CSAC EIA / CPEIA Restructure
A Detailed Analysis

I. PURPOSE

This detailed analysis is intended to explain the relationship between the CSAC Excess Insurance Authority and the California Public Entities Insurance Authority, and the proposed restructuring of the relationship between the two public entities. This analysis provides background and historical information about the relationship and discusses the benefits that member counties have enjoyed from this relationship. The current structure and proposed new structure of the two entities is discussed in detail.

II. BACKGROUND/HISTORY

The CSAC Excess Insurance Authority (EIA) was formed by and for the California counties in 1979. Twenty-five years later, this member directed joint powers authority has proven extremely successful in developing insurance and risk management programs that today provide unique and cost effective solutions to 93% of the State's counties (54 out of 58). Collectively the counties are able to be more self reliant, flexible and creative than they could otherwise be on their own. This allows them to secure broader coverage at substantially lower rates, and most importantly to maintain stability and predictability from a budget standpoint over the long term.

Based on this success, many other non-county public entities expressed interest in participating in EIA programs over the years. The interest intensified towards the end of the 1990s and into 2000. This was a result of several factors including: new legislation creating new local governmental entities and services, a continuing blurring of the lines between counties and other local public agencies and an insurance market that was starting to show signs of hardening. This changing environment set the stage for a strategic planning retreat conducted in March of 2000 involving the EIA's Executive Committee, the Chairs from the other EIA Committees and selected staff from both Driver Alliant and the EIA.

At the retreat, participants reached the conclusion that we were indeed in a dynamic environment. We agreed that as the members' needs evolved, the Authority needed to be in a position of sufficient flexibility to meet those needs as they arose, or risk stagnation and mediocrity. We also determined that our current membership structure limited our flexibility, creativity and ability to meet the growing and changing demands of our membership. The overwhelming conclusion was that we must find a way to expand program membership to include related entities (where it makes sense) and to spread the costs of providing services over a larger membership base. This was the foundation upon which the California Public Entity Insurance Authority (CPEIA) was built.

Over the next sixteen (16) months, through four Board of Directors meetings, another strategic planning retreat, numerous Executive Committee meetings and countless staff hours, the CPEIA structure, role and governance was determined. On July 1, 2001, the CPEIA was officially launched. From the beginning, it was anticipated that this new “sister” JPA would provide direct and indirect benefits, not only to the other California public agencies, but also to the EIA county members as well. Not surprisingly, these expected benefits were very similar to the benefits that the county members already received from their involvement in the EIA, but on a broader scale. The CPEIA was expected to provide the following benefits:

1. *Produce lower costs and greater stability for member counties through size/volume discounts;*
2. *Allow more services/programs to be provided by spreading costs over a larger membership base;*
3. *Enable the counties to “assist” other local entities for the benefit of all;*
4. *Benefit the taxpayers by reducing costs to local government.*

III. BENEFITS TO MEMBER COUNTIES

This section of the report identifies and quantifies where possible, the benefits realized by the county members from the existence of the CPEIA. We are focusing this discussion on the anticipated benefits that were outlined at the creation of the CPEIA as identified above.

1. Lower Costs and Stability to Member Counties

The concepts of insurance and self-insurance are both based on volume. In general, the bigger the group, the more predictable the results will be. This translates into lower rates from commercial carriers because of the greater predictability and because the larger premium is more attractive to underwriters. It also translates into lower actuarial funding requirements for self-insured entities, and allows them the ability to retain more risk. This ability helps keep the overall costs lower and more stable over the long term because more of the funding is based on actuarial projections and less is left to the whims of the commercial insurance market. Through the first four years of the CPEIA’s existence, this has certainly been the case. Members have benefited from the ability to retain more risk [Excess Workers’ Compensation Program (EWC)] and from the ability to attract new markets [Primary Workers’ Compensation (PWC), EWC and Primary General Liability (PGL)].

Ability to Retain More Risk (EWC) - The commercial insurance market became extremely hard following September 11^{th}, 2001. The California workers’ compensation market was one of the most impacted segments. For a variety of reasons, many carriers either became insolvent or withdrew entirely from the California workers' compensation market. Those few that remained significantly reduced the limits they offered, insisted on higher retentions, implemented new exclusions and dramatically increased rates. The EIA was not immune. Prior to the 02/03 renewal, the EIA pooled losses to $300,000 and American Reinsurance (Am Re) provided statutory excess limits on a reinsurance basis. The premium paid for this excess coverage was approximately $2 million. During the renewal negotiations prior to the 02/03 renewal, Am Re offered to renew the program at that same attachment for $42 million…an increase in excess of 2,000%. $34.6 million of this amount was to pay for the layer from $300,000 to $5 million per loss. Thanks to the size of the EIA, and aided by the additional volume of the CPEIA members, the Program was able to increase the pooled layer to $5 million. This additional pooled layer was funded based on the EIA's actuarial analysis at $6.2 million. *(Estimated benefit: $28.4 Million)*

