

# **STATE RISK MANAGER'S REPORT**

## **REVIEW OF REGULATORY COMPLIANCE OF ASSOCIATION OF WASHINGTON CITIES RISK MANAGEMENT SERVICE AGENCY**

*As of December 31, 2013  
Issued August 15, 2014*

### **Results:**

Based on audited financial information and documents provided by the pool, Association of Washington Cities Risk Management Service Agency meets standards adopted by the State Risk Manager in the areas reviewed.

### **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 Requirement to Obtain an Independent Claims Audit
6. Requirements for Changes to Interlocal Agreement or Bylaws
7. Compliance with Nondiscriminatory Rate Requirements
8. Compliance with Requirements for Contracts with Independent Consultants
9. Compliance with Membership Requirements
10. 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.

**Results:** A review of the actuarial report of Price Waterhouse Coopers indicates that an actuary meeting the qualifications set forth above estimated the Pool’s liability for outstanding claims at the expected and the 70% confidence level. The Association of Washington Cities Risk Management Service Agency has met this requirement.

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:** Association of Washington Cities Risk Management Service Agency met this requirement by maintaining sufficient primary assets to fund claims liabilities at the expected level as determined by the Pool’s actuary (see Primary Asset Test, page 3).

**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:** Association of Washington Cities Risk Management Service Agency met this requirement by funding claims liabilities in excess of the 70% confidence level required as determined by the Pool's actuary. The secondary assets consist of additional cash reserves, investments and other assets (property and equipment are excluded from this calculation). Also excluded were non-claim liabilities, including prepaid contributions (see Secondary Asset Test, page 3).

	<b>Test 1 - Primary Asset Test</b>		<b>Test 2 - Secondary Asset Test</b>
	(WAC 200-100-03001(2))		(WAC 200-100-03001(3))
\$10,681,806	Primary Assets	\$15,480,084	Secondary Assets
\$6,334,000	Estimated Claim Liabilities at the expected level per actuarial estimate	\$7,499,000	Estimated Claim Liabilities at the 70% confidence level per actuarial estimate
<b>RESULT:</b>	<b>PASS</b>	<b>RESULT:</b>	<b>PASS</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 70% confidence level must be less than combined primary assets and secondary assets (receivables, recoverables, real estate and other assets )</i>

(Note 1) The outstanding liabilities are estimated by an independent actuary meeting the requirements of WAC 200-100-020(1). Actuarial reports submitted as part of the annual report to the State Risk Manager are available by contacting LuAnn Hopkins, Chief Operating Officer, at the Association of Washington Cities at (360)-753-4137. Contact information is also available by visiting the Pool's website at <http://www.awcnet.org/Home.aspx>

(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 expected 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.

**Results: Association of Washington Cities Risk Management Service Agency meets this requirement by reporting the estimate of the total liability for unpaid claims in 2013 audited financial reports as \$6,334,000. This amount is supported by the written report of the Pool's independent actuary and includes the unallocated loss adjustment expenses for the Pool as required.**

### 4. Compliance with Reporting Requirements

**Requirement: The pool is required by WAC 200-100-60 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 both audited and unaudited financial statements within the time required. The Pool is not required to report quarterly. Association of Washington Cities Risk Management Service Agency received an unqualified opinion on its audited financial statements for FY 2013 from the State Auditor.**

## 5. Compliance with Requirement to Obtain an Independent Claims Audit

**Requirement: The pool is required by WAC 200-100-050 to obtain an audit of claims administration conducted by an independent, qualified auditor every three years at a minimum.**

**WAC 200-100-050** requires that “. . . ((7) All joint self-insurance programs shall obtain an independent review of claim reserving, adjusting and payment procedures every three years at a minimum. Said audit shall be conducted by an independent qualified claims auditor not affiliated with the program, its insurers, its broker of record, or its third-party administrator. Such review shall be in writing and identify strengths, areas of improvement, findings, conclusions and recommendations. Such review shall be provided to the governing body and retained for a period not less than six years. The scope of the claims audit shall include claims administration procedures listed in subsection (1) of this section(1) All joint self-insurance programs shall adopt a written claims administration program which includes, as a minimum, the following procedures:

