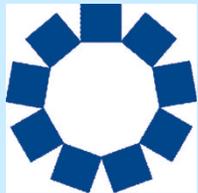


Association
of Bay Area Governments

PLAN



Association of Bay Area Governments
PLAN Corporation
Strategic Planning Meeting
October 4-5, 2001

Strategic Planning Meeting

Association of Bay Area Governments

Pooled Liability Assurance Network

October 4, 2001

Presented by:

Steve Kahn

Managing Director, ARM Tech



ARM Tech

23701 Birtcher Drive, Lake Forest, CA 92630-1783

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Independent Consultants

What Strategic Planning Is

- The process by which an organization envisions its future and develops the necessary procedures and operations to achieve that future.
- Current decisions about courses of action open in the future.
- The design of a desired future and of effective ways of bringing it about.
- Making decisions about resource allocation, priorities and action steps necessary to reach strategic goals.

Take Risk – Break the Rules

*The future is not something we enter,
it's something we create.*

Why Planning Pays Off

- Requires a view of the organization that integrates all of its components.
- Forces the setting of objectives.
- Provides a framework for decision making.
- Allows performance measurement.
- Forces the organization to deal with the most important issues.

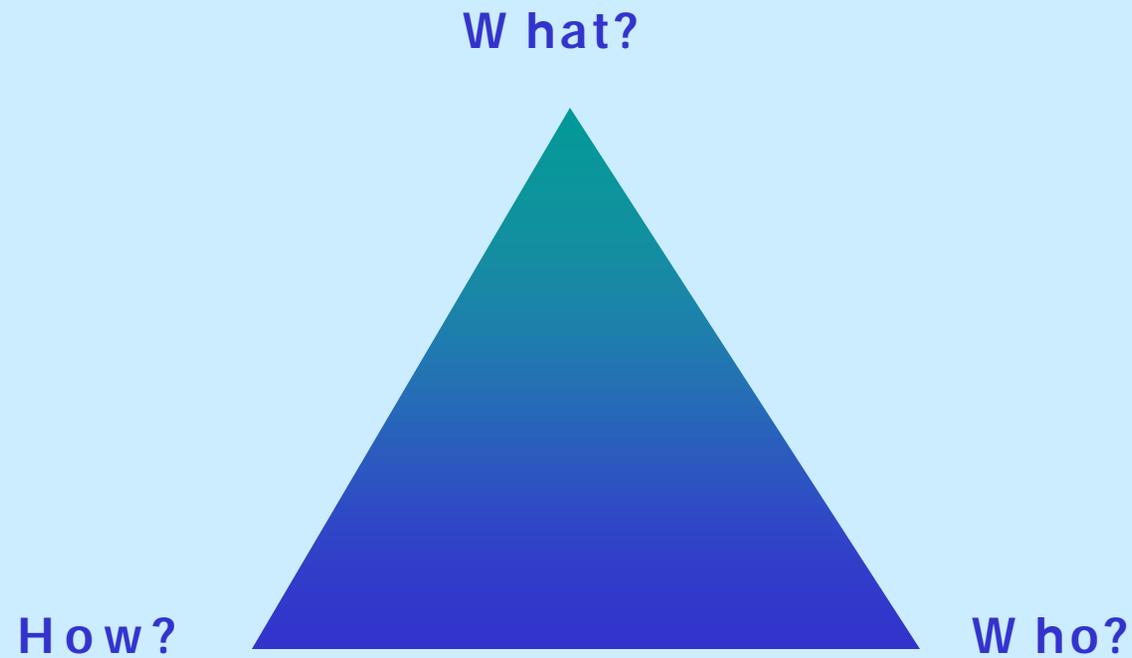
Frequently Used Planning Steps

- Develop an understanding of the strategic planning process.
- Identify W O T S U P.
- Formulate major aims:
 - Key values
 - Mission statement
 - Goals or objectives

Frequently Used Planning Steps

- Identify, evaluate and select strategies to exploit opportunities, avoid threats and achieve goals.
- Prepare a strategic plan.
- Monitor performance.
- Recycle annually.

Services, Customers, Methods



W O T S U P (Sample)

W eaknesses

- Members are not loyal to program
- Pressure to keep operating expenses low
- Short-term outlook

O pportunities

- Commercial insurers are raising rates
- Commercial insurers are restricting coverage

W O T S U P (Sample)

Threats

- Members engaging in new activities
- New theories for claims
- Other pools want our members

Strengths

- Strong claims administration
- Loss rates lower than competitors
- Strong capital base
- Good business practices

Take Risk – Break the Rules

*I skate to where I think
the puck will be.*

What values do we want to project?

- High quality service
- Strong financial position
- Responsive staff
- Low cost
- Stable cost from year to year
- Meet all coverage needs
- Take all applicants
- Other

Mission Statement Formulation

Mission statement – a statement of the organization's fundamental, unique purpose:

- States a clear purpose to all
- Communicates scope of operation
- Reflects the organization's philosophy – shared beliefs and values.

Mission Statement Criteria

- Understandable to all
- Brief
- Clearly specifies: W hat – W ho – How
- Reflects values/beliefs
- Broad enough to be flexible
- Not so broad it lacks focus
- Reflects obtainable goals
- W orded to provide a rallying point for the organization

ABAG Mission Statement

- MK insert after #3

Take Risk – Break the Rules

*If you don't know where you're going,
you're probably not going to get there.*

Goal Setting

Strategic goals

- Set by top management
- Focus on broad, general issues
- E.g., growth

Tactical goals

- Set by middle managers
- Focus on actions necessary to achieve strategic goals
- E.g., attract new members to program

Goal Setting

Operational goals

- Set by first line managers
- Focus on short-term issues necessary to achieve tactical goals
- E.g., develop a marketing plan aimed at target areas

Sample Goals or Objectives

- Establish pool performance measures
- Establish a resource data base
- Revise capital structure
- Benchmark against other pools
- Revise coverage document
- Expand by offering new coverages

A Typical Dialogue

Board Chair:

It's all quite simple. The Board sets policies, which the staff and contractors then implement.

Interviewer:

But how does the Board know what's policy and what's administration?

Board Chair:

Whatever a Board member wants to discuss is policy and the rest is administration.

Take Risk – Break the Rules

*Success always makes obsolete
the very behavior that achieved it.*

ABAG PLAN CORP. History & Current Issues

Strategic Planning Meeting

October 4-5, 2001

Presented By

Marcus Beverly, CPCU, AIC

Director of Risk Management

Insurance N



PLAN HISTORY

- Celebrating 15 Years - Formed 1986
- Began With 23 Members
- Grew to 28 Members by 1992
- Added Property Pool Coverage in 1992
- Grew to 30 members by 1995
- Added 2 and lost 2 members since then

Financial History

- Assets from \$0 to \$33 Million
- Deposits To Date = \$57.3 Million
- Disbursals to Date = \$20.7 Million
- Investment Earnings = \$21.5 Million
- Total Paid as of 9/1 = \$48.8 Million
- Current Reserves = \$5.6 Million

Per Occurrence Limit & SIR

- \$5 Million from 1986 to 1997
- \$7 Million from 1997 to 2000
- \$10 Million w / \$5 Million SIR 2001
- Lowered SIR to \$5 Mil Rather Than Increase to \$10 Mil This Year
- Purchased Excess Insurance For First Time to Fund \$5 to \$10 Mil Layer

Capital Holdback

- Capital Holdback Of 1/2 Disbursable Equity Created to Fund SIR Increase from \$5 to \$7 and then \$10 Million
 - 1998 \$1.33 Mil
 - 1999 \$3.32 Mil
 - 2000 \$1.43 Mil
 - 2001 \$0.52 Mil
 - **Total \$6.60 Mil**

Losses By Cause

<u>Cause</u>	<u># Claims</u>	<u>Incurred*</u>
Sewer	757	\$5.4
Water PD	211	\$5.3
Sidewalk	625	\$3.5
Rd. Design	133	\$4.3
Landslide	29	\$2.5
False Arrest	215	\$2.1
Assault	94	\$2.4

*In Millions

Current Services

- Statement of Benefits 2001-02
 - Coverage
 - Liability
 - Property
 - Bond & Purchasing Pools (EPL, DIC, etc.)
 - Pool Administration
 - Claims Management
 - Risk Management
 - Investment Management

Total Assets = \$33 Million

- G L Pool
 - Assets = \$31 Million
 - Expected Losses = \$15 Million
 - Retained Earnings = \$16 Million
- Property Pool
 - Assets = \$1.95 Million
 - Expected Losses = \$56K
 - Retained Earnings = \$1.9 Million

Prior Planning Meetings

- Strengths & Benefits
 - Good Business Practices - Board, Staff & Members
 - Financially Sound
 - Members in Control & Act in Unison
 - Commitment to Training
 - Lower Premiums/stable pricing (How do we know?)
 - Equity Distribution

Prior Planning Meetings

- Weaknesses & Threats
 - Complacency & lack of flexibility in responding to change
 - Lack of some member involvement/connection
 - Claims & Litigation Management
 - Short-term vs. long-term thinking (i.e. equity expectations)
 - Pressure to reduce costs
 - No scheduled reassessment of member's risk profile.
 - Bad Loss Trends - large loss(es) impact on equity/surplus

Prior Meetings Summary

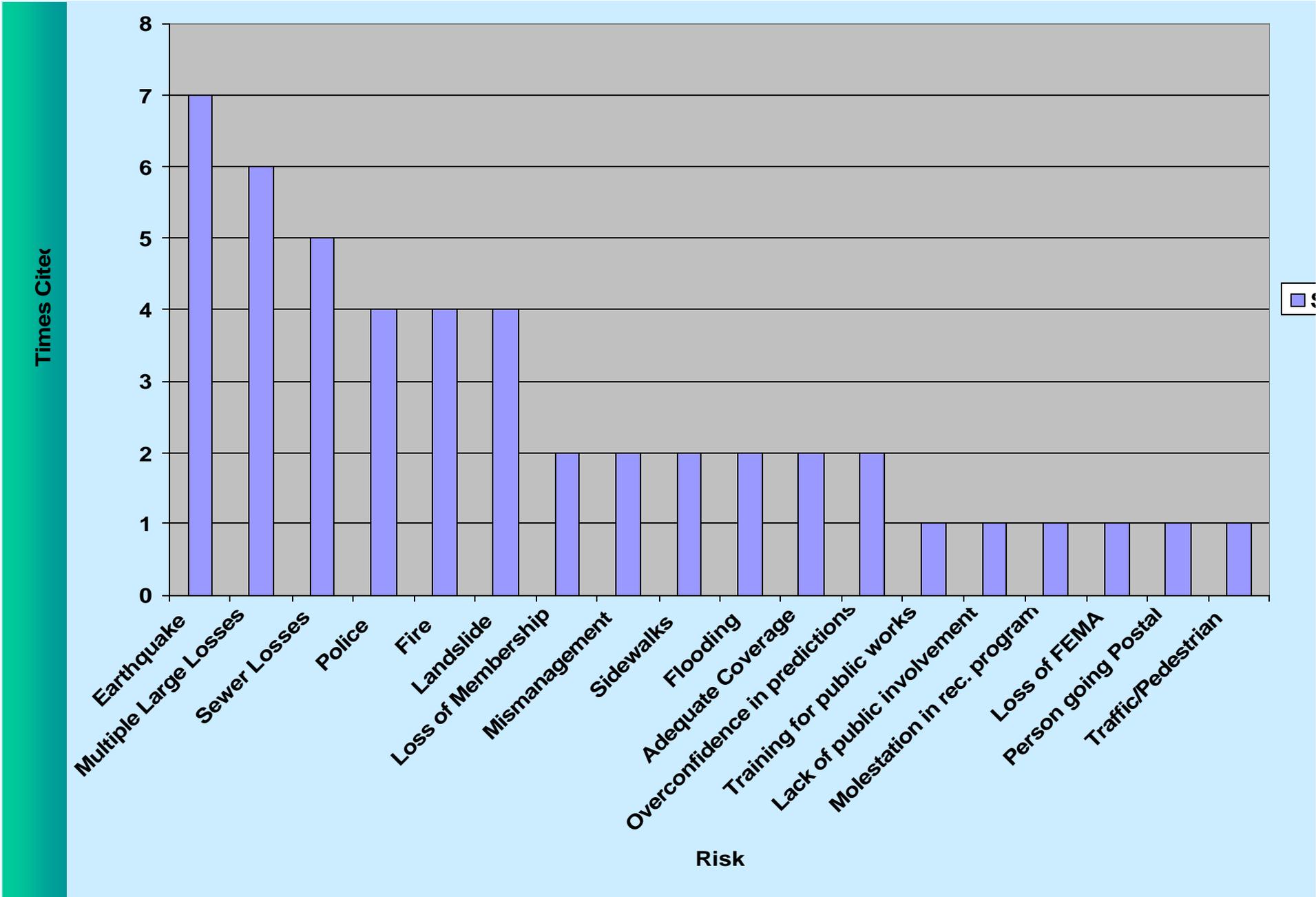
- **Benchmarking**
 - Coverage, Services, Cost, Effectiveness
- **Surplus & Equity Policies**
 - Safety, Cost, Fairness
- **Get Members Involved**
 - Incentives, Menu of Services, Customize

2001 Board Survey

Top PLAN Risks

- Earthquake
- Multiple Large Losses
- Sewer Losses
- Police
- Fire
- Landslide

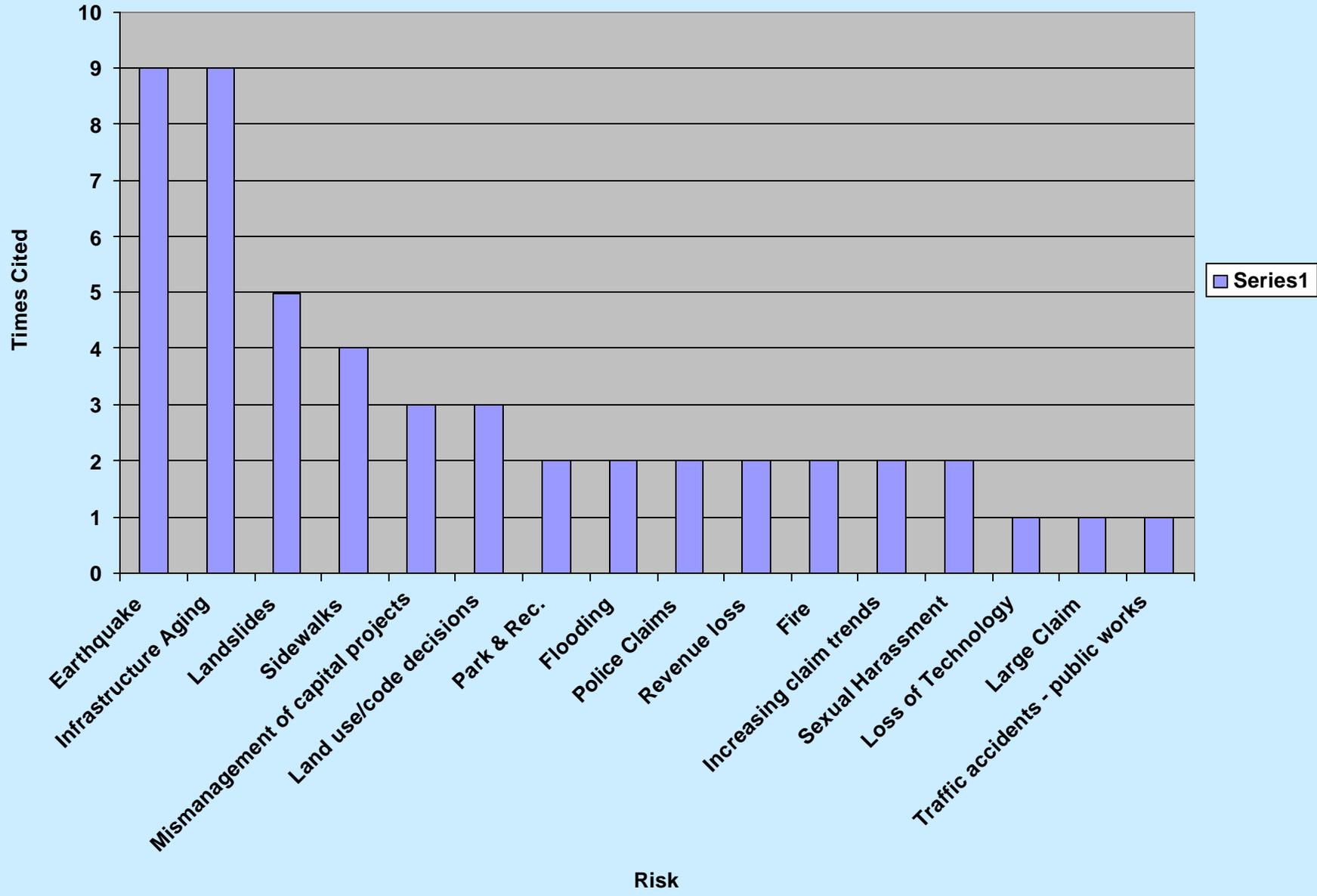
Top PLAN Risks



2001 Board Survey Top Member Risks

- Earthquake
- Infrastructure Aging
- Landslides
- Sidewalks
- Land Use/Code Decisions

