pools focus on long-term, stable pricing to match public entity budget needs. Members of pools value predictable, sustainable contributions for coverage year-over-year, rather than the sometimes dramatic premium increases and decreases more common in the profit-driven commercial insurance market. Because public entity pools are not concerned with making a profit, they are able to price coverage more effectively for public sector budgets.

Specialized Risk Management Services

Helping members manage and reduce risks is an integral part of public entity pooling. Most pools have specialized loss control and risk management programming and staff who are dedicated to the important work of reducing the number and costs of claims.

The work of pools helps keep public entities and public employees safe and healthy.

Pool Structure

There are many different structures and types of public entity pools. How a pool is structured often depends on the laws of the state in which it is formed.

A pool might be a captive, a fund, an interlocal agency, a joint powers authority, a mutual insurance company, a reciprocal, a non-profit, a risk retention group or a trust. Each of these organizational structures has specific definitions and distinctions.

The most important thing to know is what kind of structure your pool uses, why it does so, and any specific requirements as a result — including financial or tax considerations based upon your pool's legal structure.

Definition

A pool is an intergovernmental arrangement through which a group of public entities — the members — contribute to a shared fund that pays for claims and provides risk management services.

Most pools function either formally or culturally as an extension of their public entity members. The majority are governed by a board of directors comprised of appointed and elected public officials representing the members in the pool.

Many states define pools as something other than insurance. Just like conventional insurers, pools work to transfer risk in order to protect members from the volatility of claims or losses. But public entity pools are fundamentally different from conventional insurance.

The primary purpose of any public entity pool is to manage and reduce underlying risks to the benefit of public entity members and the public at large. Conventional insurers, by comparison, exist primarily to finance losses. In other words, public entity pools are collaborating partners that help public entities create, foster and manage safe environments in order to minimize personal, physical, and property damages and losses.

State Law and Regulations

Public entity pools were created on a state-by-state basis and, as a result, are organized differently in each state and subject to that state's unique laws. In general, public entity pools are not allowed to provide services across state lines — although there are a few exceptions.

How a pool is structured and how it functions depends upon the state, how the public entity pool was initially formed, and its overall environment. Some pools are considered public entities themselves. Others are regulated insurance entities under state law. Still others function with minimal regulation or are non-profit entities.

It is critical to know the laws and regulations applicable to your pool:

- Under what legislation or regulation was the pool formed?
- What state laws or regulations are the pool subject to?
- Is the pool required by state law to report to a state agency, and for what purpose?
- How does the pool monitor legislation that may affect its membership?

Pool Governance

Pools have a number of foundational documents that shape their governance and operations. Depending on its structure and the state in which it exists, a pool might have articles of incorporation or an intergovernmental agreement. Most pools have bylaws. Some pools have specific agreements with each member.

Regardless of how these things are addressed, most pools have foundational documents that cover the following structural issues:

- Membership eligibility
- Obligations of members
- Membership termination provisions
- Powers and duties of the pool's governing body
- Ownership, use and distribution of pool assets
- Assessment provisions
- Board member selection criteria and qualifications
- Board policies and procedures that provide a framework for key operational issues such as target surplus, funding criteria and more

Governing Body

The legal structure of a public entity pool and makeup of its governing body — whether referred to as directors or trustees — will dictate nuances in specific roles and responsibilities.

The size and makeup of governing bodies vary from pool to pool based upon number of members, type of public entities served, and other considerations unique to each pool. There is no "right" way to structure pool governance. The governing body of each pool must determine the best number of board members to strike a balance between representation and efficiency. How a governing body values diversity in perspective is a unique and increasingly important consideration.

There is no universal standard for how pools should structure governing body meetings, how frequently a governing body should meet, or issues the governing body decides. Pools with large governing bodies may delegate significant decision-making to an executive committee or other subcommittees.

Most pool directors or trustees participate in governance because they hold a role within a pool member organization. This means directors or trustees are fulfilling their pool roles in addition to the normal work they perform day to day within a public entity.

Establishing clear roles and responsibilities for the governing body, as well as developing a strong governing body orientation and professional development plan, are tools that pools can use to ensure effective governance. Strong collaboration between the governing body and pool staff also helps to build trust and keeps everyone moving in the same direction.

In all cases, a governing body should recognize:

- Its duty is to the pool, not to the members individually
- When it is appropriate to engage outside, technical expertise
- Actions must be taken in good faith

- The value of respectful and thoughtful debate about decisions
- Its obligation to make decisions with sufficient autonomy and independence

Pool governing bodies govern in several distinct modes**: fiduciary, strategic** and **generative.** These modes are present regardless of how the governing body is constructed and even if they are unspoken or informal.

Fiduciary Mode
When it is operating in fiduciary mode, the governing body is focused on things such as the pool's financial health, operations and legal compliance.

Strategic Mode
The governing body is operating strategically when it plans for the future, establishes mission and vision, and sets overall organizational direction.

Generative Mode
The generative mode of a governing body is important, and it happens when the board asks key questions about possibilities and future trends likely to impact the pool or its members.

Legal Counsel
Like many other governance factors, pool legal guidance varies and can be influenced by several factors.

Some pools have identified a general legal advisor who advises the pool executive and/or the governing body about governance issues. In most cases, the role of general counsel is to ensure the pool operates within defined legal and ethical parameters. Therefore, the loyalty of the general counsel is usually defined as owed to the pool, not the executive or even the governing body.

General counsel responsibilities may be limited to advising on specific governance activities or may include oversight and identification of legal issues in all aspects of the organization, including sales, finance, human resources, business policy, crisis management and compliance reporting. In some cases, the general counsel may also get involved in certain claims situations or offer guidance in coverage matters.

Coverage

Each public entity pool determines the coverage it wishes to offer based upon its own operating environment, structure and member needs. Common examples of coverage include:

- Liability
- Property
- Auto Liability
- Boiler and Machinery or Equipment Breakdown
- Cyber
- Crime and Fidelity
- Health or Employee Benefits
- Unemployment Insurance
- Workers' Compensation

Comparing coverage from one pool to the next can be difficult. For instance, in some cases pools might offer liability coverage inclusive of several specialized coverages such as police liability, employment liability or land use liability. In other cases, pools might provide these specialized coverages on a stand-alone basis for members to elect.