- (a) Claims filing procedures and forms.
- (b) Standards requiring case reserves for each claim be established in the amount of the jury verdict value.
- (c) Standards requiring case reserves be reviewed every ninety days or when reasonably practicable and such review is documented in the claims diary.
- (d) Standards requiring appropriate adjuster work loads.
- (e) Standards requiring claims payment procedures include sufficient internal controls to ensure adequate review and approval by claims management staff.
- (f) Standards requiring file documentation be complete and up-to-date.
- (g) Standards requiring timely and appropriate claim resolution practices.
- (h) Standards requiring opportunities for recoveries be reviewed and documented for each claim.
- (i) Standards requiring compliance with Internal Revenue Service (IRS) rules for 1099MISC regulations.
- (j) Standards requiring claims files be audited on the following categories: Staffing, caseloads,

supervision, diary, coverage, reserves, promptness of contacts, field investigations, file documentation, settlements, litigation management and subrogation.

**WAC 200-100-020 (7)** defines "Claims auditor" as a person who has the following qualifications:

- (a) A minimum of five years in claims management and investigative experience;
- (b) A minimum of three years of experience in auditing the same manner of claims filed against the program being audited;
- (c) Proof of professional liability insurance; and
- (d) Provides a statement that the auditor is independent from the program being audited, its vendors, insurers, brokers, and third-party administrators.

**Results:** The Pool met this requirement by obtaining an independent claims audit by a claims auditor meeting the established qualifications. The report, and its recommendations, are presented to, and discussed by, the Board of Directors.

## 6. Requirements for Changes to Interlocal Agreement or Bylaws

**Requirement:** Risk pools are required to notify members in advance of a vote to make changes to the interlocal agreement or bylaws of the program.

**WAC 200-100-02019 requires that** "Every joint self-insurance program shall provide notification of the intent to change the bylaws or foundation agreement to each member of the joint self-insurance program and the state risk manager by regular or electronic mail at least thirty days in advance of the meeting during which a vote on the proposed change will occur. Such notification shall include a copy of proposed changes."

**Results:** A review of meeting minutes and documents indicates that no changes to the bylaws or foundation agreement were made during fiscal year 2013.

## 7. Compliance with Nondiscriminatory Rate Requirements

**Requirement:** The pool must charge rates that are consistently applied and do not discriminate among the members.

**WAC 200-100-033** requires that "(1) Joint self-insurance program assessment formulas shall include all costs including rating for insured and self-insured layers of coverage. Assessment formulas shall be consistent and nondiscriminatory among all members.

(2) This provision shall not be construed to prohibit individual choice of coverage by members from several offered by the joint self-insurance program. The assessment formula, including the insured and self-insured components, shall be consistently applied to reflect the selection from among these choices.

(3) The assessment formula shall be available for review by the state risk manager."

**Results:** The Pool met this requirement by obtaining an actuarial study to determine annual assessment rates. The rates are based on criteria which include size, worker hours and other risk criteria. The actuarial rating report and assessment information

were available for review. The rating formula is approved by the Board of Directors.

## 8. Compliance with Requirements for Contracts with Independent Consultants

**Background:** RCW 48.62.061(3) requires that the state risk manager adopt rules which include standards for contracts between self-insurance programs and private businesses, including standards for contracts between self-insurance programs and brokers, actuaries, claims auditors, and third-party administrators.

**Requirement:** WAC 200-110-060 requires that pools use a formal and competitive process in selecting independent consultants to provide actuarial, brokerage, third party administrator and claims auditing services.