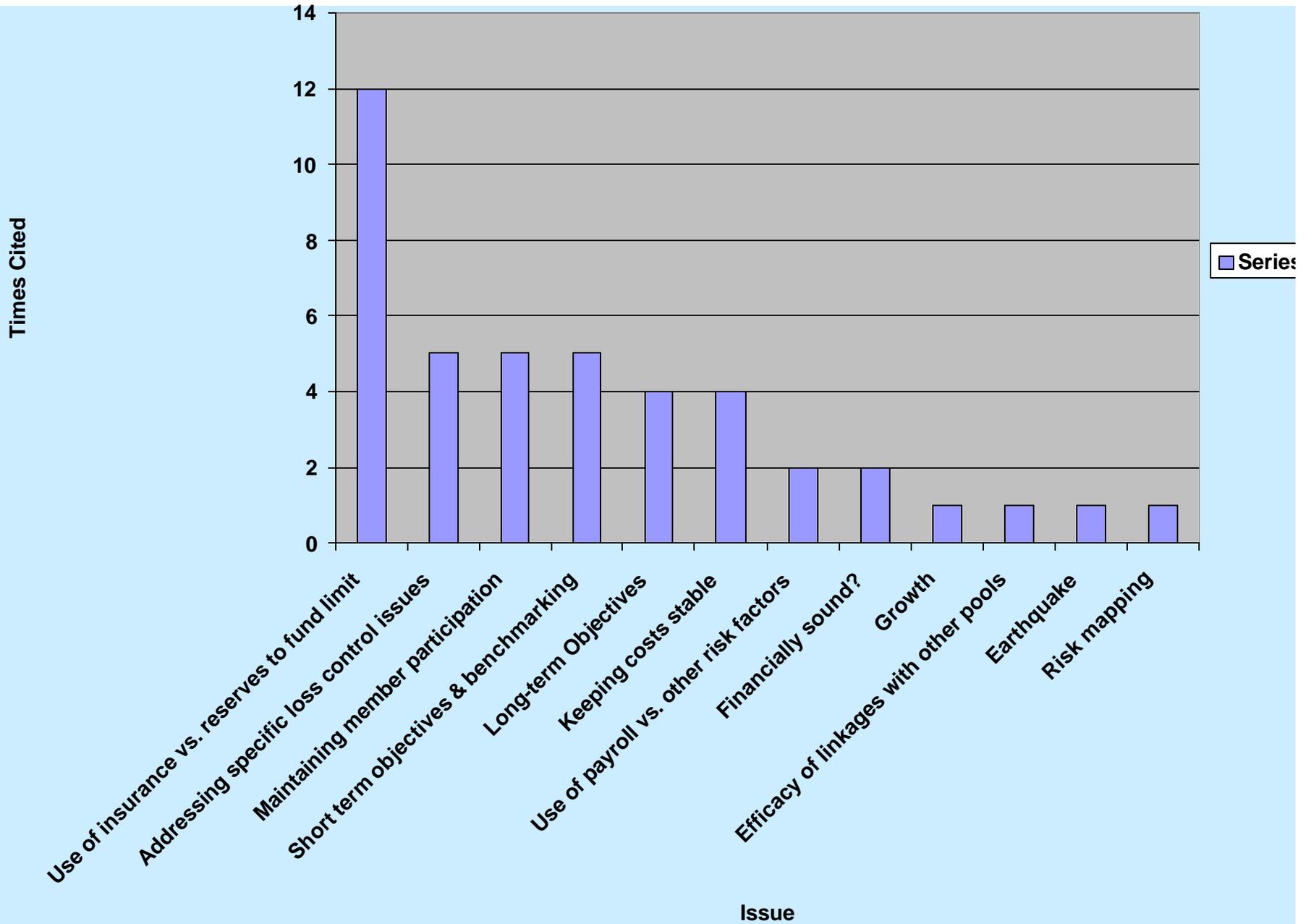
Member Risks



2001 Board Survey Top Planning Issues

- Insured vs. Self-Insured Funding
- Addressing Specific Loss Control Issues
- Maintaining Member Participation
- Setting Objectives - Long & Short Term
- Benchmarking
- Keeping Costs Stable

Meeting Issues

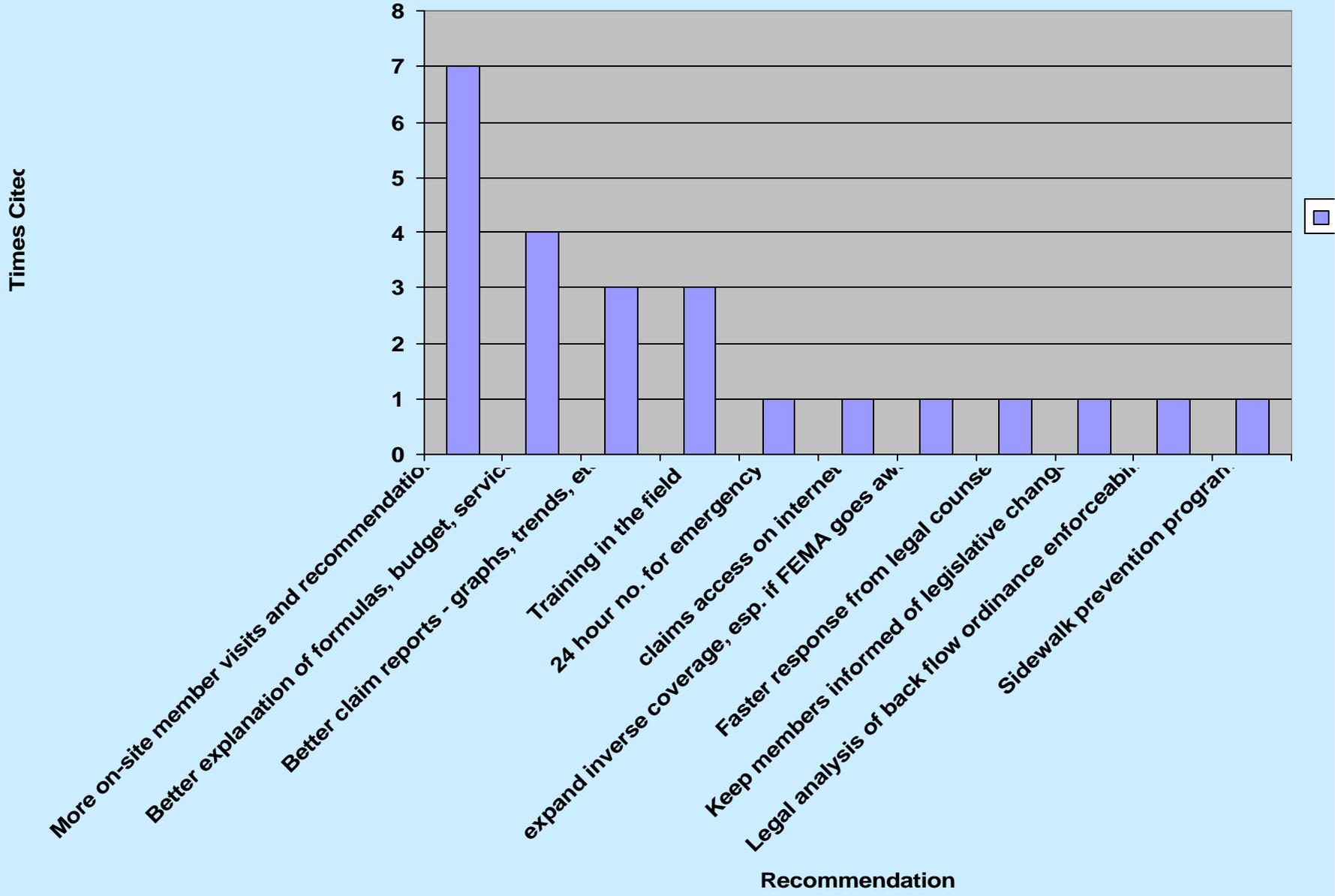


2001 Board Survey

Improving Services

- More On-Site Visits & Recommendations
- Better Explanation of Formulas, Budgets, Services
- Better Claim Reports
 - Graphs, Trends, etc.
- Training in the Field

Service Issues



Meeting Goals

- Review & Renew our Mission
- Agree on future characteristics of the pool
- Clear idea of what members want to achieve
- Establish benchmarks for determining success

Mission Statement

The purpose of the PLAN is to **benefit the citizens** of each Member Entity by establishing a **stable, cost-effective self-insurance, risk sharing and risk management program for each Member Entity.**

Benefit the Citizens

- Added Safety
- Lower Cost of Government
- More Resources for Services

Stable, Cost Effective

- Safe
- Efficient
- Good Value

Self-Insurance & Risk Sharing

- Bear Some Costs Alone
- Pooling Resources
- Working Together
- Vulnerable to other's mistakes

Risk Management Program

- Identify, Analyze, Treat, Assess Results
- Comprehensive or limited to lines of coverage?
- How to tailor for each member?

Strategic Planning Meeting

Association of Bay Area Governments

Pooled Liability Assurance Network

October 4, 2001

Presented by:

Michael M. Kaddatz, CPCU, ARM

Managing Director, ARM Tech



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Engagement Scope

- Organizational Documents
 - By laws
 - Revised Risk Coverage Agreement
 - Memorandum of Coverage
- Risk Management Programs/Services
- Financial Benchmarks
- Strategic Planning

Governing Documents

- By laws and Revised Risk Coverage Agreement comply, in all material respects, with standards of accreditation established by the California Association of Joint Powers Authorities.
- Possible Exceptions
 - Clarity on joint and several liability of participants for PLAN solvency
 - Corporate status of the PLAN vs. traditional Joint Powers Agency
 - Assess ability of members beyond original contribution

Comparison Pools

Excess Coverage

CSAC - EIA

CARMA

SELF

CJPRMA

ACCEL

CCCSIF

Primary Coverage

PERMA

CHARMA

CSRMA

ACWA - JPIA

CSJVRMA

GSRMA

Participation Features

Feature	ABAG	B	C	D	E	F	G
1 Application Fee	✓			✓			✓
2 Admission upon vote with 2/3 Board approval	✓	✓	✓	✓		✓	✓
3 Minimum Period of Participation (yrs)	3	5	3	3	3	3	3
4 Required Withdrawal Notice (mos)	6	2	6	3	6	6	6
5 Withdrawal Date is at end of program year	✓	✓	✓	✓	✓	✓	✓
6 Dividend Calculation Begins (yrs after program close)	3	10	5	3	7	0	3
7 Annual Dividend Payment	✓	✓	✓	✓	✓		✓
8 Members Subject to Assessment	?	✓	✓	✓	✓		✓
9 Maximum Assessment	None	3 x AP	25% AP	3 x AP	None	0	None

Memorandum of Coverage

- The M O C provides broad coverage approximating that afforded by JPAs
- Recommend reconsideration of:
 - Broad inverse condemnation exclusion;
 - Broad failure to supply utilities exclusion;
 - Intentional personal injury and public officials liability offense exclusions;
 - Treatment of multi-year occurrences;
 - Employment practices liability exclusion.

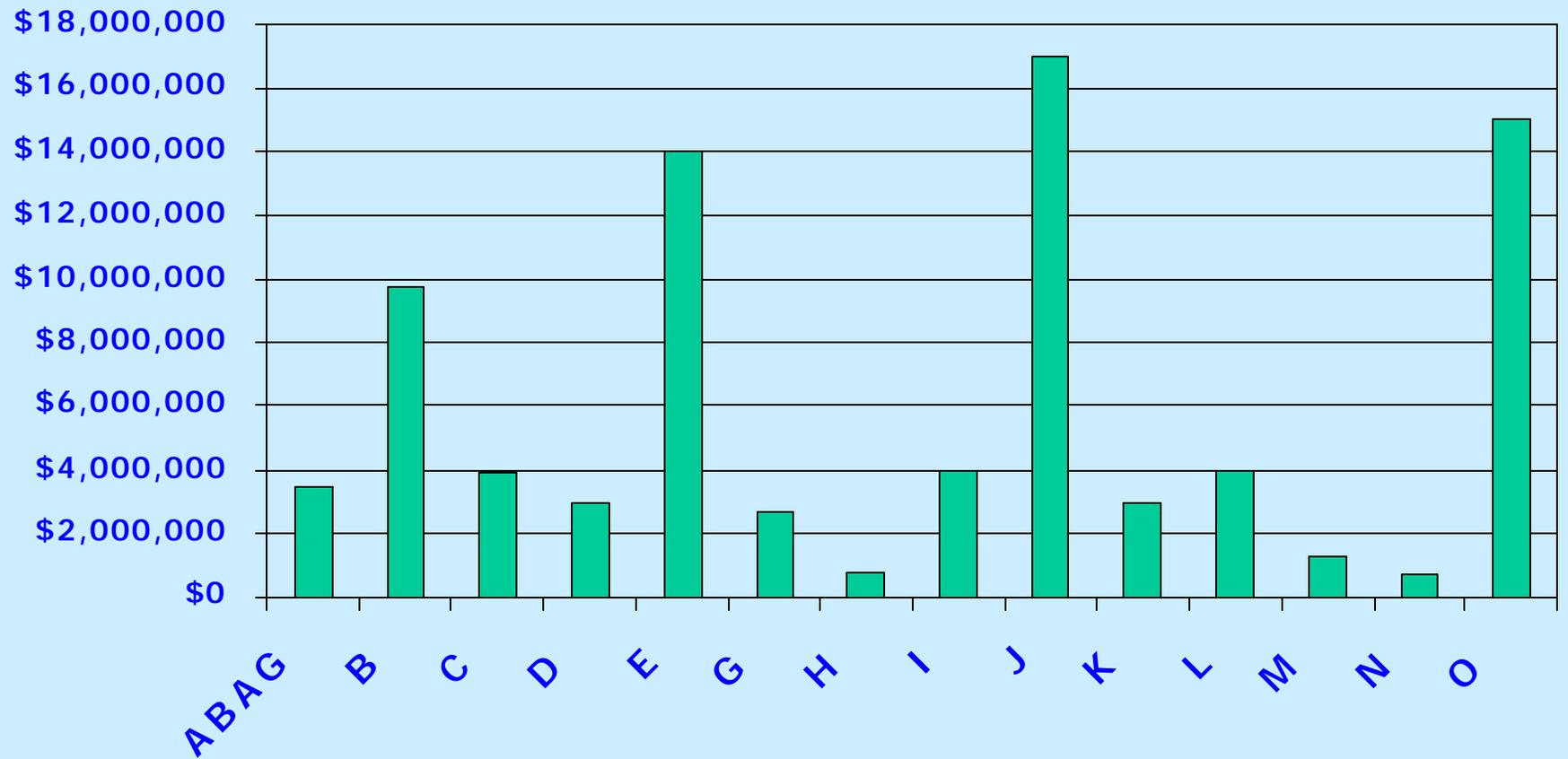
Risk Management Services

- Claims Handling
 - Solid staffing
 - Organized and managed appropriately
 - Claims management system – developing
- Loss Prevention
 - Range of issues addressed over time is typical of pools.
 - Range of issues continues to expand.
 - Need to add resources to meet growth

Liability Coverage Limits

- \$10 million is the floor for most pools.
- Most offer more or give members the option to acquire higher limits