In the commercial insurance industry, organizations such as the Insurance Services Offices (ISO) develop standardized coverage language and documents. This standardization helps insurance regulators and creates consistent interpretations of insurance coverage.

Most public entity pools do not use ISO coverage forms. Instead, public entity pools are more likely to use manuscript contracts or customized coverage forms uniquely adapted to public sector needs. Unless the state defines public entity pools as insurers, pool coverage is generally interpreted under contract law, not insurance law.

Components of a Coverage Document

Although many pools create their own coverage documents to outline coverage given to member public entities, there are several components that are common:

Declarations

Declarations are also referred to as the DEC page. The DEC page briefly outlines the line of coverage, limits of the coverage, deductibles and any special changes purchased by a member.

Coverage Agreement

This is a detailed explanation of the coverage provided.

Definitions

In the definitions section of a coverage document, key terms of coverage are identified and clearly explained.

Conditions

Conditions outline requirements of a pool member in the event of a claim. Examples of conditions include cooperating with claims investigation or taking steps to minimize losses once a claim has occurred.

Endorsements

Endorsements are specialized coverage changes, additions or coverage removals based upon a member's unique and specific needs.

Exclusions

Exclusions are restrictions to a member's coverage. A common example is exclusion for losses caused by war.

Claims

When a claim occurs, a public entity risk pool fulfills the promises it made to its member. Claims adjudication is the process of applying a pool's coverage agreement to a real situation.

At all times in this process, a pool serves both the member with the claim and the membership as a whole. The coverage document must be applied — or examined in the context of the claim — so the claimant or member gets all the benefits of the coverage agreement. Because pools are extensions of their members, coverages are often interpreted as broadly as possible to ensure a claim is paid. Remember: A primary goal of public entity pooling is to protect members from losses and make them whole when losses do occur.

At the same time, a pool must be mindful of the duty it owes its entire membership. Properly applying the coverage agreement and staying within the boundaries of the agreement is important. Non-covered claims for one member should not be paid at the expense of the whole.

Typical Steps in Managing a Claim

There is a fairly standard process to managing a claim, and most claims have some of the same key components. Sometimes it is critical to carefully follow these steps in sequence, but in other cases concurrent work may occur.

Step 1: Receive Claim Report

It is to a pool's advantage to have notice of a claim and begin actively managing that claim as soon as possible. Once the pool receives a member claim, the pool will immediately begin helping its member mitigate the loss or prevent similar losses from occurring.

Pools give their members many tools to report a claim, including options for phone, website or email reporting. Standard report forms are made available to gather critical information such as contact names, phone numbers, email addresses, names of witnesses, the address of incident, and other information important to verifying, investigating and assessing the claim.

Some information on a claim report may be public, so pools also are mindful of the need to collaborate with and sometimes educate members about data needed immediately in order to move forward.

Step 2: Determine Coverage

The pool will make a coverage determination by reviewing its coverage document, associated contracts, interlocal agreements, and reinsurance and excess coverage documents.

Pools often provide customized coverage for members, and sometimes claims invoke multiple kinds of coverage. Coverage determination may also be guided by state rules and regulations. The pool must know and interpret statutory coverages for workers' compensation, mandated coverages for health, and rules for property, liability and tort claims.

Sometimes, determining coverage is unclear. If this is the case, a pool may issue a reservation of rights. The pool helps the member but reserves rights to continue investigation and perhaps deny coverage in the future.

Sometimes, there is no coverage for the member's loss. There can be legal, membership, and reputational risks associated with making an incorrect decision about coverage, so pools approach claim denials very carefully.

Step 3: Investigate the Claim

Once coverage is determined, a pool begins its investigation of the claim. This process can last from one day to many years, depending upon the type and complexity of the claim.

Investigating a claim might include taking statements of all involved parties, gathering reports, inspecting the scene, and gathering all the specifics of the who, what, when, where, how and why a claim-related incident occurred. For more complex cases, the pool may meet several times with its member public entity, the member's employees and contractors.

Step 4: Evaluate Responsibility

In some claim situations, responsibility is clear or even assumed (or simply doesn't matter). Workers' compensation injuries and health claims, in most cases, are simple to evaluate for responsibility.

In liability cases, the pool must determine the negligent or at-fault parties. Negligence laws differ from state to state, and sometimes federal laws apply, for instance in a claim of a civil rights violation.

Because pools see many claims and have operated within the public entity environment for years, they are experts in determining the likely responsibility and liability of claims. In some cases, liability might be tested through defense of a claim in a court of law.

Step 5: Estimate Costs and Damages

There are many different types of damage depending on the type of claim. A general liability claim might include damages for pain and suffering, loss of enjoyment of life, medical expenses and wage loss.

Property claims often include costs to repair the building, loss of income and extra expenses such as renting a generator. Property coverage might require damages payment based upon replacement cost, actual cash value, stated value or other valuation methods.

Health and workers' compensation claims include medical costs such as physician care, hospital stays, surgery, therapy or rehabilitation, prescription drugs and more. Workers' compensation damages may also include wage loss benefits. For medical care and wage loss claims, there may be state fee schedules or other provisions that define maximum allowable damages.

In all cases, pools apply a standard of reasonableness to test costs and damages. An expert might be retained to assist with this determination, such as an independent medical examination, construction expert, cost of living expert or other specialized type of discipline that can offer expertise to the claims adjudication process.

Step 6: Determine Method to Resolve

Ultimately, a pool and its members share the goal of resolving all claims.

Health claims have a resolution process that is driven primarily by individual needs and relatively short treatment periods. Health claims tend to resolve quickly.

While some workers' compensation claims are only for short-term medical treatment, occasionally an employee injury can result in long-term wage replacement costs and medical care. Closing a workers' compensation claim through settlement negotiation might be difficult based upon state and federal laws. Workers' compensation claims are highly rule-bound, and larger claims tend to remain open for lengthy periods — sometimes 40 years or longer, depending upon the age of the injured individual.

Liability and property claims are typically mid-range and can resolve through settlement negotiations or by mediation, arbitration or trial. Whenever a case is settled by these means, there is a written agreement of settlement terms signed before payment is made.