WAC 200-100-60 requires that “. . . Every joint self-insurance program shall use a formal competitive solicitation process in the selection of consultants. The process shall provide an equal and open opportunity to qualified parties and shall culminate in a selection based on pre-established criteria which may include such factors as the consultant's fees or costs, ability, capacity, experience, reputation, responsiveness to time limitations, responsiveness to solicitation requirements, quality of previous performance, and compliance with statutes and rules relating to contracts. Bid responses, solicitation documents and evidence of publication shall be retained in accordance with laws governing public records and shall be available for review by state risk manager and state auditor.

WAC 200-100-020(9) defines "Competitive solicitation" as a documented formal process requiring sealed bids, providing an equal and open opportunity to qualified parties and culminating in a selection based on criteria which may include such factors as the consultant's fees or costs, ability, capacity, experience, reputation, responsiveness to time limitations, responsiveness to solicitation requirements, quality of previous performance, and compliance with statutes and rules relating to contracts or services.

WAC 200-100-020(10) defines "Consultant" as an independent individual or firm contracting with a joint self-insurance program to perform actuarial, claims auditing or third-party administration services, represent the program as broker of record, or render an opinion or recommendation according to the consultant's methods, all without being subject to the control of the program, except as to satisfaction of the contracted deliverables.

WAC 200-100-020(27) defines "Third-party administrator" as an independent association, agency, entity or enterprise which, through a contractual agreement, provides one or more of the following ongoing services: Pool management or administration services, claims administration services, risk management services, or services for the design, implementation, or termination of an individual or joint self-insurance program.

**Results:** The Pool did not issue a solicitation for insurance brokers, claims auditors or actuaries during fiscal year 2013. The Pool does not contract with a private business for third party administrator services.

## 9. Compliance with Membership Requirements

**Requirement:** Participants in the Pool's insurance program must sign the interlocal agreement and must also be responsible for the contingent liabilities of the program 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. Our review of the membership list and interlocal agreements indicates that participation in the Pool's excess and self-insured retention layer is limited only to those members signing the Pool's interlocal agreement. The interlocal agreement requires that members are responsible for contingent liabilities of the program if assets are insufficient.

## 10. 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 was taken directly from the audited financial statements of FY 2013. Upon review, no adverse financial trends were noted (See Attachments A & B, page 11 & 12).

**Attachment A - Trends in Assets, Liabilities and Membership**

<b>Fiscal Year End</b>	<b>12/31/2013</b>	<b>12/31/2012</b>	<b>12/31/2011</b>	<b>12/31/2010</b>	<b>12/31/2009</b>
<b>Assets:</b>					
Cash/Cash Equivalents	\$12,103,503	\$12,034,367	\$10,164,338	\$9,336,548	\$8,760,677
Receivable from Reinsurer	\$992,280		\$16,312	\$61,560	\$19,424
Member Deductibles	\$33,228	\$26,516	\$40,550	\$42,733	\$14,644
Prepaid Expense	\$1,173,970	\$500,985	\$501,222	\$563,999	\$549,392
Equipment,Net of Acc Depreciation				\$0	\$0
Contract Receivable	\$40,000	\$42,500	\$45,000	\$47,500	\$0
Dividends Receivable from Reinsurer				\$0	\$2,335
Reinsurance Deposit	\$239,149	\$239,149	\$239,149	\$239,149	\$239,149
Equity in NLC MIC	\$2,319,651	\$2,190,860	\$2,094,930	\$1,994,419	\$1,885,724
<b>TOTAL ASSETS:</b>	<b>\$16,901,781</b>	<b>\$15,034,377</b>	<b>\$13,101,501</b>	<b>\$12,285,908</b>	<b>\$11,471,345</b>
<b>Liabilities:</b>					
IBNR-Current	\$4,055,224	\$4,476,940	\$5,158,830	\$5,091,781	\$4,417,358
Unpaid Claims-Current	\$2,040,049	\$2,346,379	\$1,723,524	\$2,778,759	\$3,059,683
Reserve for ULAE	\$235,000	\$285,000	\$290,000	\$300,000	\$300,000
Accts Payable	\$211,637	\$125,943	\$125,022	\$242,125	\$122,043
Unearned Member Assessments		\$58,144	\$62,657		
Payable-Forks Claim	\$1,210,060				
<b>TOTAL LIABILITIES:</b>	<b>\$7,751,970</b>	<b>\$7,292,406</b>	<b>\$7,360,033</b>	<b>\$8,412,665</b>	<b>\$7,899,084</b>
<b>TOTAL NET ASSETS/EQUITY</b>	<b>\$9,149,811</b>	<b>\$7,741,971</b>	<b>\$5,741,468</b>	<b>\$3,873,243</b>	<b>\$3,572,261</b>
Members	92	90	87	86	86