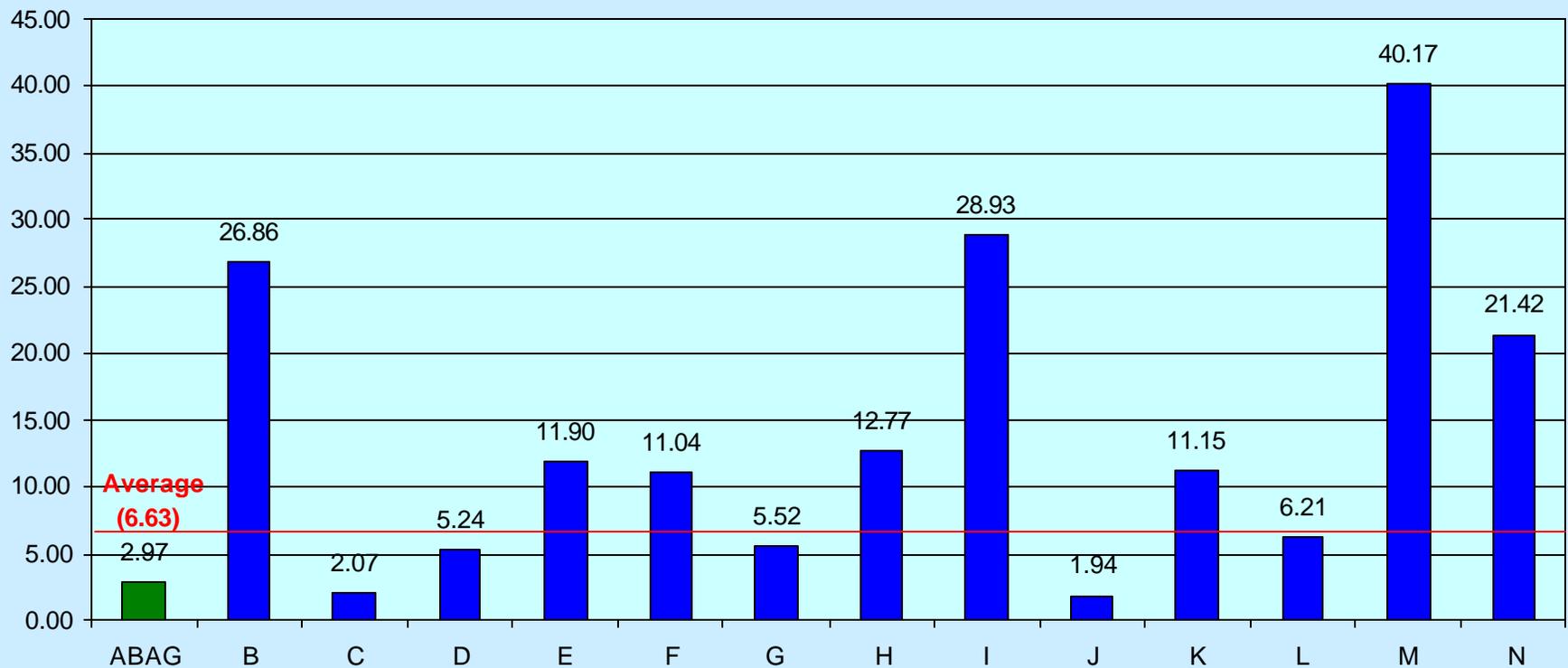
Largest Liability Losses



Surplus to Largest SIR

- Measures Conservatism in Funding
- Commercial insurers typically at 10:1 to 20:1
- Pools typically at 5:1 to 15:1
- ABAG ratio is below benchmarks at 2.97:1
- Options to consider
 - Lower SIR
 - Increase Surplus

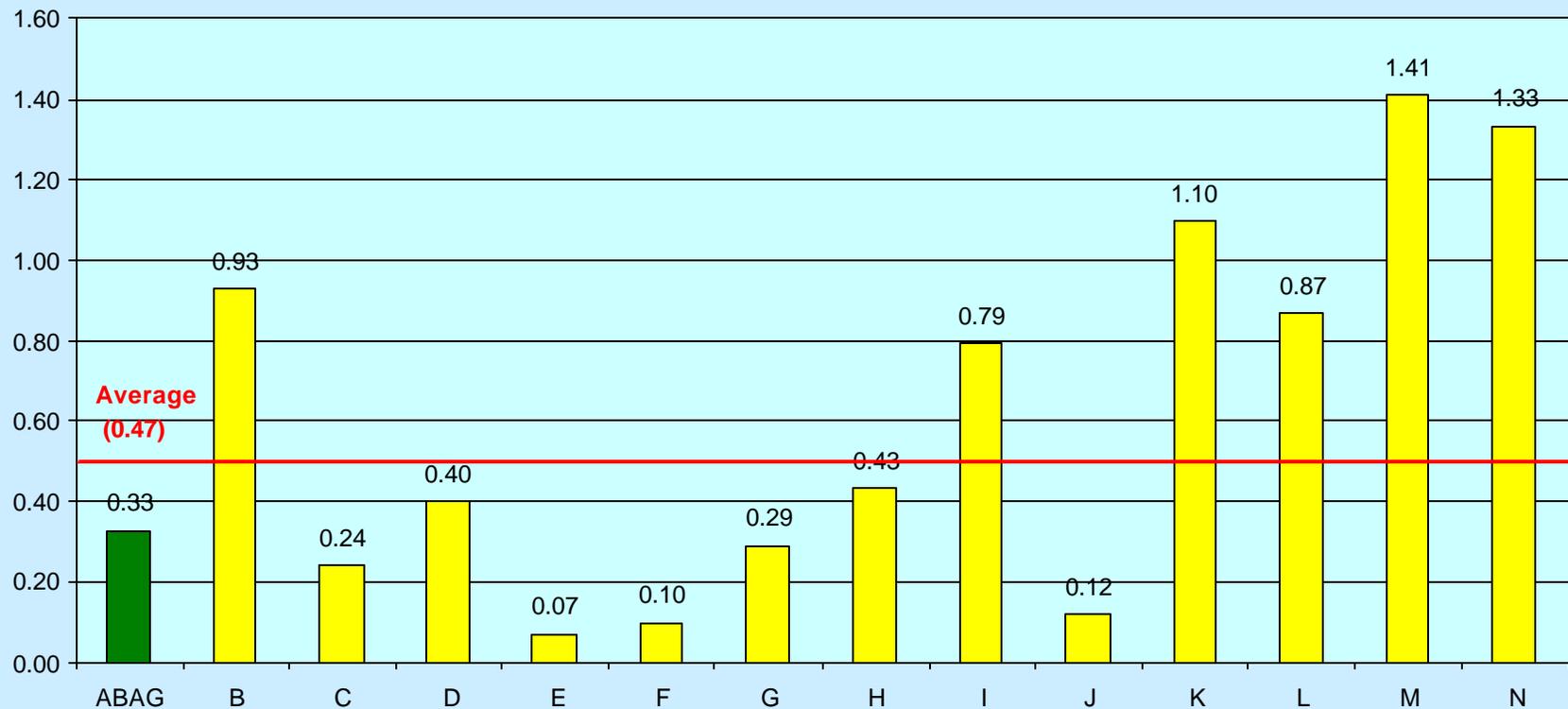
Financial Ratio Comparison Surplus to Largest SIR



Net Contributions to Surplus

- Measures growth potential supported by surplus
- Commercial insurers typically at 1:1 to 3:1
- Pools typically at 5:1 to 2.5:1
- ABAG ratio is better than benchmarks at 33:1
- Options
 - Write more business
 - Return surplus

Financial Ratio Comparison Net Contributions to Surplus



Loss Reserves to Surplus

- Measures contingency funding
- Commercial insurers typically at 1:1 to 3:1
- Pools typically at 0.4:1 to 2.5:1
- ABAG ratio is within benchmarks at .96:1
- Options
 - Write more business
 - Return surplus

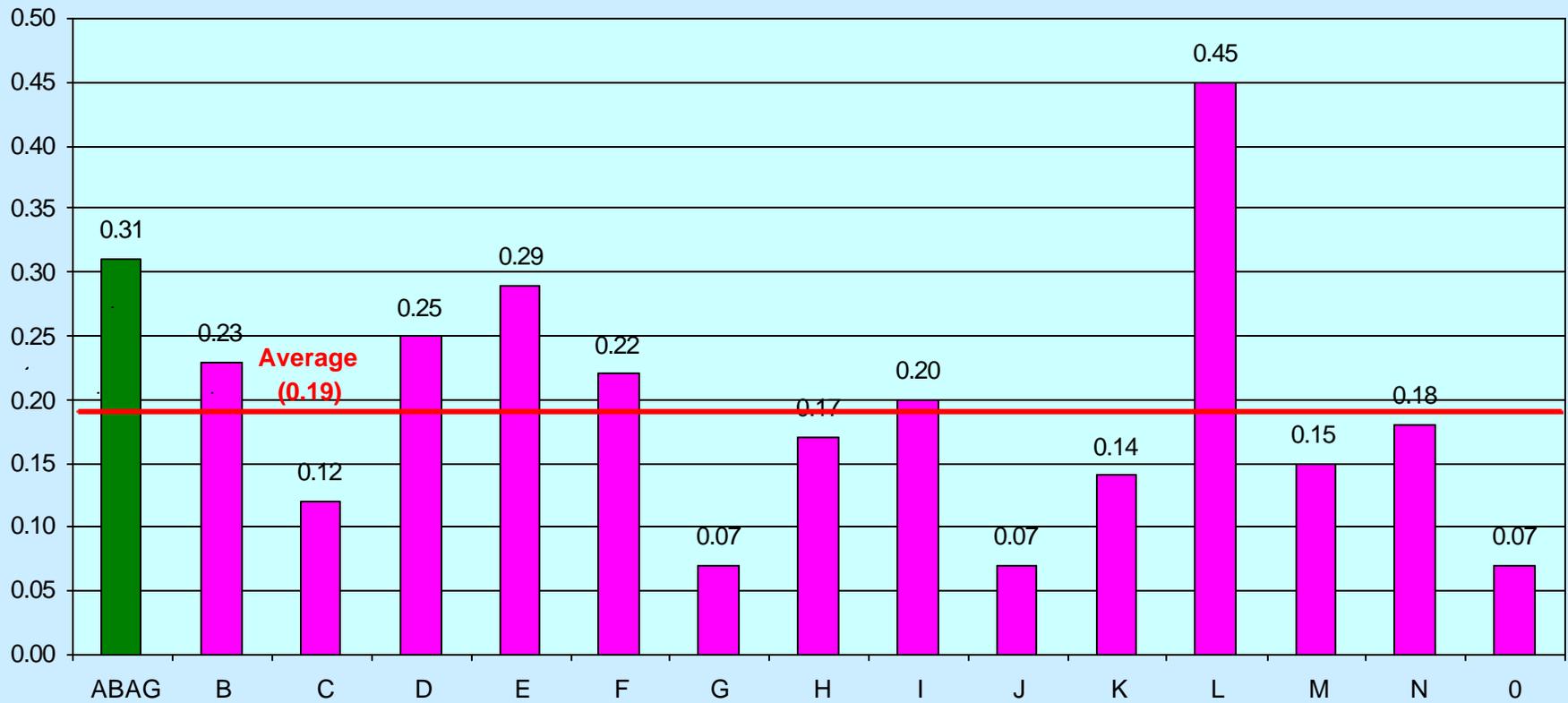
Financial Ratio Comparison Loss Reserves to Surplus



Operating Expenses to Gross Contributions

- Measures operating costs
- Commercial insurers typically at 0.15:1 to 0.25:1
- Pools typically at 0.10:1 to 0.35:1
- ABAG is within benchmarks at 0.31:1

Financial Ratio Comparison Operating Expense to Gross Contributions



Review of ABAG Governing Documents

Presented October 2001
by Gregory V. Moser

Documents Reviewed

- Bylaws of ABAG Plan Corporation
- Risk Coverage Agreement
- Memorandum of Coverage

Document analysis done:

- Are they consistent with current law?
- Do they clearly address common areas of conflict within self-insurance pools?
- Are differences between public law and insurance law clearly identified and addressed explicitly?
- Do they reflect the intent of the members?

Bylaws: Key Issues

- “Trust” created by “irrevocable” dedication of assets to “promoting the social welfare” of citizens of “San Francisco Bay Area”
 - Unintended consequences of trust law?
 - Limits membership to Bay Area?
 - Limits use of funds, including interest
 - Gives “beneficiaries” certain rights
 - Attorney General may supervise

Bylaws: Key Issues

- “Trust” created by “irrevocable” dedication of assets to “promoting the social welfare” of citizens of “San Francisco Bay Area”
 - Fiduciary standards imposed on administrators
 - Implication that corporation operates individual accounts, not than group self-insurance “pool”
 - (Example: *Grossmont Hospital Corp. v. Program BETA*)

Bylaws: Key issues

- Committee roles unclear in some areas:
 - Process for resolving coverage disputes not clearly addressed-- self-insurance pools can require exhaustion of administrative process
 - Claims, Program and Actuarial/Underwriting could all claim jurisdiction
 - Appeal process should be spelled out, here or in other program documents

Bylaws: Key issues

- Are the members jointly and severally liable for the corporation's negligence?
 - Question unclear under Government Code section 895.2 (CAJPA split on question)
 - AB 277 (Chap. 38, Stats. 2001) says no such liability if agency is pool member and has insurance or reinsurance for its operations
 - Indemnity in Risk Coverage Agreement could have unintended effect

Bylaws: Key issues

- Should ABAG Plan Corporation be a nonprofit, or a JPA?
 - Either way, it shouldn't need to file tax returns
 - JPA gets governmental immunities; unclear for corporation
 - Corporation need not bid construction; JPA would likely need to follow city rules
 - JPA employees are governmental for benefits (ABAG employees already in PERS)

Bylaw s: Key issues

- Should ABAG Plan Corporation be a nonprofit, or a JPA?
 - Corporation looks more like charitable trust
 - JPA real property not subject to property tax; corporation gets only annual exemption

Bylaws: other issues

- Brown Act compliance:
 - Location of meetings not limited
 - Telephonic meetings not restricted
- Board membership:
 - Failure to attend doesn't result in automatic vacancy, despite large board
 - Need majority for quorum-- this could be reduced, at least for some decisions

Bylaws: other issues

- Must the corporation adopt a conflict of interest code?
 - Probably a “public agency” under *Siegel* decision of FPPC
 - May require brokers, others to report financial interests, disclose when decisions are made
 - Many staff, board members already report, but will have to expand to assets within any member city

Agreement: Key issues

- Effect and timing of withdrawal or admission of members should be clear and consistent under all documents
 - Agreement and coverage documents should be coordinated to operate as single contract
 - Example: auto claim after withdrawal from JPA
 - Need express statement under Gov. Code section 6512.2 (amended 1997), that agreement not terminated by withdrawal

Agreement: Key issues

- Effect and timing of withdrawal or admission of members should be clear and consistent under all documents
 - Members may have no right to return of “premium” (Gov. Code sec. 990.8(e), added 1997)
 - Statement that fund not “subject to levy or attachment” implies member “ownership”

Agreement: Key issues

- Effect and timing of withdrawal or termination of member should be clear and consistent under all documents
 - Right to set terms and conditions
 - For example: (1) pool's right to assessments; (2) option of member to assume or purchase tail coverage at rates set by pool; (3) effect of a change in coverage, rates on withdrawing party vs. presumption of "nondiscrimination"

Agreement: Key issues

- Effect and timing of withdrawal or admission of members should be clear and consistent under all documents
 - Consider occurrence, claims-made coverage, restricted coverage for former/new members
 - Consider access to excess or reinsurance
 - Have right to expel member
 - Should be consistent with GA SB-10 reports

Agreement: Key issues

- Language describing “Claims Fund” as trust should be eliminated
 - Permitted uses of fund should be spelled out
 - Rights of new , withdrawn members to fund
 - Any right to “surplus” or “equity” from “Claims Fund” should be clearly stated
 - Options include: none, vesting, or pro rata based on contributions

Agreement: Key issues

- Language describing “Claims Fund” as trust should be eliminated
 - Distribution at member withdrawal, or only termination of pool? (Gov. Code sec. 6512.2)
 - Distribution formula solely based on “contributions made” (Gov. Code sec. 6512), or also consider “claims or losses paid” ? (Gov. Code sec. 6512.2)

Agreement: other issues

- Delete investment disclaimer
 - corporation is responsible for investment losses, per Gov. Code section 53600.3 (Perhaps review investment policy?)
- Update to allow purchase of reinsurance
 - (Gov. Code section 990(d), added 1996)
- Broaden authority of program
 - include purchase of risk management, brokerage, TPA services

Agreement: other issues

- Simplify amendments
 - Allow majority to amend terms; minority to withdraw or be bound?
- Prohibit assignments
 - Risk of assignment to strangers who do not understand program
- Require risk management
 - Non-complying members may have coverage restricted or be expelled (e.g., litigation mgt.)