Litigation

If the public entity's covered claim is triggered by a lawsuit filed and served against the member, the pool providing coverage is generally obligated to retain and pay for a defense attorney to represent the member. The pool will typically select and manage the defense counsel and manage the litigation.

There are financial, reputational, emotional and political risks to litigation. Litigation is very expensive, can tarnish a public entity's good reputation, may involve intense emotional investment, and can cause political upheaval within a public organization.

Despite these challenges, litigation is sometimes in the best interest of public policy to protect important statutory immunities, preserve tort caps, and ensure public bodies can continue to manage resources wisely for taxpayers.

When managing a litigated claim, defense costs are always a factor, especially when considering settlement. Regardless of responsibility, managing total costs for pool members is key. For instance, if a plaintiff prevails against a public entity in a federal court case involving civil rights, the public entity and pool would be required to pay the defense costs of the plaintiff.

Other Important Claim Considerations

Claims adjudication is a primary function for all public entity pools, so there are many important aspects to appreciate — even if it is only at a high level.

Reserves

Claim reserves are the estimated value of ultimate costs. The reserve can be adjusted throughout the life of the claim as additional information is discovered. It is a balancing act to accurately reserve a claim.

Adjuster Caseload

A pool will carefully monitor caseloads for claims adjusters and will balance the need for efficiency with providing great member service. If the caseload is too big for an individual adjuster, member service can suffer.

The more complex the claim, the more claims adjusting time and resources are required. Some types of claims can take much longer to settle and close; these need more adjuster expertise.

Authority Levels

Each pool has a prescribed set of financial authority levels for reserving and resolving claims of all varieties. There are multiple authority levels to consider, including what the claims adjuster, claims supervisor, claims manager, executive director and/or governing body may approve.

The authority levels specific to each claim might be complemented by financial authorities who may approve and/or sign payments. Segregation of authorities is designed to protect the assets of a pool and provide appropriate oversight.

Staffing Models

Each pool staffs the claims function uniquely to meet its own operational needs. Some pools hire all their own staff, while others use a third-party administrator (TPA) for claims. Some combine these two methods. There are pros and cons to every claims management approach.

Health claims operations are more likely to be outsourced, but claims assistance for public entity employees (healthcare consumers) are often provided by a pool. There is also a complex set of activities health pools typically manage, including provider networks, pharmacy networks and benefits, case management, well-being providers and repricing services.

Claims Information Systems

A well-functioning claims information system is a critical component of pool operations. Much of the financial analyses conducted for underwriting, actuarial review and risk management depend upon validated claims data and the ability to extract and analyze information.

Many pools have been around long enough to implement a second- or even third-generation claims system. Technology now changes frequently enough that pools are in an almost constant state of evaluation and transition when it comes to claims systems.

A pool might ask three key ongoing questions about its claims system:

- Should we buy a claims system from a vendor? Or should we build claims functionality unique to our needs?
- If we use a TPA for claims, should we also purchase its claims system? Or should we build or buy a stand-alone system?
- How wide is the scope of implementation for our claims system? Is it just for claims administration, or will we also use it for underwriting functions, risk management or other pool operations?

Communications

The claims team advocates for a pool and its members, and claims staff play a key member services role. More and more, pools are looking to claims staff to be excellent communicators in email, on the phone and in person.

Even claims communications that are standardized are carefully reviewed by public entity pools to be sure they are appropriate for their unique member relationships. Pools make an effort to ensure standard communications and form letters don't look too much like insurance documentation, unless the pool itself is a defined insurer.

Underwriting

Underwriting is the process of determining whether a risk is acceptable, identifying the basis of exposure is (such as number of vehicles, payroll amount or property value), and calculating the correct amount of rate to charge for the risk.

In the pooling world, underwriting also includes the process of allocating a pool's expenses and total exposures to each member in a fair and easily understandable method. The outcome is the appropriate contribution (or premium) to be charged as a whole and to each individual entity.

Pools might have robust underwriting systems that maintain thousands of exposures and apply complex rules and calculations to assist underwriters. Some underwriting systems interface with claims systems, risk management systems or other member management tools; some of these same features may be embedded within an underwriting system.

Underwriters are heavy data users who examine claims and trends, exposures and rates; often, the underwriting department will use a data warehouse or data analytics. Although underwriting systems can be complex, many pools maintain exposures, rates and associated underwriting calculations on a spreadsheet or similar tool. Even when the pool has a comprehensive underwriting system, spreadsheets are commonly used to manage one-off member or calculation needs.

Role in Coverages and Reinsurance

Underwriting is often the internal expert for determining appropriate coverage for members and for securing and evaluating reinsurance coverage for the pool. Underwriting, claims and legal departments work together on complex claims and coverage questions. They evaluate emerging coverages such as cyber liability or drones and develop methodologies to develop coverage language, exposures, overall contribution adequacy and specific rates for coverage.

Market Conditions and Member Relationships

Underwriters must be keenly aware of national and local insurance market conditions as well as emerging insurance products and services. In a competitive market environment, the underwriter must collect contributions to meet the needs of the pool but at a price that is competitive with other markets.

Underwriting might also function as a pool's sales and service team, meeting one-on-one with potential members to promote the pool as an option for coverage. They might also navigate member needs or areas of dissatisfaction. Additionally, underwriting may also manage for the pool's distribution methods, such as working with local agents.

Underwriters access and interact with every other pool function: risk management, claims, finance, legal, administration and member services. Underwriters often have strong relationships with reinsurers, pool brokers and state regulators

Typical Underwriting Steps

State regulation may impact some pools' underwriting activities. For instance, pools may have to file underwriting rates for approval by a regulator before the pool can implement rates for members. A pool may also be required to use state-mandated base rates as a starting point for calculations.

The following are typical steps in a pool underwriting process, although each pool may have variations on this process depending on regulations, membership, lines of coverage or other unique factors.

Step 1: Determine the Exposures

Exposures are the major activities or categories that are statistically connected to losses. Underwriters use exposures that have a strong statistical correlation to losses to determine appropriate contribution levels.

Common pool exposures include population, payroll, budget, number of employees, number of students, miles of road or piping, number of vehicles and total value of properties.