**Attachment B - Trends in Revenues and Expenses**

<b>Fiscal Year End</b>	<b>12/31/2013</b>	<b>12/31/2012</b>	<b>12/31/2011</b>	<b>12/31/2010</b>	<b>12/31/2009</b>
<b>Revenues</b>					
Member Assessments	\$6,632,447	\$7,200,477	\$7,239,580	\$6,634,509	\$5,912,860
Other Income	\$63,712	\$44,914	\$61,297	\$39,407	\$44,334
Interest Income	\$21,738	\$23,915	\$19,292	\$18,659	\$69,874
Increase/<Decrease> in Equity in NLC MIC	\$128,791	\$95,930	\$100,511	\$106,361	\$206,685
<b>Total Revenues</b>	<b>\$6,846,688</b>	<b>\$7,365,236</b>	<b>\$7,420,680</b>	<b>\$6,798,936</b>	<b>\$6,233,753</b>
<b>Expenses</b>					
Claims Loss Expense -- Current Year	\$2,425,000	\$2,640,000	\$2,685,000	\$2,740,000	\$2,879,000
Change in Claims Loss Expense -- Prior Years	(\$640,165)	(\$1,127,595)	(\$1,062,140)	\$59,945	\$493,158
Change in Unallocated Loss Adjustment Expenses	(\$50,000)	(\$5,000)	(\$10,000)	\$0	\$34,150
Insurance Premiums	\$1,971,829	\$2,249,899	\$2,369,407	\$2,434,543	\$2,145,156
Claims Administration and Loss Control Services	\$599,939	\$354,311	\$323,226	\$260,096	\$297,752
General and Administrative Expenses	\$1,132,245	\$1,253,118	\$1,246,962	\$1,003,370	\$762,590
<b>Total Expenses</b>	<b>\$5,438,848</b>	<b>\$5,364,733</b>	<b>\$5,552,455</b>	<b>\$6,497,954</b>	<b>\$6,611,806</b>
<b>Changes In Net Assets</b>	<b>\$1,407,840</b>	<b>\$2,000,503</b>	<b>\$1,868,225</b>	<b>\$300,982</b>	<b>(\$378,053)</b>

**Conclusion:** We appreciate the cooperation and assistance of the staff and management of Association of Washington Cities Risk Management Service Agency during this process. No exceptions were noted and no recommendations were made as a result of this review.

**About Association of Washington Cities Risk Management Service Agency:**

The Association of Washington Cities Risk Management Service Agency (AWCRMSA) is a municipal self-insurance pool that was formed on January 1, 1989. Located in Thurston County, the Agency provides property and casualty insurance coverage to 92 participating member cities of the Association of Washington Cities (AWC). The Agency does not have employees; rather, the Agency contracts with the Association of Washington Cities, a non-profit entity, for administrative services.

An elected, seven-member Board of Directors governs the Agency. The Board is comprised of elected city officials within the state. The primary source of revenue for the Agency comes from member assessment fees.

Public entity self-insurance pools, such as AWCRMSA, are authorized by [RCW 48.62](#) and utilize an Interlocal Agreement and Bylaws to link members together. The Pool is regulated by the Washington State Risk Manager's Office (part of the Department of Enterprise Services) and is audited annually by the Washington State Auditor's Office.

## **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.