Coverage: Key issues:

- Consider differences between commercial insurance and self-insurance pools
 - Courts decide ambiguities in favor of insured because of “adhesion” contract rule
 - Conflicts between insurer and insured lead to right to *Cumis* counsel
 - Insurance Code sec. 533 forbids liability coverage of inherently “bad acts”
 - Aggregate cap for group of insureds illegal

Coverage: Key issues:

- Self-insurance pool opportunities:
 - Members participate in designing coverage, so coverage interpreted like ordinary contract
 - Eliminate extra expense of duplicative defense counsel since *Laws*, not *Cumis* applies
 - May pay for some “intentional” misconduct if make findings (Gov. Code sec. 825(b).)
 - Aggregate cap permitted

Coverage: Key issues:

- Self-insurance pool opportunities:
 - Members participate in designing coverage, so coverage interpreted like ordinary contract
 - Establish transparent process for changing coverage
 - Underwriting committee participation
 - Documentation of intent of parties limits disputes
 - Courts will respect internal administrative process (*City of South El Monte v. SCJPA*)

Sample coverage approach:

- ① Read contract as statement of shared intent
- ② Look for coverage actively
- ③ Check history of consideration of issue by pool, including underwriting
- ④ Use ordinary contract interpretation rules
- ⑤ Rely on facts objectively determined
- ⑥ Resolve reasonable doubts in favor of coverage

Coverage: Key issues:

- Self-insurance pool opportunities:
 - Eliminate extra expense of duplicative defense counsel since *Laws*, not *Cumis* applies
 - Allow second defense counsel on case-by-case basis
 - Possible use of Civil Code section 2860 as guide
 - Make position on *Cumis* clear in coverage document

Coverage: Key issues:

- Self-insurance pool opportunities:
 - Rules on “intentional” misconduct
 - If find in course and scope, good faith and best interests of public agency, may pay punitive damages for employees (Gov. Code sec. 825(b))
 - Elected officials get no defense or indemnity for intentional torts, except defamation, and agency must attempt to recover costs from “guilty” official (Gov. Code sec. 815.3)
 - Malicious prosecution, harassment can be covered: Insurance Code sec. 533 inapplicable

Coverage: Key issues:

- Self-insurance pool opportunities:
 - Aggregate cap permitted
 - Rules for allocating fund in the event of shortfall should be established
 - Will assessments be made?
 - Risk of shortfall can be minimized by reinsurance

Coverage: other issues:

- Achieve consensus on intent:
 - When, if ever, is emotional distress covered?
 - Is disaster recovery expert costs covered?
 - Include attorneys fees in damages definition?
 - Cover malicious prosecution?
 - ERISA claims excluded, but parallel claims based on state law aren't
 - Should inverse condemnation be partly covered based on negligence?

Coverage: other issues:

- Achieve consensus on intent:
 - Address elected officials' indemnity/defense
 - Does pool follow member findings on payment of punitive damages?
 - Should pool agree to be treated as "other insurance"? (Not required under *Orange County Water Dist. v. ACWA JPA* case)
 - Pollution exclusion doesn't apply to ag. or storm water, but should it?

Coverage: other issues:

- Achieve consensus on intent:
 - Cover errors in administration of employee benefit plans?
 - Breach of fiduciary duty appears to be covered (bad investments of city or employee funds)
 - Exclude discrimination due to workers comp. claims? (Labor Code sec. 132a)
 - Coverage for “permissive use” of autos based on city policy?

Recommendations:

- Replace “trust” language with “pool” language addressing “equity” and rights of pool and withdrawing, new parties
- Update documents to reflect changes in law
- Establish internal processes for:
 - Drafting coverage
 - Handling coverage disputes
- Compare coverage to insurers as guide

ABAG PLAN CORPORATION

Status of the Insurance Market

October 4, 2001

Presented by:
Dennis Mulqueeny
Driver Risk Services

*Robert
F. Driver
Company*

Status of the Insurance Market

- *Presentation Outline*
 - Historical Perspective (Cycles)
 - Conditions Leading to Current Market
 - The “Current” Market
 - Property
 - Liability
 - Workers’ Compensation
 - Implications of the W TC Tragedy
 - What to Do?

Historical Perspective of Cycles

- Cyclical Trend - Market reverses every 6 -7 years
- In the 1970's
 - Medical Malpractice and Auto coverage losses plagued insurers
 - Insurers expected investment gains to offset underwriting losses
- In the 1980's
 - "Loss Free" clients had premiums double to quadruple
 - Public agencies either couldn't get coverage or only at greatly reduced limits, and greatly increased premiums

Conditions Leading To The Current Market

- **Adverse Litigation Trends**
- **Irrational Competition**
- **Poor Underwriting Results**
- **Poor Investment Climate**
- **Depleted Loss Reserves**
- **Higher Reinsurance Treaty Costs**

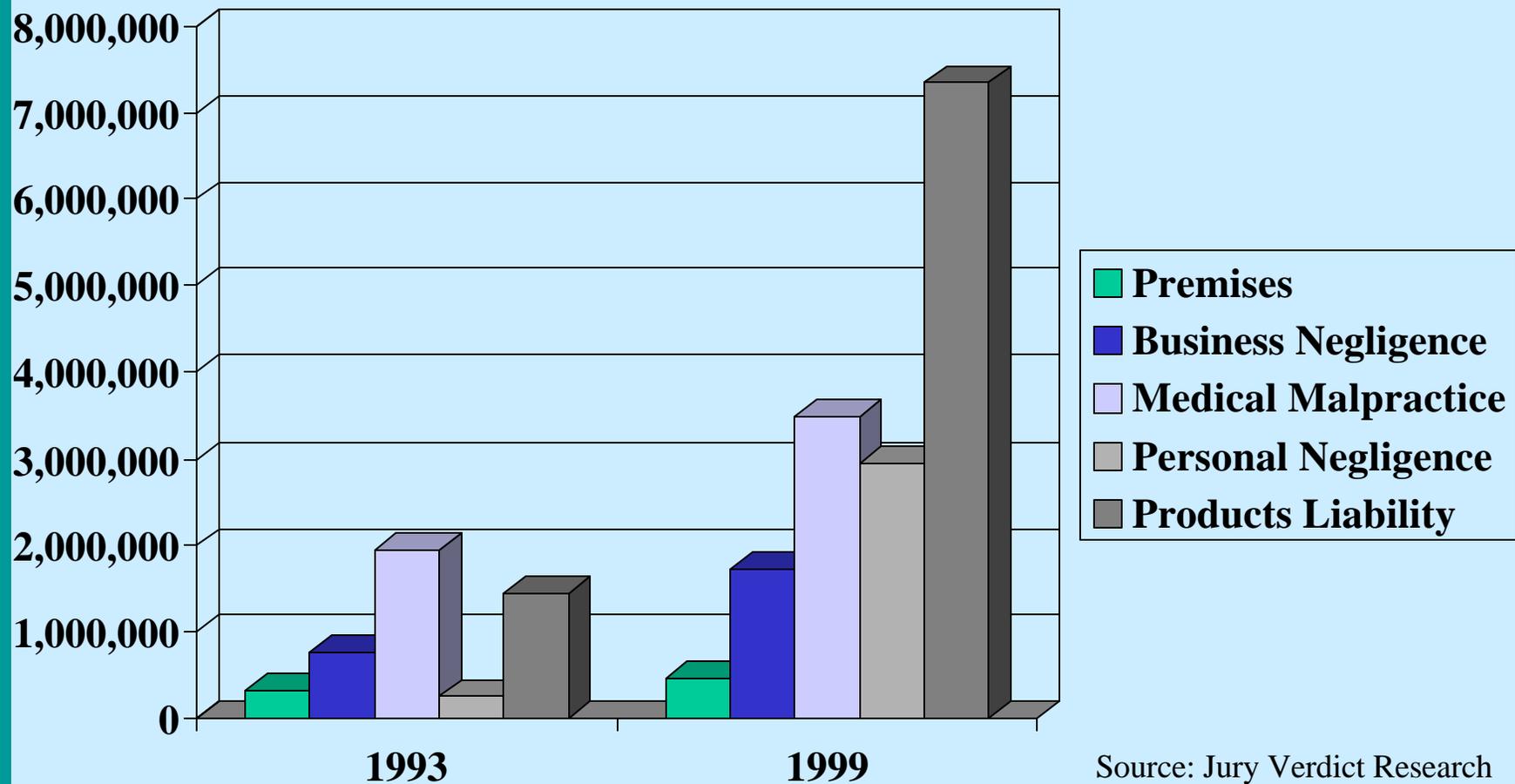
Litigation Trends

- Average jury awards have increased substantially:
 - Up 93% from 1993
 - Average award now \$1 million
 - CPI Index for the same period up 15%

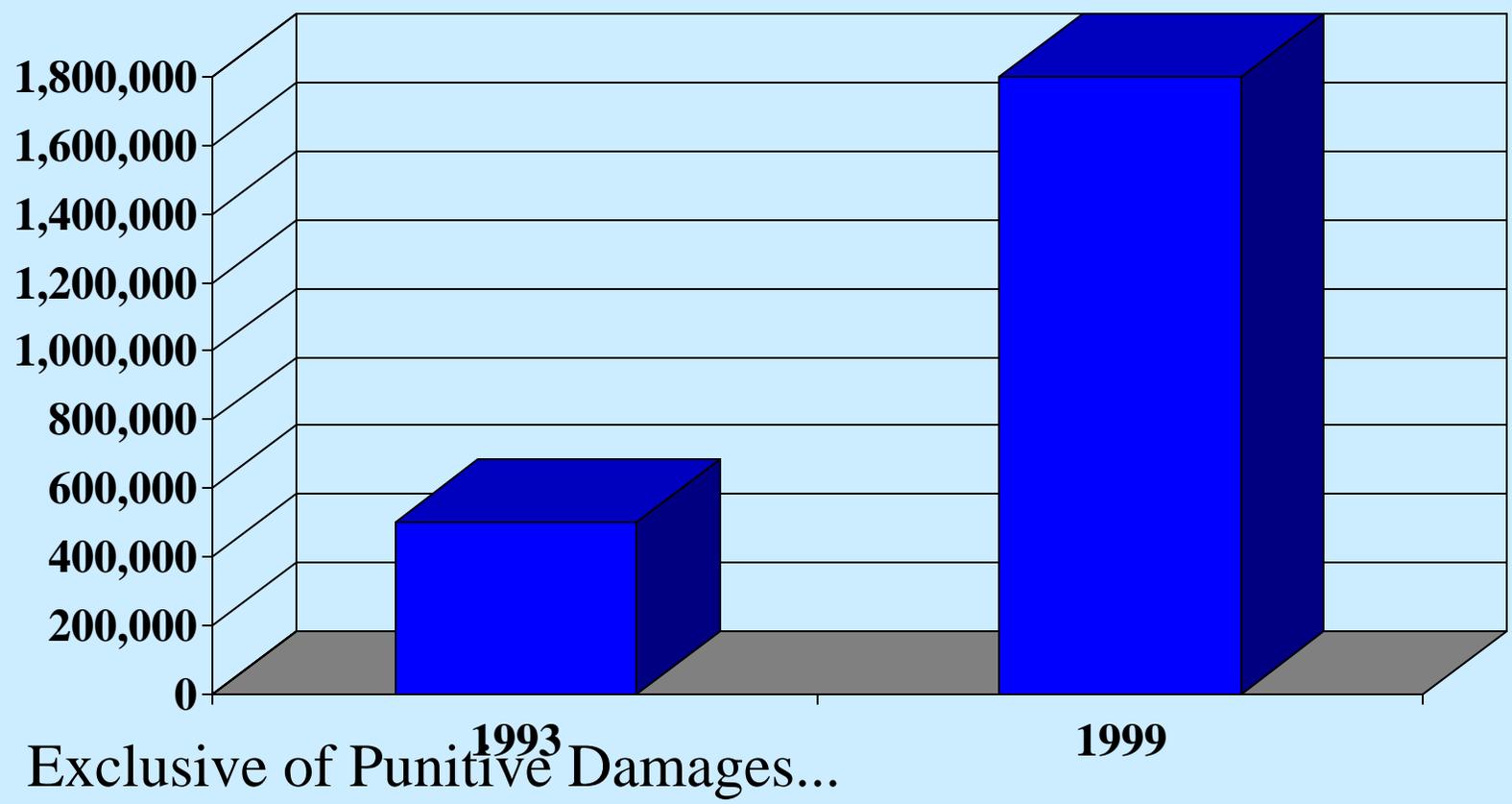
Recent Examples:

- **1998** Death settled @ 4.8 million, single not married no dependents

Change in Average Verdicts



Median Verdicts



Source: Jury Verdict Research

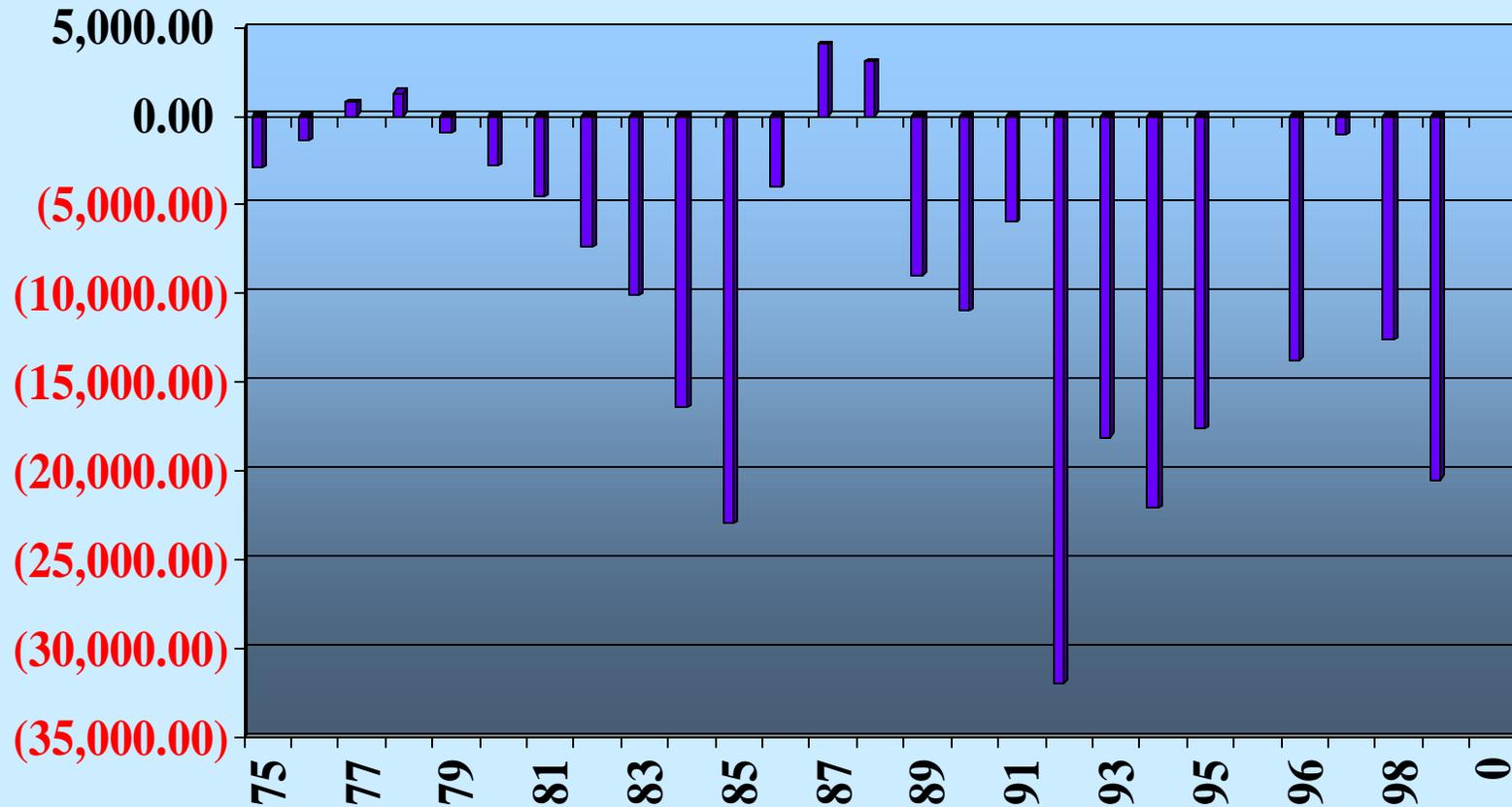
Irrational Competition

- Expiring carrier *lost* \$4 million over 8 years
 - at \$300k for \$9mm xs \$1mm layer
 - Q uoted \$875,000 do \$10mm xs of \$2mm
- Coverage placed with another carrier at:
 - \$400,000 for \$10 xs of \$2 million
- All other quotes *higher* than \$875,000
- Trend of increasing renewals, but under pricing new business.