Step 2: Determine a Rate for Each Exposure

Rate is the amount charged for each exposure unit. When applied to exposures, the rate needs to provide the necessary funds to pay for claims, reinsurance and pool expenses. A member's baseline contributions are determined by the applicable rates multiplied by that member's specific exposures.

A statistical method sometimes used for rate determination is a regression analysis (R-squared score). Regression analysis is a method to determine the causal relationship between exposures and losses. It is used to validate rates as reasonable for expected losses.

Step 3: Develop an Experience Modification Factor

Many pools use experience modification factors (EMF) in the underwriting process to more specifically allocate total contributions on a per-member basis. The theory of EMF is that members with higher claims experience should pay more than members with low claims. While pools exist to distribute risk among the membership, no member should be asked to carry an unfair burden on behalf of a member with persistent, avoidable risks.

Underwriting might use an EMF to adjust contribution and reflect a member's claims experience. The EMF usually considers the cost of claims (severity) and the number of claims (frequency) by member. Generally, a member with average claims would have an EMF of 1.0. A factor over 1.0 means the member's claims are worse than expected; a factor less than 1.0 means the member's claims are better than expected.

The EMF calculation is usually developed by the underwriter, working in concert with the pool's actuary.

A simple example of how rate, exposure and EMF might be applied for contribution:

Rate	Exposure	Experience Modification Factor	Member Contribution
$15/student	10,000 students	1.15 (below average)	$172,500

Step 4: Member Loss Pick

Underwriting often prepares a loss pick — or estimate of claims for the upcoming year for a member — as another check on contribution needs. Underwriters may apply several statistical techniques to determine the loss pick. Common techniques include reviewing member loss frequency and severity, examining loss ratios by members, and looking at how member losses have developed over time.

An underwriter might also look at changes in a member's operations to determine if historical losses are a good indicator of current risks. Depending on the member's loss pick, an underwriter might further adjust the desired contribution.

Step 5: Apply Deductible or Alternate Plan Credits

Many pools offer varied size deductibles or alternative plans that allow pool members to share in some risk and save contribution dollars. Underwriting evaluates the value of any optional credits and applies them to the premium.

Step 6: Apply Surcharges and Discounts

Underwriting may apply discounts for risk management activities, size or volume discounts, multiline discounts, etc. There may be a surcharge assigned for unusual risks or credits applied to temper a large increase to a member's renewal. It's generally the goal of pools to apply surcharges and discounts based upon stated criteria — and in a manner fair to all members, even when the underwriter has discretion to determine surcharges or discounts.

Step 7: Review for Limits to Pricing Changes

Sometimes pools might apply contribution increase or decrease limits so no member's contribution changes too much in any given year. This is especially common when the pool is in a position of needing a significant overall increase to contribution that will be applied to all members, but it wants to smooth the increase applicable to specific members over several years.

Use of Investment Income

In some cases, particularly within the workers' compensation line of coverage, investment income can be used as an offsetting factor to a pool's overall need for member contributions. To the extent investment income is used to offset contributions otherwise needed from members, member contributions alone may be insufficient to cover all losses.

Use of investment income to buffer contributions presents an important factor in pool underwriting. The pool must always know and understand the impact of any major contribution offsets, such as investment income, and must adequately appreciate the "real" contributions needed to support losses and operations.

Health Pool Underwriting

Health pool underwriting is generally heavily regulated by state and federal agencies to ensure health rates are not discriminatory and are applied fairly to large and small employers. A number of added or different steps may be present in a health pool's underwriting process, although the basic process of ensuring contributions is adequate to cover losses — and fairly allocated among members — remains the same.

Reinsurance

Reinsurance and excess insurance protect a pool from unforeseen or extraordinary losses that might otherwise undermine its financial solvency. Reinsurance is an important financial and risk management consideration for all pools, and it is typically purchased to achieve one or more of the following goals:

- **Provide catastrophe protection** for single, very large events or for multiple events that could otherwise have a devastating impact to a pool's financial solvency.
- **Smooth contribution needed from members.** Because reinsurance helps a pool cap the upper layer of volatility from larger claims that might occur, or protects from spikes in claims frequency, reinsurance allows the pool to stabilize member contributions over time. The pool is protected from making large contribution increases to cover claims that, without reinsurance, would impact its operations.
- **Offer greater coverage or limits to members** than a pool could alone, by bringing greater total financial resources to the table.
- **Test new coverages** by taking on some of the cost of newer risk areas, while a pool examines coverage language and assesses the totality of risk within its membership.
- **Support a pool's operations** with expertise in unique underwriting matters, difficult claims management and related operations.

You'll want to understand why your pool structures reinsurance in the manner it does. Reinsurance is a key protection for pools, so the structural rationale matters in how your pool protects its members.

Differences in Reinsurance and Excess Insurance

The difference between reinsurance and excess insurance comes down to who writes the insurance policy. The lines between these two are often blurred, and both are commonly referred to as "reinsurance." Although knowing the difference between excess and reinsurance coverage can be an important nuance, it might not be important for a pooling newcomer.

Reinsurance

Reinsurance follows the form of the coverage document in place between a pool and its member. The pool writes its own coverages on behalf of members, and the reinsurer agrees to cover the pool for losses above a certain level, using the pool's own coverage document as the underlying basis for adjusting and paying a loss.

In other words, if a claim is covered by the pool on behalf of its member, it will be covered by the reinsurer for the pool. Typically, control of the claim remains with the pool, and the reinsurer follows the fortunes of the pool in terms of how the claim is resolved.

Excess

Excess insurance uses the excess insurer's policy to govern how the loss is paid. In an excess relationship, the pool's underlying coverage document does not play a role in triggering coverage as it does for reinsurance. In fact, the only thing that matters is that the pool's coverage trigger and retention with the excess carrier has been met.