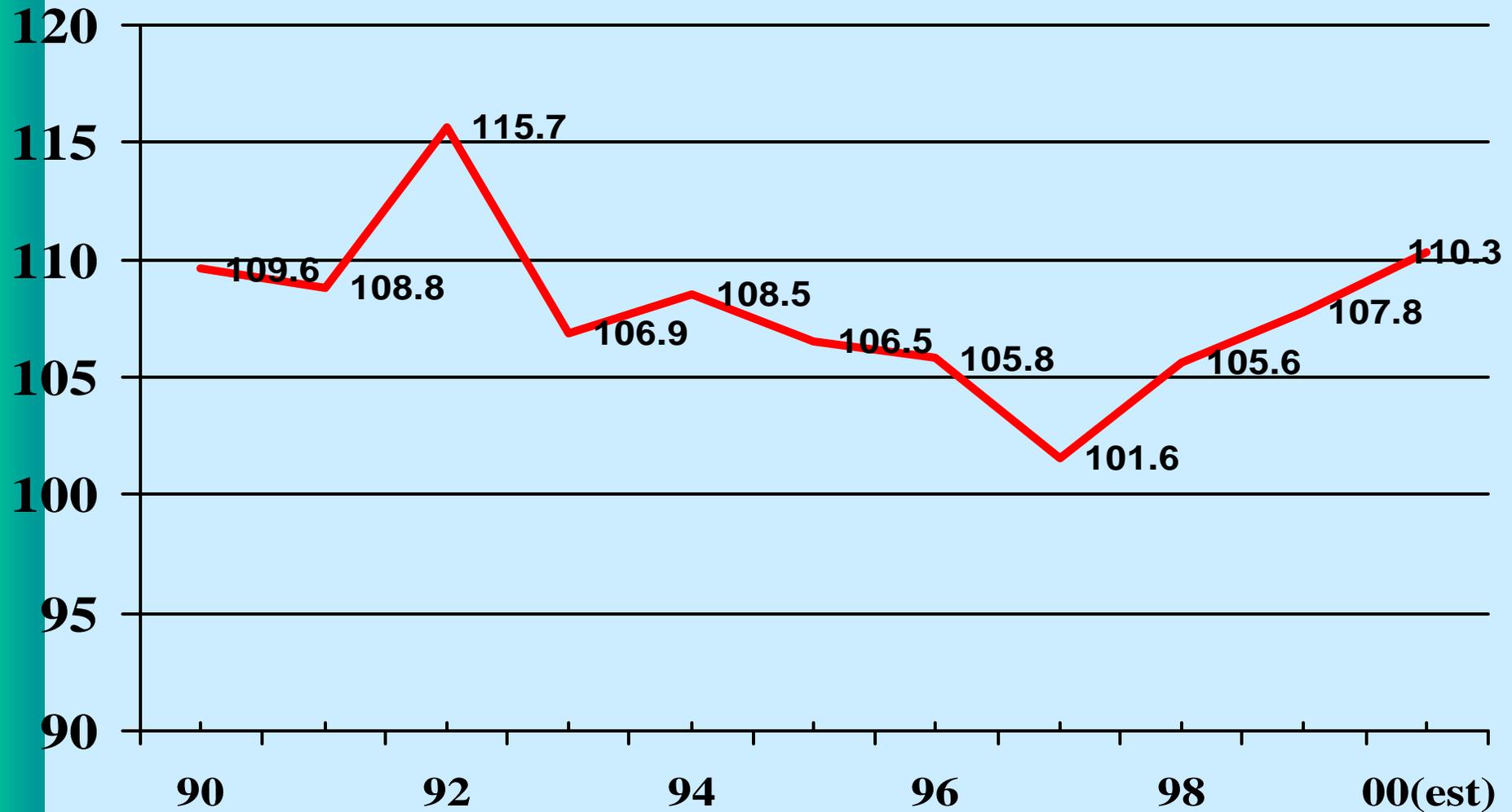
Poor Underwriting Results

- Property Casualty results, first nine months of 2000:
 - Losses up 43.9 %
 - \$21.9 Billion
 - Average Combined Ratio 109%
- Combined Ratio for 1999 was 107.8%

Property Casualty Underwriting Results in Millions



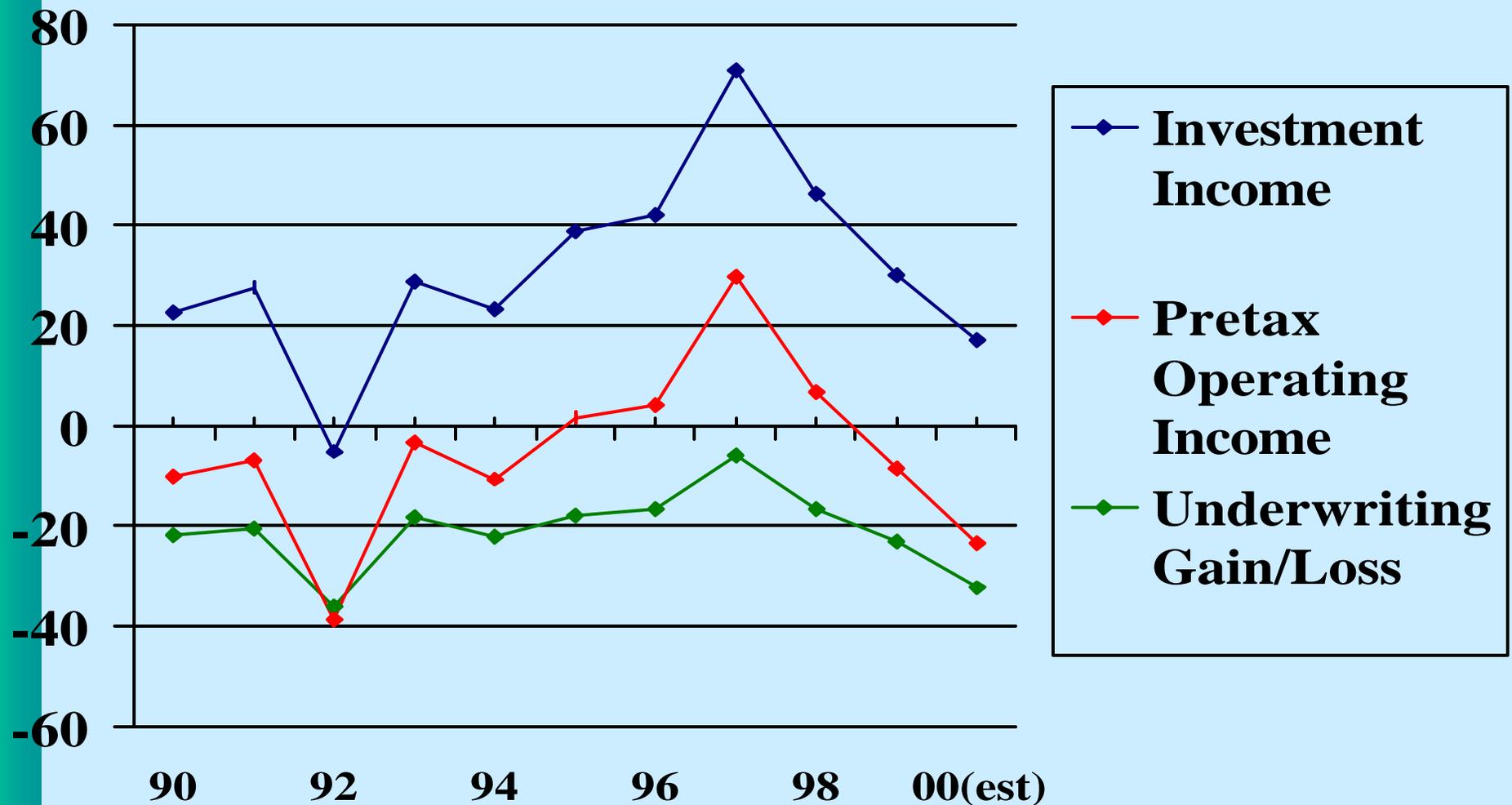
CONSOLIDATED P/C INDUSTRY COMBINED RATIO



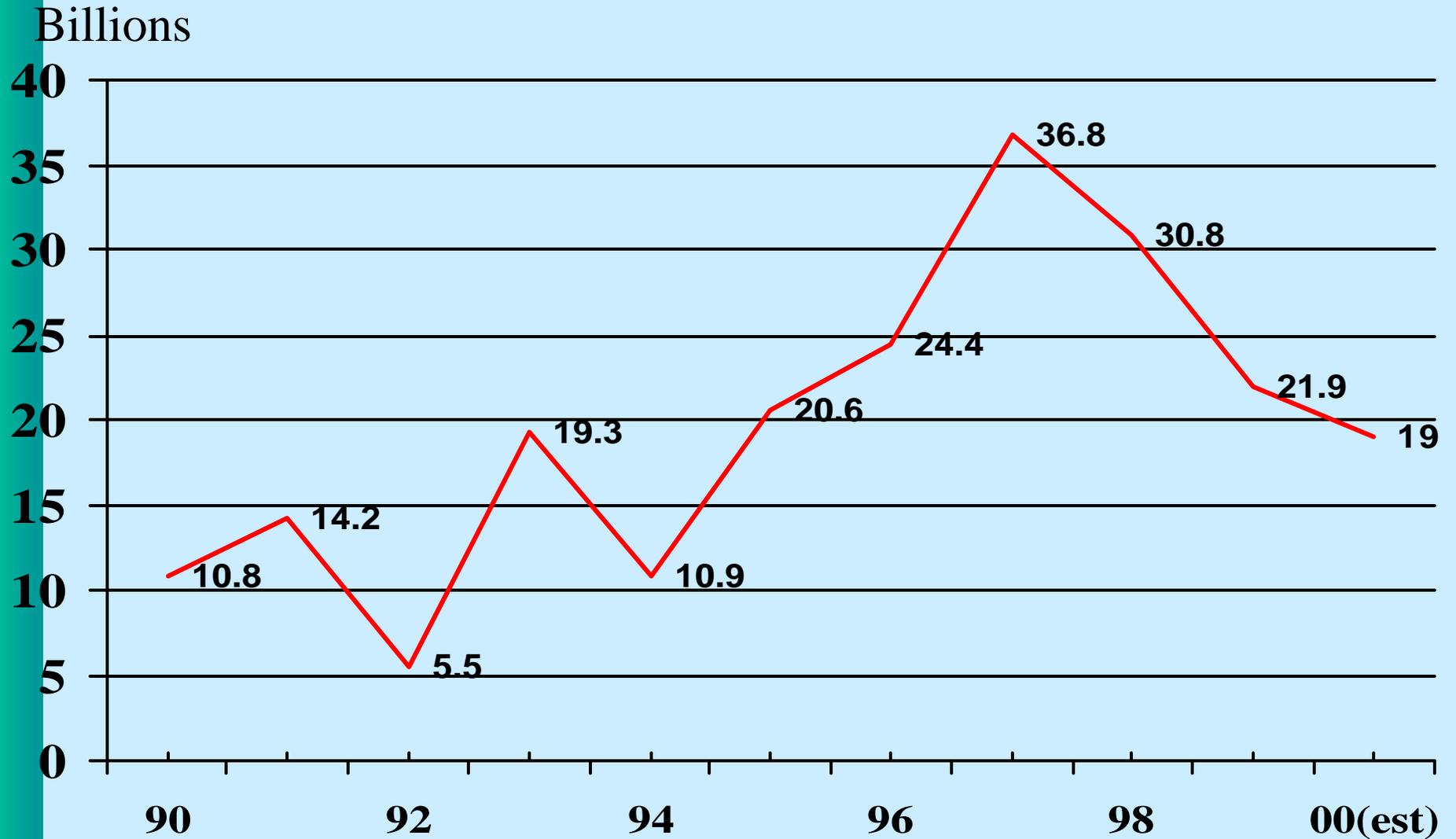
Poor Investment Climate

- RO E for U S P/C market fallen from:
 - **13.1%** in 1997, to **6.5%** in 1999, and to **5.8%** in 2000
- Net Income dropped from:
 - **30.8b** in 1998, to **21.9b** in 1999, and to **19b** in 2000
- P/C Insurers' Combined Ratio for 2000 is projected at 110.3%, up from 107.8% in 1999
- Average RO E only **8.4%** through the 1990's compared to **13%** for the Fortune 500

UNDERWRITING vs. INVESTMENT INCOME



CONSOLIDATED PROPERTY/CASUALTY INDUSTRY NET INCOME



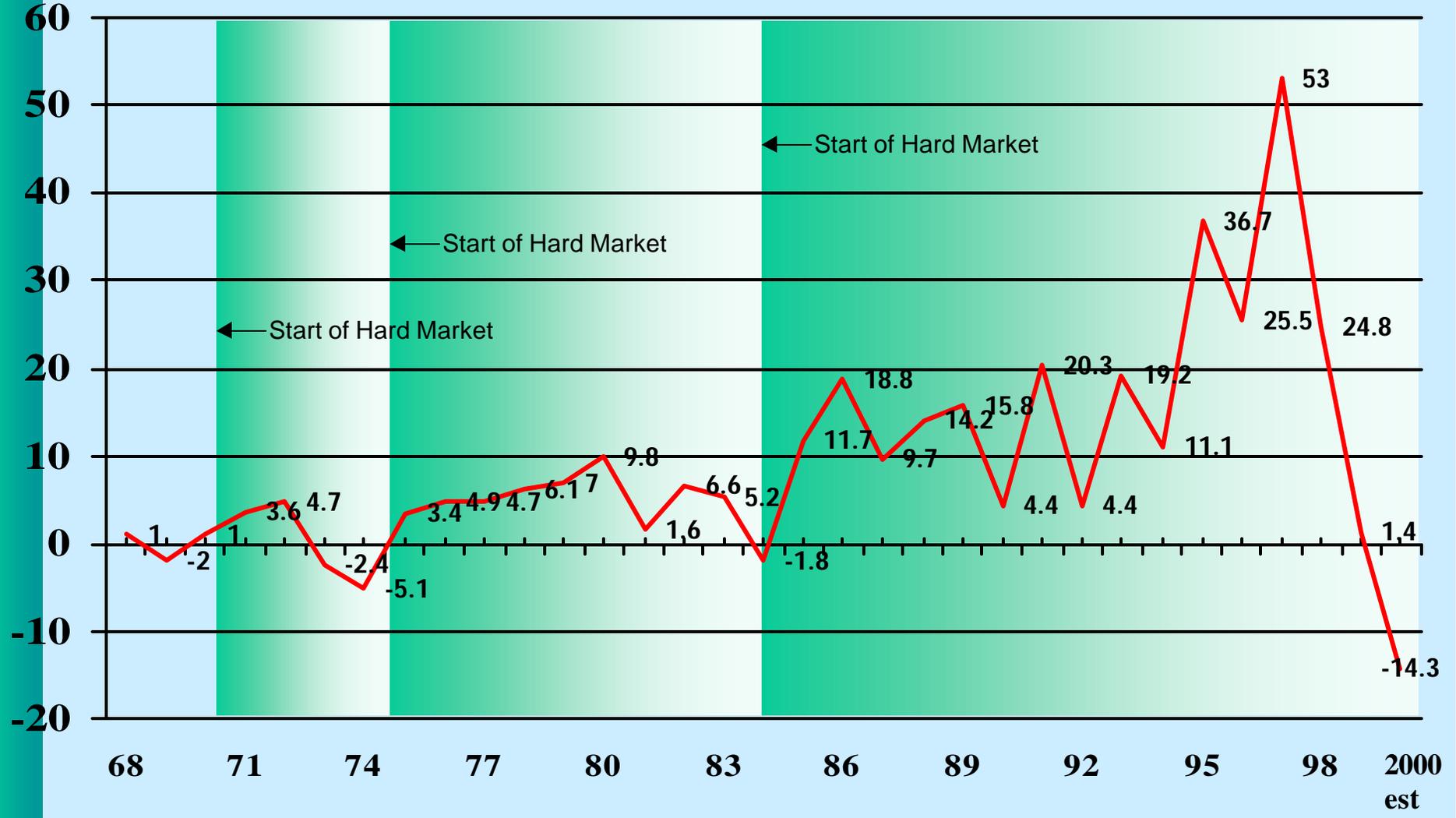
Industry Consolidation...