Reinsurance Markets

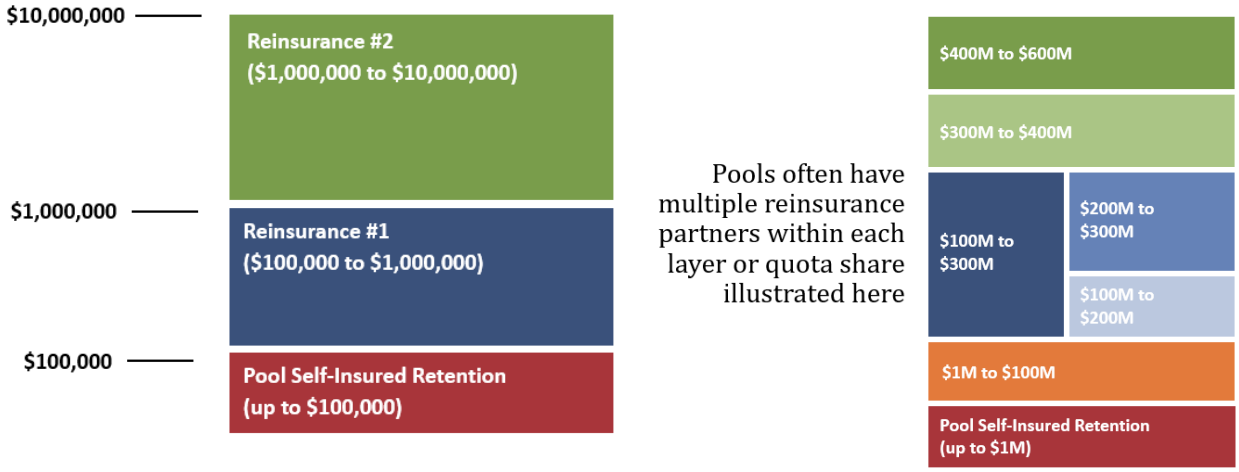
Reinsurance and excess markets are subject to the same sort of hard and soft market cycles as the underlying primary insurance market, although the factors at play and cycle lengths may be different.

At times, reinsurance coverage may be relatively cheap and easy for pools to acquire. In other circumstances — especially after a devastating series of claims — reinsurance options can be very limited and expensive.

Reinsurers and excess carriers vary in how they market, respond to solicitations and distribute coverage. Many pools use a reinsurance broker to solicit competitive quotes and evaluate coverage options on a regular basis.

Reinsurance Structures

Like any other key decision, the reinsurance structure used in one pool may look significantly different than in another. Based upon coverage and financial needs, some pools may have a pretty simple reinsurance coverage structure. Other pools have very complicated reinsurance structures in place with a variety of partners.



Above and to the left is a sample of a simple reinsurance structure. At its right is a complicated property reinsurance program with multiple reinsurance companies covering the pool. Some reinsurance companies provide insurance at different limits within the complicated example.

The point, however, is clear: Reinsurance varies based upon the unique and particular needs of each pool and is crafted to meet those needs.

Deductible and Retention

Deductible and self-insured retention (SIR) are terms used between pools and their members — as well as between pools and their reinsurers. Although the concept is similar in both relationships, the focus here is the relationship between the pool and its reinsurer.

A deductible or SIR is the amount of risk the pool retains — or pays out for a member loss — before any remaining loss costs are passed to the pool's reinsurance partner.

Generally speaking, the higher the deductible or SIR, the lower the reinsurance premium charged to the pool. There's usually a sweet spot for pools to consider, where the time value of money invested is worth taking on more short-term risk with a higher deductible or SIR. On the other hand, buying reinsurance at the lowest possible level — especially when the market is soft — can be very valuable to a pool.

It won't be surprising that — as with most things related to pools — deductibles and SIRs can vary depending upon the pool's needs. Deductibles and SIRs can be set up to be "per occurrence," which means the deductible and coverage applies to one event, no matter how many individuals are injured or the degree of member property damaged. Deductibles and SIRs can also be applied per claim (applies to each claimant individually) or applied with an annual aggregate (applies to all claims that occur during a policy year).

Pro Rata and Excess of Loss

Another important consideration is whether reinsurance arrangements are pro rata or excess of loss. These are methods for further sharing risk between a pool and its reinsurers.

In a pro rata arrangement, the pool and its reinsurer share losses in the reinsurance layer. As an example, consider a reinsurance contract in which the pool holds the first $1 million of risk (its deductible or SIR amount) and the reinsurer agrees to pay 80 percent of the losses that take place between $1 million and $10 million. In this pro rata arrangement, the maximum exposure the pool faces — or the total possible losses it could experience — is $2.8 million. This includes $1 million of the retained risk, then 20 percent of the remaining $9 million. One benefit of this structure is that the pool and reinsurer share risk and reward.

In excess of loss arrangements, the reinsurer covers all amounts above the pool's retained level. Say a pool purchases a reinsurance contract for all claim losses above its SIR of $1 million. In the event of a $4.5 million claim, the pool will retain the first $1 million of loss and the reinsurer will cover the next $3.5 million. A benefit of excess of loss coverage is that it relieves a pool of all claims above its retention.

Treaty and Facultative

Treaty and facultative are two terms often used with reinsurance.

Treaty is another word for the agreement between a pool and its reinsurer. Exposures are transferred in accordance with the reinsurance treaty or agreement.

Facultative reinsurance occurs when individual exposures within the pool are specifically and uniquely reinsured. A pool may have a large or unusual exposure within its membership that it would like to avoid — for example, a large dam or utility operation. A facultative reinsurance agreement is one way to pass this risk to a reinsurer under contract.

Reinsurance Pools

There are a number of reinsurance and excess insurance pools. Reinsurance pools offer reinsurance to pools and/or to individual large self-insured public entities and provide similar advantages such as unique coverages, competitive costs and helpful services.

Financial Oversight

Balance sheets and income statements are foundational documents for all public entity pools, and financial oversight includes these typical tools in addition to important financial concepts related to claims and capital management.

Understanding actuarial projections and rate-setting methods is crucial to effectively managing a pool's long-term financial health. And, because a public entity pool operates within the realm of its public entity members, it also may be subject to required or voluntary additional scrutiny.

Financial oversight within a public entity pool is the responsibility of upper-level management, whether in-house or contracted, and the pool's governing body. Some pools may be regulated in terms of financial oversight and expectations — although the vast majority of pools are self- governing.

A pool's assets are equal to the combined value of its liabilities plus the value of its member equity, which may also be called "surplus." If a pool were to dissolve, any assets that remain would be distributed according to the member agreement or similar documentation.

Capital Adequacy

Perhaps the most complex and important question any pool can ask is: Are we funded adequately to meet promises we've made to our members?

Capital adequacy is not a singular definition, and the question doesn't go away just because a pool has answered it once. Measuring adequacy of a pool's capital is dynamic and ongoing.

Capital adequacy means a pool has enough funding to pay all claim and operational liabilities. Because ultimate claim liabilities are hard to project long into the future, pools hold significant reserve funding and may also hold significant amounts of member equity or surplus as additional assurance that all financial obligations can be adequately met in any circumstance.

Member equity also helps a pool navigate unexpected changes or challenges — new coverage mandates, changes in reinsurance availability or costs, membership changes and other factors.

There is no singular measure or metric to determine the adequacy of a pool's overall funding. Although baseline financial ratios exist for the insurance industry, they're only a starting point for most pools. Other factors, like confidence level funding and discounting practices, can also significantly impact a pool's overall financial picture.

It's important that pool management and the governing body have regular, informed discussions about capital adequacy. Some questions to consider:

- How does our pool measure its capital adequacy?
- What is the purpose for which we hold member equity or surplus?
- What is the minimum member equity we want to hold for financial solvency purposes and to make good on our member promises?
- What is the maximum member equity we want to hold?
- How will we measure our financial solvency and adequacy over time, and how will we evaluate our minimum and maximum goals?
- How does our funding level compare to other pools, and what are the reasons for any differences?

Release of Capital

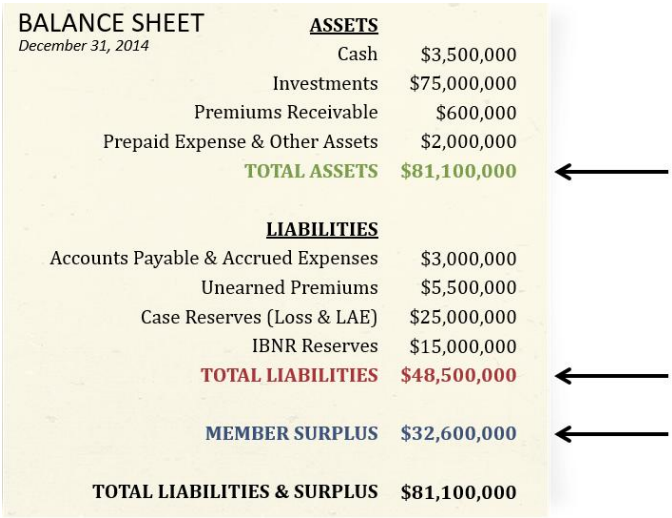
Once a pool has determined its measures of solvency and adequacy, a logical next question might be whether to return member equity to participating public entities.

Pools release capital in different ways — and some not at all. Refunds (or dividends) and contribution offsets are common among those pools that have achieved maximum capital adequacy goals and decide to release capital.

Investments

Many pools have significant financial resources that are invested to produce additional income. Investment regulations and practices vary widely by the lines of coverage a pool offers, its structure and state rules.

Understanding your pool's specific investment goals and associated regulations is important. It's also critical to understand how significant under- or over-performance of invested assets would impact your pool's overall financial solvency and capital adequacy goals.



BALANCE SHEET *December 31, 2014*		
	ASSETS	
	Cash	$3,500,000
	Investments	$75,000,000
	Premiums Receivable	$600,000
	Prepaid Expense & Other Assets	$2,000,000
	TOTAL ASSETS	**$81,100,000**
	LIABILITIES	
	Accounts Payable & Accrued Expenses	$3,000,000
	Unearned Premiums	$5,500,000
	Case Reserves (Loss & LAE)	$25,000,000
	IBNR Reserves	$15,000,000
	TOTAL LIABILITIES	**$48,500,000**
	MEMBER SURPLUS	**$32,600,000**
	TOTAL LIABILITIES & SURPLUS	**$81,100,000**

Balance Sheet

The balance sheet is a snapshot of a pool's financial position at a particular moment in time. It clearly reports what the pool owns and what it owes — its assets and liabilities.

A pool's balance sheet is different from that of a typical business because it includes information about the pool's investments and reserves. These items are unique to pools and insurance companies, which retain substantial capital to ensure the ability to pay future claim obligations. These reserves are held in an investment portfolio for many years and are tracked separately on the pool's income statement.

Income Statement

An income statement illustrates the revenues from pooling operations, expenses of operating the pool, and the resulting net income (or loss) of the pool over a specific period of time. A pool's income statement might also be called a "Statement of Operations and Changes in Member Surplus."

Revenue in a pool consists primarily of premiums or contributions, along with investment income. Primary operating expenses for any pool are claims and loss adjustment expense (LAE), which include case and incurred but not reported (IBNR) reserves. Income statements may be generated quarterly or annually to monitor financial performance.

Actuarial Review

Actuaries provide important analysis on the financial viability of a pool. Actuaries use mathematics, statistics, economics and fiscal sciences to calculate — as closely as possible — the estimated cost of all claims or losses for all years into the future.

Pools use actuaries to help establish annual funding requirements (or contributions) that pool members will be required to pay. To determine contributions, the actuary must examine historical losses and also consider any changes taking place, such as changes in coverages, regulatory shifts, the litigation environment, benefits levels and additional costs such as administrative expenses and reinsurance premiums.

Loss Projection Analysis

Loss projection analysis is the primary method by which a pool determines baseline contributions needed for the upcoming coverage year. Loss projection analysis is a forward-looking examination of likely loss costs.

To determine the loss projection analysis, the actuary will review historical losses and exposures from previous periods. The actuary will estimate the ultimate losses for each of the previous periods, using several different methods. The most common methods used are the incurred and paid-loss development methods.

The actuary also will take into account any anticipated changes that may impact the number or cost of claims going forward.

Reserve Analysis

An actuarial reserve analysis estimates a pool's outstanding liabilities from past written coverage. Reserve analysis is a look back to see what has happened and an evaluation of what further claim development is likely.

This is critical because claim costs from any given year change over time, even though contributions from that same year do not change. Contributions for a year are established long before a pool knows the costs for paying out claims for that same period.