- Number of independent property/casualty groups declined 10% in 1999
- Between 2000 & 2001 another 12% property/casualty will lose their autonomy
- Of 1,100 property/casualty groups in the U.S., 13% control 90% of the total market with the top 10 groups having 45% of the market premium.

CHANGES TO

POLICYHOLDERS SURPLUS

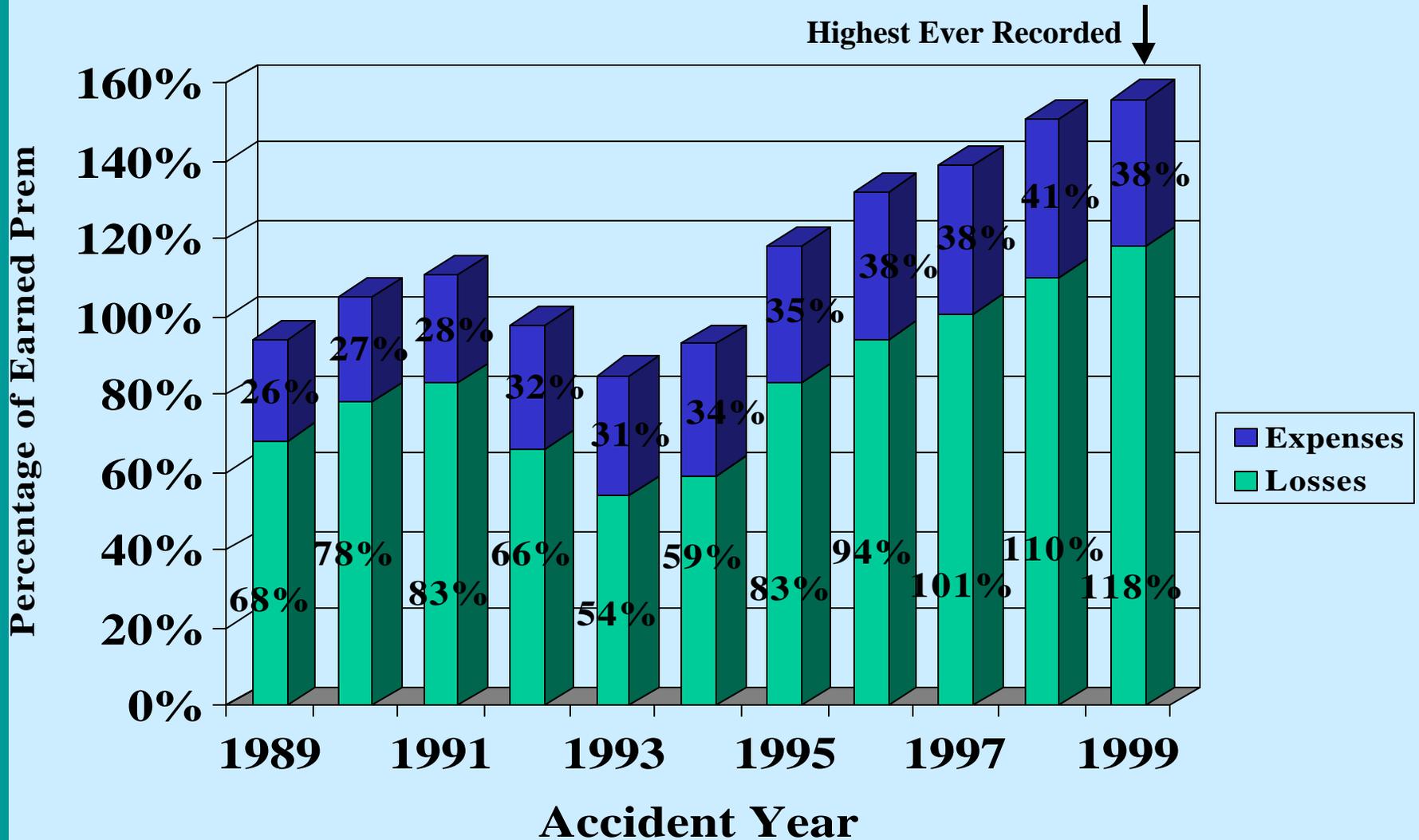
US\$B



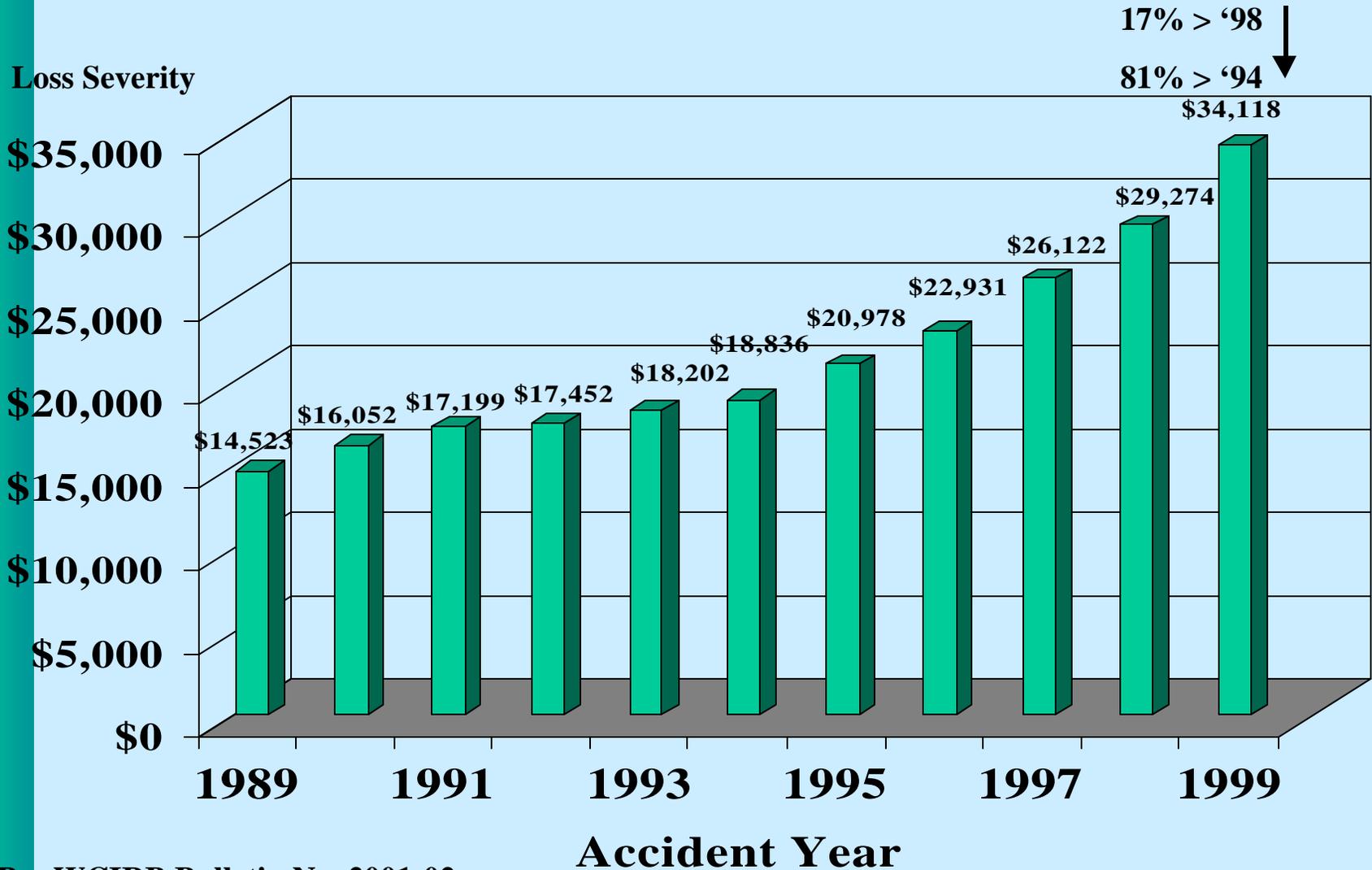
Workers Compensation Trends

California Workers' Compensation Accident Year Combined Loss And Expense Ratios

(as of 9/30/2000)



California Workers' Compensation Estimated Ultimate Total Loss Per Indemnity Claim (as of 9/30/2000)



Expected Legislation ?

- *No* increase to indemnity levels in 2001,
- Governor Davis has advised he *will* sign a bill next year.
- SB 71 has passed out of committee. Could cost \$3.6 billion. Likely to be signed in 2002.

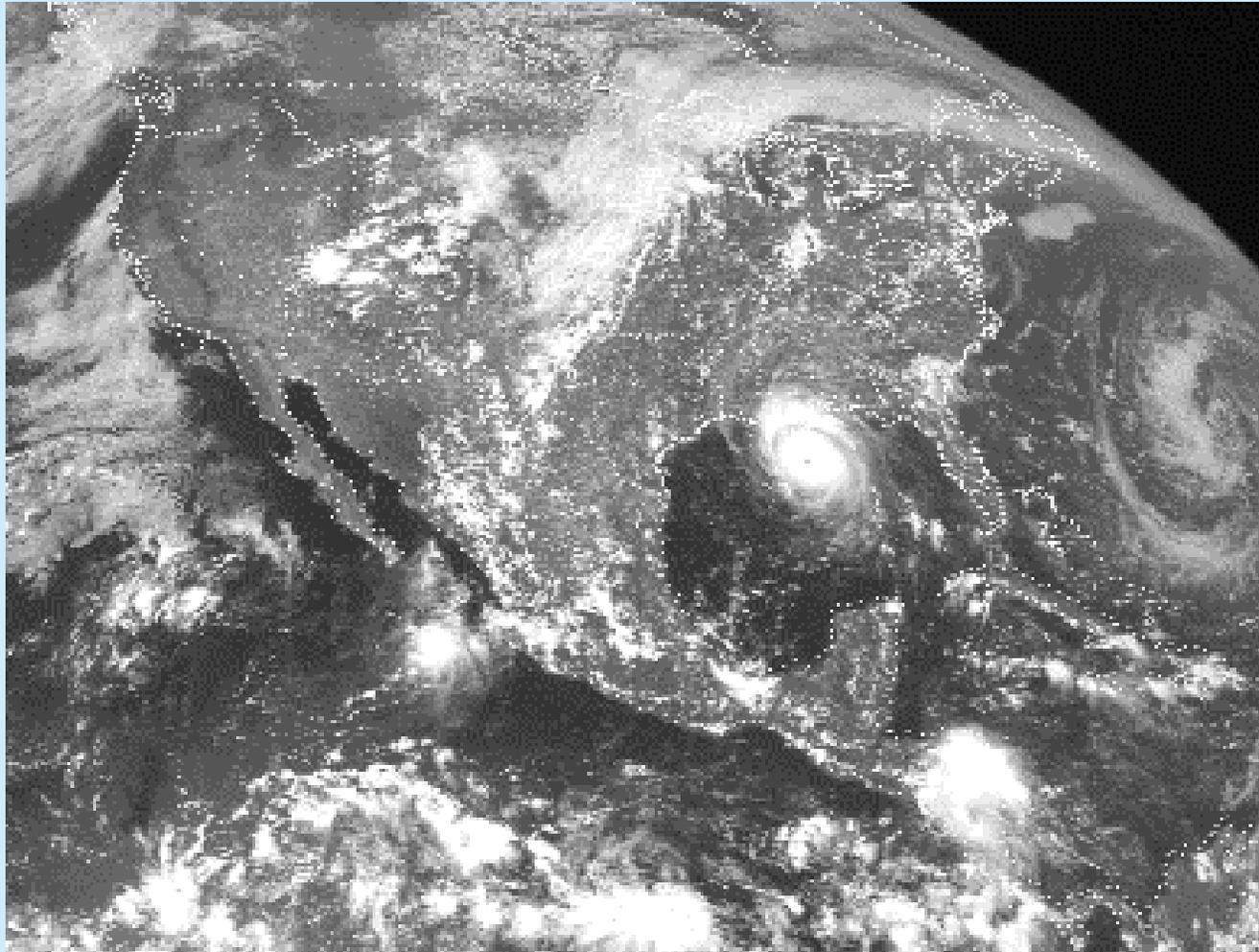
Liability Trends

Liability Insurance Trends

- Minimum price increases of 15% for good loss history accounts. Higher increases for lower retentions and poorer accounts.
- Expect:
 - Restriction in liability forms in areas such as Employment Practices, Pollution, Inverse Condemnation
 - Increased deductibles/retentions
 - Return of Claims-made coverage in 2002

Property Trends

Catastrophes



Recent Catastrophic Events

	<u>Disaster</u>	<u>W here</u>	<u>Total Damages</u>	<u>Death Toll</u>
• 1999	Hurricane Floyd	U SA	\$6,000,000,000	75
	Earthquake	Turkey	\$5,000,000,000	15,814
	Cyclone	India	\$ 650,000,000	9,500

Source: *Business Insurance, At the Millennium (Special Issue Jan 2000)*

- 2000 ♦ 24 Catastrophic Events (Insured loss excess \$25,000,000)
- U SA ♦ Total claims of \$4.3 billion vs. \$9.1 billion 10 year average

Source: *National Underwriter 2/5/01*

- Europe ♦ Ericson Files Massive Business Interruption claims (\$511,000,000) on Fire at sole source supplier.

Source: *Business Insurance 10/9/00*

- ♦ 1999 Insured Storm losses of \$9.7 billion

Source: *Business Insurance 12/25/01*

- 2001 Business Insurance estimates Seattle earthquake's insured loss at \$1 Billion

Source: *Business Insurance 3/5/01*

Property Insurance Trends

- Catastrophe Excess carriers requiring increased retentions.
- Sub-limits will be reduced - end of the “freebees”.
- Business Interruption risks will be scrutinized if exposure is large.
- Fire Rates rising substantially (25-50%), Catastrophe peril(CA Earthquake, FL W ind & possibly AK, W A Earthquake) to rise *extra* substantially (40-300%)

First Quarter 2001 Results

- 25 - 30 carriers increased premiums, 18 more than 10%
- Net premiums up 10.4% (St. Paul up 32%)
- Investment income *decreased* 2.6%
- Only 12 of 29 reported improvement to combined ratios
- Overall combined ratio was 106.2 compared with 107.2 for 2000 (for the first quarter)

From National Underwriter

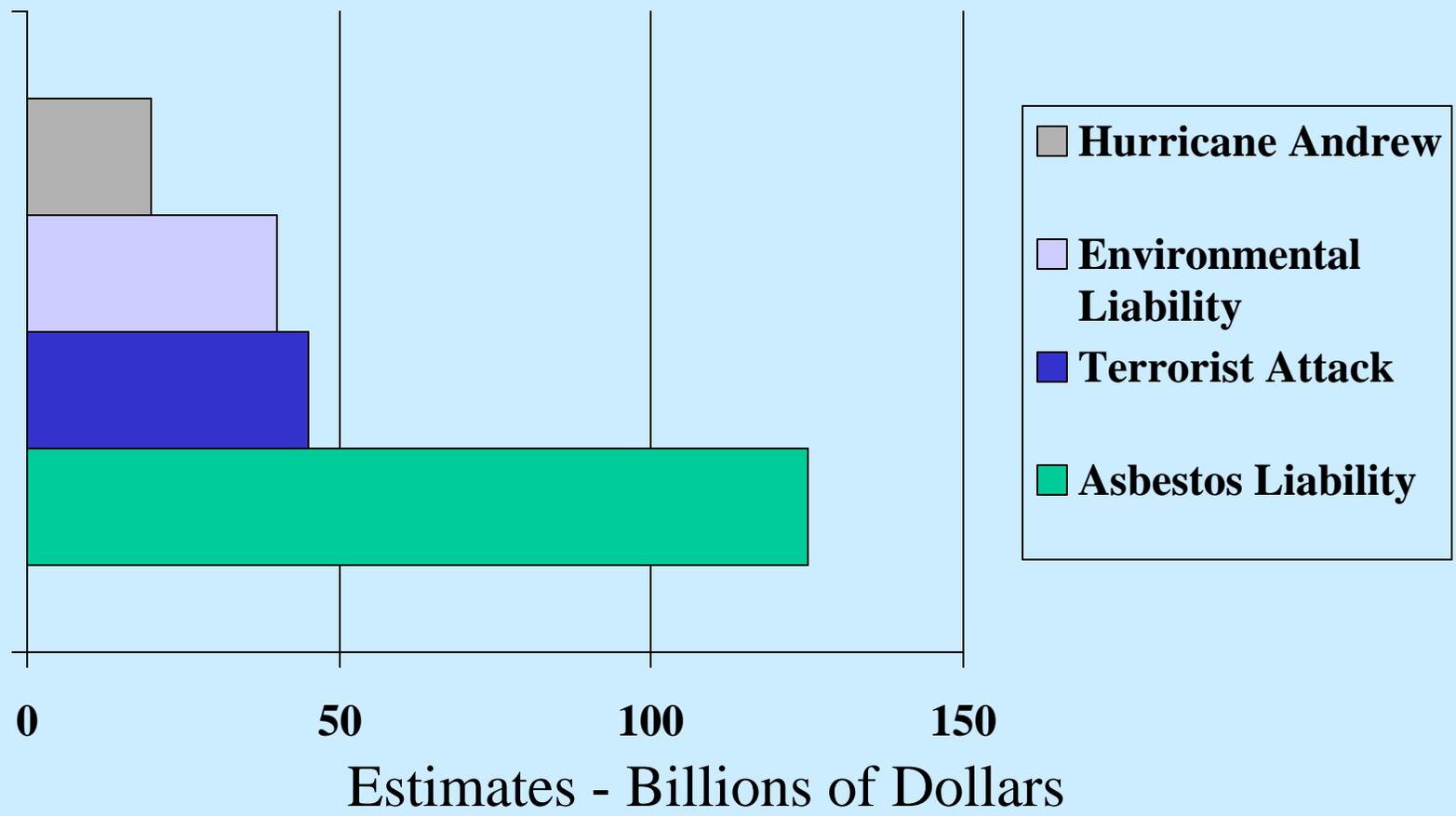
A.M. Best Comments

- “...at current pricing levels, it will take many commercial insurers two years of sustained price increases ...to reach ... break-even.”
- “Sadly for many, sustained price increases are needed simply to offset reserve deficiencies that have built up over the past three years.”
- “...a lot rides on whether catastrophic losses occur in the next twelve months.”