Each kind of claim has a different payout period and norm. Property claims generally have a shorter timeline for payout than workers' compensation claims. For instance, if a pool member has a building loss, the building is likely to be rebuilt in a matter of years. But, if that same pool has a workers' compensation claim filed by an employee in their 20s, that claim could be paid out over the decades of that employee's remaining life.

These outstanding liabilities are evaluated in two ways: through case reserves and INBR.

Case Reserves

Case reserves include amounts estimated by a claims adjuster, lawyer or other insurance professional. They are shown on the loss run and represent the amount of money estimated to be needed for future payments for a particular claim.

Incurred But Not Reported (IBNR)
Incurred but not reported reserves (IBNR) are made up of two parts. Pure IBNR reserves are the estimated amounts needed for claims that have happened but have not yet been reported to the pool. Development IBNR reserves are estimated amounts needed to settle known claims. This may be additional cushion above the case reserve.

Confidence Level

One important concept of actuarial analysis is the confidence level at which projections are stated. Standard (or best estimate) confidence level for all actuarial work is 55 percent. In simple terms, this means that if a pool funds to the actuarial projections, it will be funded sufficiently for losses 55 percent of the time.

Some pools choose to plan conservatively when it comes to setting contributions, so they may fund at a level in excess of best-estimated losses.

Confidence level conversations come into play in several ways within a pool. On a forward-looking basis, a pool may set contribution rates for the future on the basis of a confidence level projection (usually 55 percent or greater). On a retrospective basis, a pool might have conversations about solvency measures based upon the confidence level of ultimate claim projections for all coverage years.

Discounting

Discounting is a consideration in a number of pool financial functions, including setting reserves, evaluating actuarial estimates and managing investments.

Discounting is the practice of anticipating future income from invested assets. A pool may discount claim reserves in anticipation of investment income from the portion of reserves that are not being paid out immediately. Discounting is most notable in workers' compensation, where a pool might set very high claim reserves, many of which will pay out over decades. It's reasonable to expect some return on investment of reserve assets over the life of long-term claims.

Independent Financial Audit

A pool's financial reporting process is evaluated by independent verification from a certified public accountant that the pool's financial statements are free from material misstatements. The independent financial audit is an important check to ensure no financial misstatements are present, regardless of whether caused by mistakes or fraud.

An independent financial audit provides reasonable assurance for the pool governing body and pool members to rely on the financial results presented. The exact nature of an independent audit might vary based upon the type of organizational structure of a pool and the accounting standards to which it is accountable.

In the past decade, auditing standards have expanded due to the ever-changing financial landscape. Standards have become more robust and complex.

Other Audits

In addition to independent financial audits, pools might also engage outside audit review into claims processes, underwriting, technology systems and more. The focus of other audits like these is more operational than financial.

In addition, pool reinsurers or excess carriers also often perform audits of pool operations that might have impact on the reinsurance relationship or claims.

Risk Management

When a pool assumes risk, it's for good purpose: to allow and support public entities providing important public services. Law enforcement, waste management, building maintenance and other core public entity activities all include inherent risks that pools help manage.

If the risks are too significant or not fully managed, the public entity purpose can be thwarted. A city cannot meet its public safety objectives if police officers are injured. A sewer district cannot meet its objectives if the treatment plant is not operational. Schools cannot meet educational objectives without creating a safe learning environment for students. Pools are in a great position to assist members managing their risks.

Risk management protects and adds value to both the pool and members by identifying key loss areas, then developing strategies to mitigate and prevent losses. Risk management allows a pool and members to partner toward a common goal: preventing unnecessary loss expense and protecting the safety of public entity workers, property and events. In addition, risk management allows a pool the additional opportunity to be seen as a service partner to its members.

Protects the Pool and Members

Pool risk management efforts protect the pool and members by reducing the number and overall cost of losses (claims). Every pool has a unique mixture of risk management priorities and programs, depending on the coverage the pool offers, its membership and the availability of other risk resources. Every pool must determine for itself what kind of risk management or loss control programs are appropriate for its membership.

Many pools offer incentives or discounts for members to actively manage risk, such as providing a discount if the member adopts state policing standards, safety or equipment grants, or other financial incentives to encourage robust safety and risk management cultures within the pool membership.

There are two baseline realities when it comes to risk management efforts:

- Generally speaking, the cost of implementing a risk management effort is far less than the cost of one large claim that could have been prevented by better risk management.
- Efforts to manage the "return on investment" for risk management initiatives are limited by trying to measure the cost of a loss that never happened. If a risk management initiative is fully successful, there should never be a claim.

It's also true that public entities have limited resources and have to focus risk management and safety efforts on where they will be most meaningful. Pools can have a big influence on a public entity's risk management priorities.

Measuring the efficacy of risk management efforts is difficult, but some pools are beginning to use data analytics to examine and improve their risk management efforts and programs. Pools are mining data to pinpoint causes of loss and offer risk management recommendations. There is increasing use of pilot projects with statistically valid control groups to evaluate the long-term success of risk management incentives.

Risk Management Examples

One example of a common risk management service provided by pools is fleet safety. Fleet safety programs might include a fleet safety policy, safe driving courses and even driving simulators. Fewer auto or transportation claims help a member achieve its transportation objectives. And fewer or less severe claims also means the ultimate cost of fleet accidents should be less to the pool and to the members.

Support for implementation of OSHA safety policies and practices are also a common risk management service provided by pools. Safe behavior standards might be provided along with guidance on member entity safety committees, ergonomic evaluations, job hazards analysis and safety education.

Guidance in health risk management — well-being and whole-body health through exercise and nutrition — is commonly provided by health pools to their members.

Sometimes pools take on risk management initiatives that may not have a directly quantifiable impact on losses, but which are reasonably understood to have a causal relationship in the number or cost of claims for member entities. Examples might include elected official training, compliance services for state safety regulations, and free "pre-loss" legal services for members to help reduce employment, land use and other legal claims.

Similarly, some pools offer sample contract manuals and contract review services to help members achieve contracting objectives. Contract review commonly includes construction and mutual aid agreements, and it may go beyond a basic review of indemnification or insurance coverage requirements.

Finally, cyber risk is an emerging area in which pools add value with cybersecurity recommendations and even penetration testing and analytics.