September 11, 2001

Largest Insurance Losses...



World Trade Center Industry Response

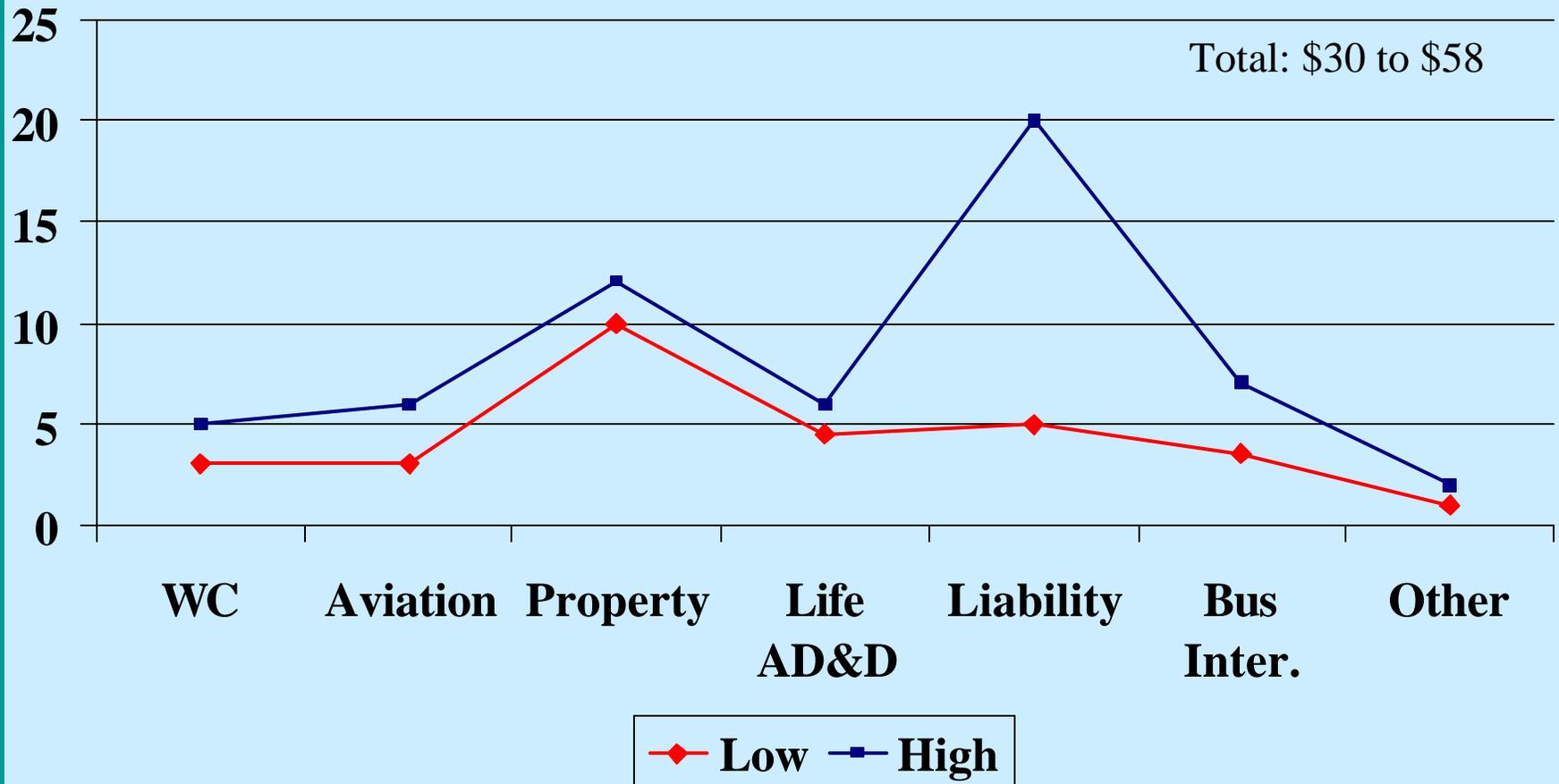
- Insurance companies are deploying thousands of people to cope with what will be the largest disaster in insurance history.
- "This is why insurance is vital to society," said Gordon Stewart, president of the Insurance Information Institute.
- "Without insurance, it would be impossible to recover from this disaster. Insurers are committed to the rebuilding of New York City."
- *September 14, 2001 Newswire*

Estimated Costs to Insurers

- As high as \$30 to \$58 Billion total cost.
- The Trade Center itself was probably insured for \$3.6 billion though worth over \$5 billion
 - It was considered unlikely that both buildings would be lost so the insured value is for one building.
- It is considered highly unlikely that any property or life insurers excluded coverage based on acts of war or terrorist exclusions, but it is likely that such events will be excluded going forward.
 - *As of September 18, 2001*

Estimated Costs to Insurers

Billions



Source: Towers Perrin, Sept. 20th

Can the Insurance Market withstand the impact?

- ◆ Standard & Poor's: Insurance Industry Not Crippled by W TC Attack, L O N D O N , Sep 14, 2001
- ◆ Standard & Poor's announced that the direct financial losses relating to the disasters will in all likelihood exceed the largest insured losses ever yet seen.
- ◆ "Any attempt to quantify the financial impact of the recent terrorist actions must be purely speculative until more information becomes available, which may take weeks," said Steve Dreyer Managing Director for U.S. Insurance Industry Ratings at Standard & Poor's.
- ◆ "But the insurance industry is strongly capitalized and can withstand an enormous financial hit without threat to the stability of the system overall. Totals would have to exceed \$50 billion before we would begin to worry about the insurance system," he said.

Significant technical questions:

- Even if primary insurers in the U.S. do not exclude terrorism, do their reinsurers? This is common practice among European reinsurers.
- Will the crashes and subsequent building collapses be considered a single event or multiple events?
- Definition of the losses either as a catastrophic single event, or as a series of separate large claims will determine which insurers and reinsurers eventually prove liable for the losses.

Reductions and Increases

- **Reductions**
 - Availability of limits
 - Number of carriers willing to entertain risk
 - “Flight to quality” by insureds leads to fewer acceptable carriers/reinsurers
 - Market withdraws from certain sectors
- **Increases**
 - Premium
 - Retentions/Deductibles

W hat to D o?

Managing through the Cycles

- ❖ From 1978 to 1994 JPA's helped public entities to find insurance.
- ❖ From 1994 to 2000, JPA's fought off the competition of the commercial carriers, lowered retentions, and increased coverage.
- ❖ From 2001 to 2004, what will JPA's do?

At this point, it appears well managed and well funded JPA's are poised to assist their members weather the upcoming difficulties...

Reassess Your Objectives

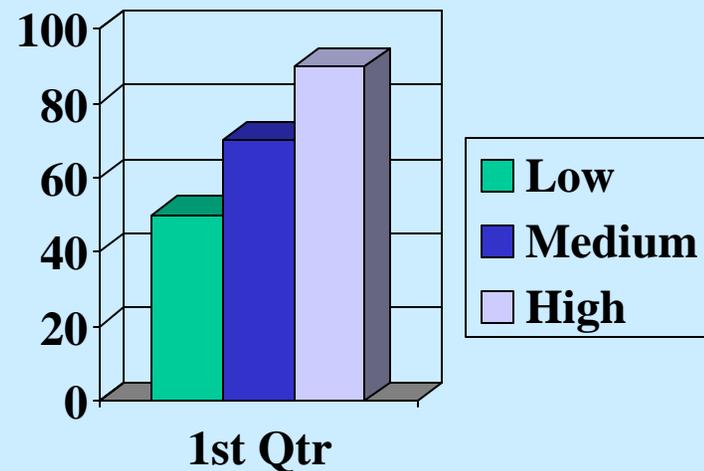
- ❖ Reaffirm why you formed your JPA in the first place
 - Group purchase, to obtain economies
 - Ability to self insure when pricing goes beyond the cost to self insure)
 - Provide coverage not otherwise available
- ❖ Are your objectives still current?

Evaluation of Excess Insurance Purchase

- What criteria do JPA's Use to determine their level of excess insurance purchase?
 - Philosophical considerations regarding "risk appetite".
 - The cost of the layer under consideration *relative* to actuarial predictions.
 - Internal funding capabilities *relative* to likely frequency of events.

Managing through the Cycles

- Selection of a “Confidence Level” for pool funding that is consistent with your “risk appetite”
 - 50%, 70%, 90%
- Deficit Reduction
- Rate Stabilization



Renewal Process Advice

- Begin the Process Early
 - Update schedules
 - Review and up-date loss history
 - Review and up-date loss payees
 - Review existing terms that should be defended at all costs as opposed to those that could be sacrificed, if necessary.
- Leverage Long Term Relationships
 - Now is not the time to play games with your carrier. Develop a “win-win” solution.

Renewal Process

❖ Evaluate Contribution Levels

- Now is not the time to be “trading” dollars with the insurance industry. It is more cost effective for a JPA to retain and pay for the “expected” claims than to transfer this cost to an insurance company

❖ Update Membership Information

- Underwriter’s appetite for accurate information has become insatiable in this hard market
- Underwriters are demanding full COPE and loss history on new and renewal business

Strengthen Your Risk Management Programs

- Utilize your service abilities, both internal and external
- Revitalize Risk Management Techniques
 - Evaluate Loss Statistics
 - Review Policies and Procedures,
 - Do your Members use them?
 - Review Injury and Illness Prevention Plans
 - Push Loss Control



Q uestions...

?

ABAG PLAN Corporation

Actuarial Methodologies for ABAG PLAN's
Funding and Equity Distribution

The September 11 Terrorist Attack: Potential
Impacts

Board Meeting
October 4, 2001

Ronald T. Kozlowski, FCAS, MAAA

This document was designed for discussion purposes only and is not intended to present detailed information on our analysis and findings. It is incomplete, and not intended to be used, without the accompanying oral presentation and discussion.

Topics of Discussion

- Actuarial Methodologies
 - Estimated Outstanding Liabilities as of June 30, 2001
 - Premium Allocation
 - Equity Distribution

- September 11 Terrorist Attacks:
Potential Impacts

Calculating Outstanding Reserves

- Data
 - Paid and incurred loss & ALAE
 - Reported claim counts
 - Payroll exposure
- Develop Ultimate Loss & ALAE
 - Determine development patterns
 - 4 development methods to project ultimate losses
 - paid/incurred loss development
 - paid/incurred B-F methods
 - Select ultimate loss & ALAE
- Outstanding reserves = selected ultimate loss & ALAE
- paid loss & ALAE

Development Patterns

ABAG PLAN CORPORATION

Liability
 Incurred Loss & ALAE (at ABAG Retention Limits)
 Data Evaluated as of 9/30/00

Accident Year	Evaluation Age in Months												
	15	27	39	51	63	75	87	99	111	123	135	147	159
1986-1987							1,611,934	1,629,660	1,646,660	1,659,161	1,659,161	1,659,161	1,651,216
1987-1988						539,852	539,852	539,852	539,852	539,852	539,853	539,852	539,852
1988-1989					453,492	447,458	445,975	445,975	447,458	452,459	452,458	465,958	
1989-1990				741,214	1,154,819	1,974,730	2,238,582	2,333,581	2,391,580	2,261,460	2,260,815		
1990-1991			905,352	1,573,770	1,467,701	1,534,949	1,527,449	1,539,205	1,539,205	1,517,760			
1991-1992		229,597	1,195,980	1,521,546	1,601,748	1,582,846	1,582,846	1,582,846	1,582,846				
1992-1993	49,220	236,981	441,853	652,219	735,295	746,447	882,516	866,509					
1993-1994	518,202	713,311	2,163,718	2,568,313	2,375,546	2,375,547	1,870,307						
1994-1995	301,000	533,851	1,269,526	2,224,700	2,150,677	2,123,196							
1995-1996	334,479	117,931	261,697	486,326	950,160								
1996-1997	67,500	445,197	697,469	615,573									
1997-1998	529,605	1,732,648	3,126,591										
1998-1999	2,297,285	3,240,365											
1999-2000	492,765												

Accident Year	Age Interval in Months												
	15 to 27	27 to 39	39 to 51	51 to 63	63 to 75	75 to 87	87 to 99	99 to 111	111 to 123	123 to 135	135 to 147	147 to 159	159 to 171
1986-1987							1.011	1.010	1.008	1.000	1.000	0.995	1.000
1987-1988						1.000	1.000	1.000	1.000	1.000	1.000	1.000	
1988-1989					0.987	0.997	1.000	1.003	1.011	1.000	1.030		
1989-1990				1.558	1.710	1.134	1.042	1.025	0.946	1.000			
1990-1991			1.738	0.933	1.046	0.995	1.008	1.000	0.986				
1991-1992		5.209	1.272	1.053	0.988	1.000	1.000						
1992-1993	4.815	1.865	1.476	1.127	1.015	1.182	0.982						
1993-1994	1.377	3.033	1.187	0.925	1.000	0.787							
1994-1995	1.774	2.378	1.187	0.925	1.000	0.787							
1995-1996	0.353	2.219	1.858	1.954									
1996-1997	6.596	1.567	0.883										
1997-1998	3.272	1.805											
1998-1999	1.411												
1999-2000													

Labels	15 to 27	27 to 39	39 to 51	51 to 63	63 to 75	75 to 87	87 to 99	99 to 111	111 to 123	123 to 135	135 to 147	147 to 159	159 to 171
Average 1	2.681	2.200	1.431	1.205	1.007	1.020	1.006	1.006	0.990	1.000	1.010	0.998	1.000
Average 2	2.152	2.134	1.472	1.049	1.001	1.043	1.003	1.001	0.998	1.000	1.010	0.998	1.000
Average 3	1.713	2.284	1.390	1.068	1.085	0.988	1.012	1.009	0.980	1.000	1.005	0.996	1.000
Average 4	1.720	2.122	1.354	1.048	1.004	0.986	1.014	1.009	0.980	1.000	1.005	0.996	1.000
Average 5	1.872	1.780	1.493	1.037	0.997	0.922	0.999	1.011	0.967	1.000	1.005	0.996	1.000
Average 6	1.254	1.150	1.122	1.084	1.043	1.024	1.014	1.009	1.006	1.003	1.002	1.001	1.000
Prior Selection	2.000	2.250	1.500	1.080	1.050	1.040	1.010	1.010	1.008	1.005	1.005	1.002	1.000
Selection - Total Limits	1.567	1.304	1.154	1.036	1.022	1.013	1.007	1.005	1.005	1.003	1.002	1.001	1.000
Selected													
Selected	2.000	2.200	1.500	1.086	1.064	1.025	1.013	1.009	1.003	1.003	1.002	1.001	1.000
LDF to Ultimate:	8.062	4.031	1.832	1.222	1.125	1.057	1.031	1.018	1.009	1.006	1.003	1.001	1.000

Development Methods

- Loss Development Methods
 - Based on actual loss data for ABAG PLAN (net of member deductibles)
 - Projects each year's losses to ultimate value based on age of year and corresponding development factor
 - Assumes that relative change in a given year's losses from one point to the next is similar to the relative change in prior years at similar evaluation

Development Methods

- Bornheutter-Ferguson Development Methods
 - Initial estimate of ultimate loss developed based on:
 - loss development method
 - frequency/severity method
 - Unpaid/unreported losses based on initial estimate of ultimate losses and payment/reporting patterns
 - Paid/reported actual losses added to expected unpaid/unreported losses
 - As a year matures, more weight is given to actual loss experience and less to expected losses
 - As an accident year matures, the two development methods converge to a single estimate
 - Produces more stable results than loss development method

Outstanding Liabilities as of June 30, 2001

- Outstanding Liabilities

 - = selected ultimate loss & ALAE - paid loss & ALAE

- Outstanding liabilities are comprised of:

 - case reserves

 - where (reported loss & ALAE - paid loss & ALAE)*

 - IBNR

 - where (selected ultimate loss & ALAE - reported loss & ALAE)*

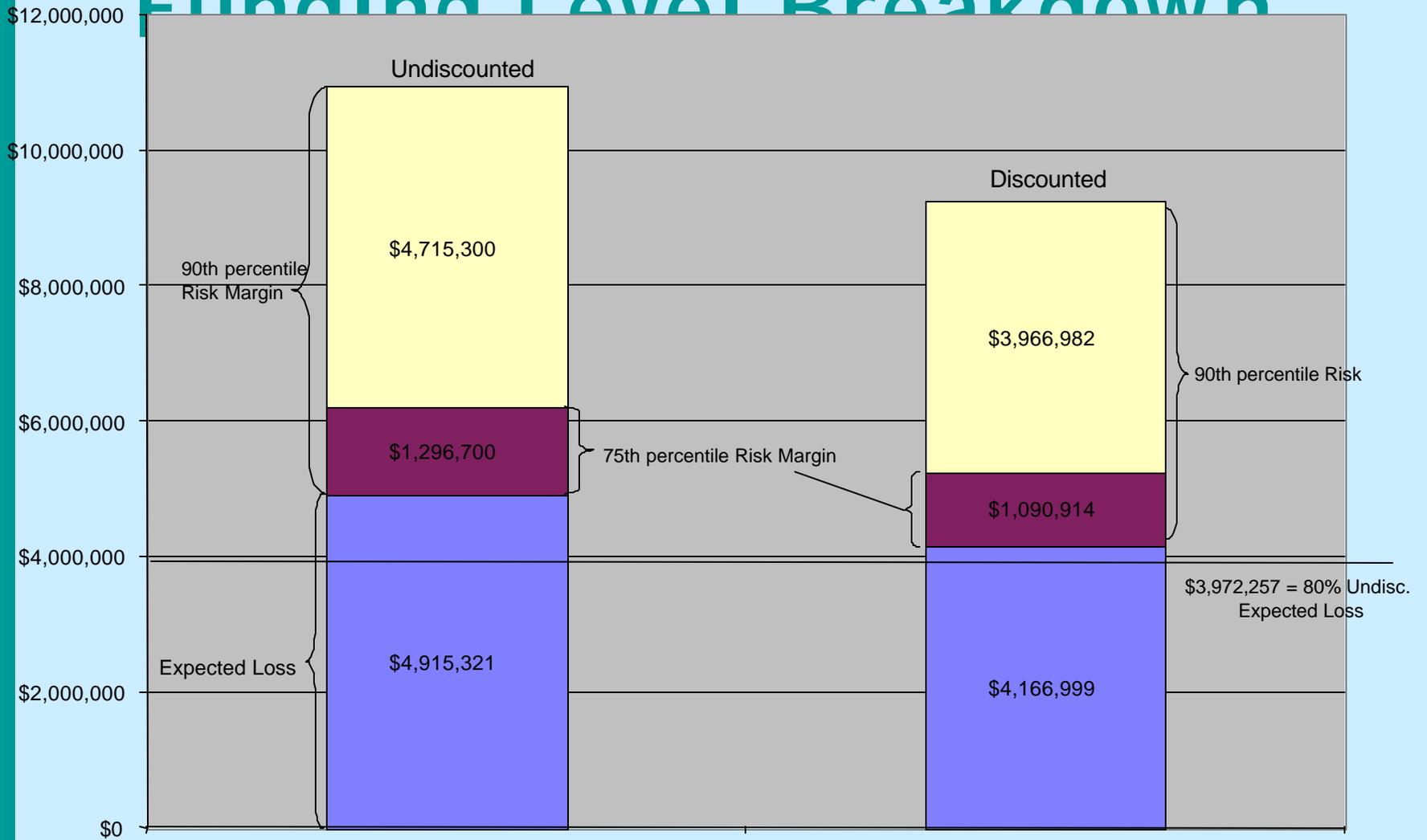
- ABAG provided losses as of December 2000 and Tillinghast projected payments between January 1, 2001 and June 30, 2001 to determine expected Outstanding Liabilities as of June 30, 2001.

- Actual loss payments between January 1, 2001 and June 30, 2001 were \$1.5 million less than expected. Assuming ultimate loss projections are still reasonable, this translates to higher outstanding reserves of \$1.5 million.

2001 - 2002 Premium Allocation

- Loss funding
 - Overall pool premium - 80% of undiscounted loss & ALAE
 - Experience modification factors (five years of losses)
 - Member's deductible
- Administrative Expenses
 - 60% fixed / 40% variable
 - Variable = 1/3 weighted on reported claims > \$1 and 2/3 weighted on paid losses
- Premium limited to $\pm 30\%$ increase from prior year's premium

Funding Level Breakdown



Equity Distribution Methodology

■ Equity distribution equal to:

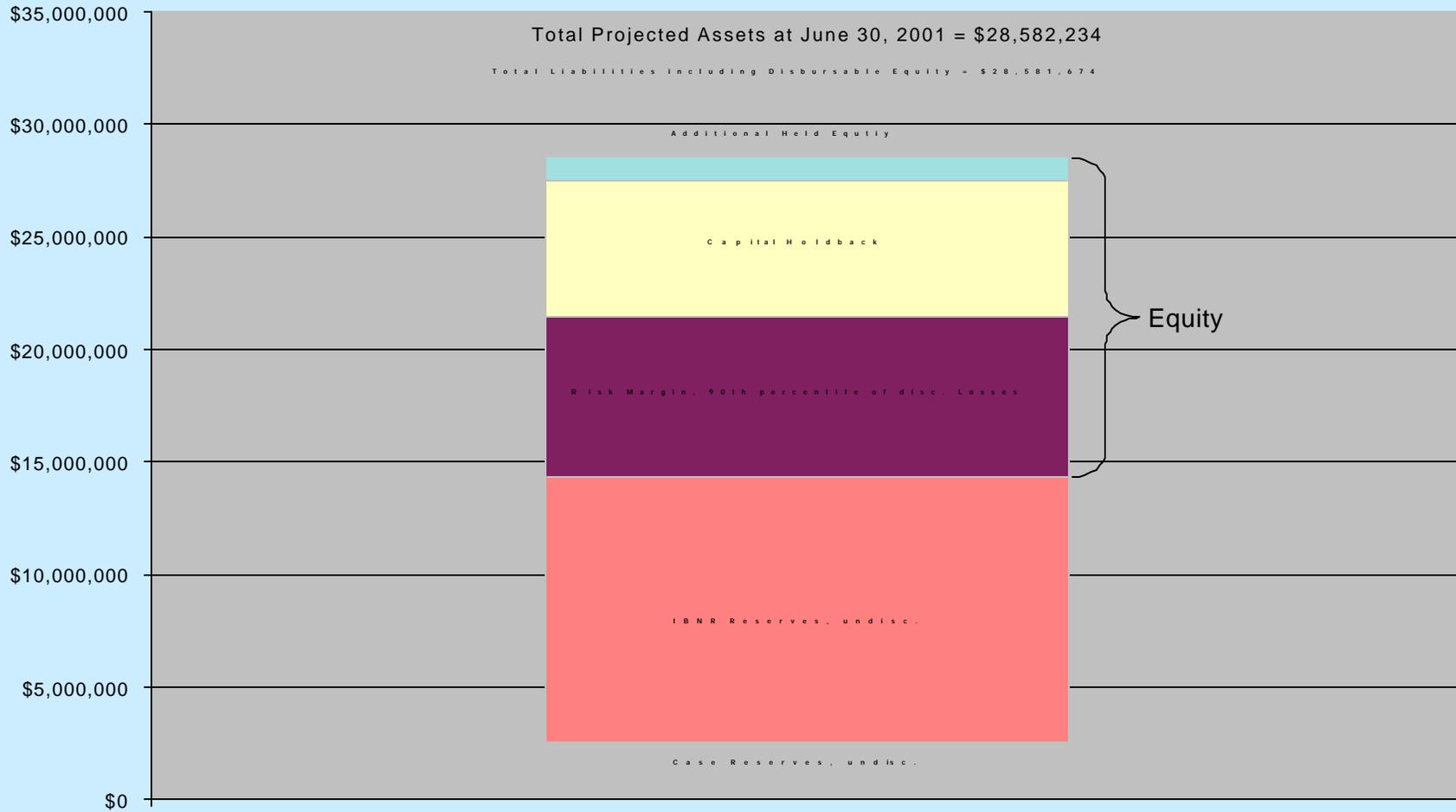
Premium paid

+ Investment income

- Weighted incurred losses (50% on actual losses and 50% on premium distribution)
- IBNR allocation (split based on weighted incurred losses)
- Capital hold back (split to members based on premium)
- Risk margin hold back (split to members based on outstanding losses)
- Dividends paid to date

Composition of the Equity Distributions

Breakdown of Equity Liabilities



Liability Breakdown at June 30, 2001

September 11 Terrorist Attacks: Executive Summary

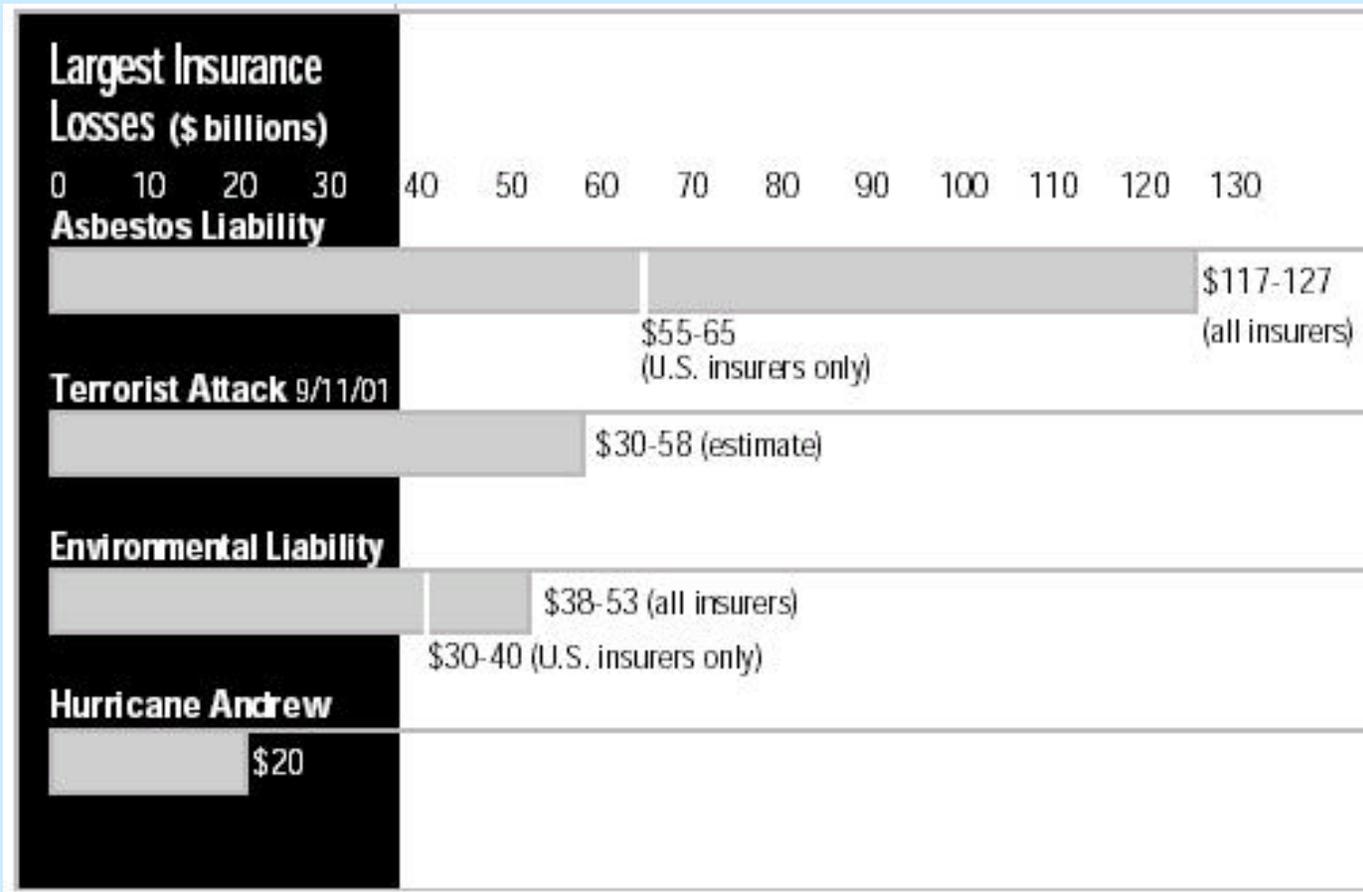
- Estimated insured loss is between \$30 billion and \$58 billion - the largest insured single event loss in history
- A loss of this magnitude will test the solvency of reinsurers and other pooling mechanisms
- Expect reduced reinsurance capacity including catastrophe reinsurance
- Workers compensation markets will continue to harden
- Property and business interruption markets will also continue to harden
- The aviation market may be affected the most
- Calls for government mechanisms will occur

Sept. 11 Terrorist Attack: Estimated Insured Losses

Insured Loss Amounts (\$ billions)		
Line of Insurance	Low	High
Workers Compensation	\$ 3.0	\$ 5.0
Aviation	3.0	6.0
Commercial Property	10.0	12.0
Life, AD&D	4.5	6.0
Liability	5.0	20.0
Business Interruption	3.5	7.0
Other	1.0	2.0
Total	\$30.0	\$58.0

Source: Tillinghast - Towers Perrin estimates

Insurance Industry Largest Losses



Potential impacts on Public Entities

- *Limit consideration* - Concern that potential losses might exceed limit of insurance. Rethinking by entities and pools on how much coverage to buy or offer
- *Trend towards self insurance* - Higher retentions may be forced on self insureds
- *Definition of occurrence* - Need for a tighter definition (one or more occurrence)
- *War/terrorism exclusion* - Impose new coverage restrictions that exclude terrorist acts
- *Business interruption* - Originally designed to deal with manufacturing or retail losses. Quantifying office related losses extremely difficult
- Concern over *mental health and stress-related illness* affecting people and health plan across county
- Concern over physical (e.g., sprinklers) and operational response to risk

Potential impacts on Public Entities

- Excess insurers / reinsurers
 - Not every reinsurer will be able to pay. Reinsurers may discover that their losses exceed the limits of their retrocessional protection
 - The available capacity may shrink
 - Prices for reinsurance may rise dramatically
 - Use of “clash” or aggregate covers that protect against losses across multiple lines
 - Institute exclusions for toxic tort claims, losses from exposure to mold, war, terrorism and cyber torts
 - Target risk building underwriting standard
 - Concern over worst quality of commercial property risk (e.g., California earthquake exposure)
- Flight to quality, both by the entity being insured and the insuring / reinsuring entity

Potential impacts on Public Entities (con't)

- Government pools may be necessary
 - If terrorist activities or similar catastrophic events are deemed beyond the ability or willingness of the insurance industry to finance, governmental mechanisms may be required. Such mechanisms include the longstanding federal riot and flood programs. More recently-and more to the point- would be pool re and the U.K. Terrorist reinsurance program
- Risk management
 - Traditional insurance solutions are not designed to take care of all the possible risks and financial implications
 - Increase loss control programs, disaster planing to mitigate risks