Pools often provide best practice guidelines, templates or model policies to members. Pool risk management and loss control staff might meet regularly with members to monitor how the member is achieving the best practice recommendations from the pool. Common best practice topics include:

- Safety/OSHA/ergonomics
- Wellness programs
- Student discipline policies
- Anti-bullying programs
- Fleet and transportation management
- Claims management practices
- Structural safety (building, grounds, parks, dams, etc.)
- Public officials training and policies
- Use of force training and policies
- Procurement and contracting procedures
- Computer security, cyber protocols
- Public information and disclosures
- Emergency/crisis planning and response
- Continuity of operations
- Contracts
- Special events management
- Distracted driving prevention
- Employment practice (hiring, termination, employee handbooks, sexual harassment prevention, etc.)
- Infrastructure maintenance (roads, bridges, water, sewers, etc.)
- Financial controls and processes

Member Services

Whether it's called out as a distinct role or not, member services is a key pooling function.

Pools operate in a unique space of expertise, bringing together public entity operational knowledge, risk and coverage specialization. Facilitating conversation with pool members about their needs, emerging issues and operational shifts is absolutely critical for a pool to effectively meet member expectations.

Through a member-focused service mentality, pools listen to what is or isn't working well within local government and school operations. Pools pay attention to what member public entities say they need and work diligently to help identify and implement solutions.

Pool services in all areas often go above and beyond typical coverage and risk management provided by other organizations. This is because pools operate as extensions of the public entity members they serve. A pool's primary goal is simply addressing identified needs for local public entities.

Member Service Examples

As is the case in many areas of public entity pool operations, the member services function might vary widely from one pool to the next. Some of the services and activities typically identified as member services include:

- **Offering orientations and formalized onboarding for new members to the pool.**
- **Conducting regular visits to pool members** to determine whether members know about all available pool coverage and services and to address any questions. During these visits, member services might also assist the underwriting or risk management functions of a pool by conducting site inspections or completing documentation about member facilities.
- **Conducting training.** In some cases, this might be closely affiliated with pool risk management activities. In other cases, the training might be less directly connected to defined risks. One common example is governance training for newly elected public officials.
- **Representing the pool** at conferences, association events and related groups where pool members might be gathered.
- **Leading structured communication efforts** to keep members informed and engaged. This might include a website, a member portal, electronic publications, social media and more.
- **Interacting with local insurance agents**, if a pool or its members use agents.
- **Helping to attract or recruit new public entity members to the pool.**

Technology and Communications

Like any organization, pools have internal operational functions that support day-to-day business activities. There are financial teams, human resources management, technology infrastructure and operational support, and communication activities that are an important part of every public entity pool.

As technology advances become more prominent and fast-paced, and as communication preferences shift amid generational turnover, related considerations for pools have risen to be primary management concerns.

Technology Considerations

Pools must implement, operate and manage complex technologies that perform underwriting and claims functions, manage member services, house robust data sources and produce timely information for members.

Public entity pools today are often involved in multiple system implementations and upgrades at any given point in time. Many pools are reconsidering technology investment strategies — asking how technology can be put to the highest and best use on behalf of members, achieve new efficiencies and be successfully managed through more frequent system changes and upgrades.

Some pools see technology innovation as an opportunity to provide enhanced member services. Pools might introduce mobile apps that support local government or school operations — things like anonymous reporting of school bullying incidents or reporting of potholes to a city or county public works department.

Because the technology environment has become so complex, and because technology systems are critical to successful pool operations, many pools today are placing higher priority on their technology focus and initiatives.

Communication Considerations

Communication with members must be robust and transparent, with information sources that are ready upon demand. Often, there are crossover issues between a pool's communication and technology strategies to address member expectations for self-service, on-demand training or information resources, or ease of transactional needs like underwriting applications and claim filing.

Communication needs and preferences are also heavily influenced by demographic shifts. As younger generations enter the public entity workforce, pools must engage effectively with members who have changing communication preferences.

Similar to the increased efforts pools are putting forward in technology, many pools are implementing strategies to refresh communications and member outreach. Social media strategies, member portals and personalized information sharing are seen as key enhancements for the future of public entity pool communication.

Additional Resources

AGRiP provides a variety of resources to its members focusing on everything from best practices to preparing for the future of public entity pooling. Visit our website for more information.

Pooling Information

- Operations Manual for Public Entity Pools
- PR Toolkit

Advisory Standards for Recognition

- Overview of Standards
- Advisory Standards
- Recognition Application

Specialized Resource Collections

- Operational Efficiency Resources
- Conscious Culture Resources
- Digital Transformation Resources
- Succession Planning Resources
- Inclusion Resources
- Generational Foresight Resources
- Strategic Foresight Resources

Select *Intelligence* Publications (view all)

- Teach People to Make Decisions
- Make Room for Your Pool's Most Important Work
- Five Myths and Truths About AI in Pooling
- Managing Use of AI by Service Providers
- Eight Digital Proficiencies Your Pool Must Master
- How to Transfer Pooling Knowledge
- Build a Better Post-COVID Pool Workspace
- Strategic Planning for Pools
- Strategies for Leading Remote Teams
- Pools Responding to COVID-19: Three Case Studies in Crisis Management
- PTSD Presumption: A Known Unknown for Pools
- Elevating Pool Governance Through Inclusivity
- Sexual Abuse and Molestation Claims in the Public Sector

Select Webinars (view all)

- (Re)setting the Table for Generative Thinking
- Challenging the Notion of "Efficient" Meetings
- Demystifying Generative Governance
- Executive Succession Planning Tips for Pool Governing Bodies
- The Role of Strategic Foresight in Governance
- Conversations Every Pool Board Should Have
- Elevating Pool Governance Through Inclusivity

Select Pooling Perspectives (view all)

- The Importance of Digital Decentralization for Pools
- What Pool Directors Say About Transferring Their Knowledge
- Key Insights From Our Succession Readiness Assessment
- Methods to Improve Your Meetings
- Prepare Now for Hybrid Meetings
- The (Pool) Business Case for Automation
- How Public Entity Pools Are Beginning to Address Health Inequities
- Consider Your Pool's Role in Influencing Member Entity Outcomes
- Responding to Two Common Pooling Misconceptions
- Using the Overton Window to Anticipate Change