Ability to Attract New Markets (PWC, EWC & PGL) – Members joining the PWC Program made commitments to remain in the Program for five years. Upon the expiration of the initial five-year commitment, the two largest member counties in the program withdrew. Fortunately, the premium volume that was critical to the success for the program was more than made up for by new CPEIA members, thereby saving the PWC program for the remaining 20 counties. CPEIA participation saved the PWC program a second time in July, 2004. The 04/05 renewal of the PWC Program would not have been accomplished without the CPEIA volume. The incumbent carrier, Am Re, had provided the aggregate stop loss protection for the program since its inception in 1997. Through that period of time no other carrier was willing to compete with Am Re for the Program. Am Re provided renewal terms for 04/05, but was only willing to add $3.5 Million in limit to the multi-year rolling program. This equated to about 5.5% of the attachment point, and was not considered acceptable for the long term viability of the program. Fortunately, another market, Renaissance Reinsurance Company (Ren Re) entered the picture. Ren Re matched the premium that Am Re had offered, but agreed to a limit equal to 17.5% of the attachment point (calculated at $11.2 Million at the time of the renewal). Ren Re's interest in the Program was absolutely based on the size of the group. Without the CPEIA volume, this deal most likely would not have been possible and the Program would have been faced with the choice of an insufficient limit or going without reinsurance protection entirely. The premium and overall funding for the program did not change, but the difference in limit between the two offers was a significant benefit to the members. *(Estimated benefit: $7.7 million)*

Historically, the PWC and EWC programs had always been placed together with the same carrier. Am Re did not ultimately provide a quote for the 04/05 EWC Renewal, but using their 03/04 rate against the 04/05 payroll, one can estimate their premium for 04/05 to be $17.3 Million. Ren Re's quote was $3.9 Million less than this estimate. The members used this savings to purchase $50 Million of additional limits resulting in an overall limit per occurrence for the Program of $100 Million. *(Estimated benefit: $3.9 million)*

The PGL Program was also faced with the prospect of going without reinsurance protection. This was avoided when another new market, Imagine Insurance Company, emerged. Imagine agreed to fully reinsure the program above the members' $10,000 deductibles with pricing based on the actuarially determined 80% confidence level. The security this provides to the Program was equivalent to funding at the 95% confidence level. This additional security, calculated to be $1.5 Million, is a definite benefit to the members. It would not have been possible without the CPEIA volume, which makes up over 32% of the total program. *(Estimated benefit: $1.5 million)*

(Total Estimated Benefit Due to Added Volume: $41.5 Million)

2. Additional Services/Programs through Greater Spread of Cost

In the last four years, the EIA has also added or expanded numerous services for the members. These include regional training programs, Internet-based training, Internet-based claims services, an expanded website, integrated bill review and many others. The EIA has also launched the new EIAHealth Program, a group health insurance plan. These additional services and programs, as well the additional size of the other EIA Programs, have led to the addition of 15 new staff members since 2001/02. We estimate that seven of these positions would have been necessary additions without the CPEIA. Six of the positions are directly attributable to the CPEIA and two positions were required based half on EIA demands and half on CPEIA. Member county administrative costs should have significantly increased over the last four years; however, the additional administration revenue contributed by the CPEIA members has been more than sufficient to cover the cost of all 15 new positions. This economy of scale allows for expanded services to the County members without additional costs. In addition, in order to preserve the level of service provided to member counties, the EIA has structured the relationship such that most of the client contact and servicing of CPEIA members is provided by Driver Alliant staff. CPEIA members pay an additional broker fee to Driver that the counties do not pay.

In addition, it was agreed that the CPEIA members would pay a special administrative fee of one-half of one percent of premium. This participation fee does not go to reduce administrative expenses of the EIA, but goes into a special fund that is available for distribution as a dividend back to the member counties only. On October 1, 2004, the Board of Directors declared distribution of a $489,153 dividend covering the first three years, 2001-04, to be set up as a special risk management subsidy account. The amount of participation fee collected from the CPEIA members for the county risk management subsidy fund for 2004/05 alone is estimated to be $446,173. This participation fee was designed to be tangible, direct evidence to the counties of the value of the CPEIA organization. *(Estimated Benefit General Admin $1.2 Million, annually, plus Participation Fee $446K, annually)*

3. Counties Assisting Other Local Entities

There is little doubt that through the CPEIA, the counties have accomplished their goal of providing assistance to other local entities. The large volume of California public entities that have joined the CPEIA since its inception speaks to the value that the programs provide and the real need that the CPEIA was able to fill. Many of these members are county affiliated entities such as In-Home Support Services, county contracts with cities, and individual county departments. Today, CPEIA membership stands at 206 member units. This number includes many other JPAs, who themselves have many underlying public entity members, so the total number of California public entities being served by the CPEIA exceeds 1,400. In fact, over 78% of all California cities are now participating in one or more of the EIA programs through the CPEIA. The following table shows the number of CPEIA members by year and by EIA program.

Participants By Program	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**Total**
Primary Liability	1	11	13	1	**26**
Liability I & II	2	26	20	3	**51**
Primary W.C.	0	7	9	7	**23**
Excess W.C.	4	23	46	15	**88**
Property	3	11	2	1	**17**
EIA Health	0	0	0	1	**1**
All Programs	**10**	**78**	**90**	**28**	**206**

4. Reducing Costs to Local Government

The formation of the CPEIA coincided with an already hardening insurance market that became an extremely hard market overnight due to the World Trade Center disaster on September 11th. As a result, commercial insurance rates went through the roof, minimum retentions were raised, coverage and limits were restricted and in some cases needed coverage was simply unavailable. Many California public agencies turned to the JPA community for solutions. The new CPEIA JPA was there to provide what was in many cases the only viable option for coverage. This was especially true in the Excess Workers' Compensation Program as evidenced by the numbers in the preceding graph. Many entities that joined the CPEIA were able to realize as much as a **50%** rate reduction from expiring rates (depending on the line of coverage, SIR, loss experience and other factors). The savings was often even more dramatic when compared to renewal quotations provided by other markets. While we do not have access to the other quotations provided for all of the CPEIA members, we have analyzed those that we do know of, and have used them to make a conservative estimate of the total savings afforded to the CPEIA membership due to their participation in the programs. These estimated savings are shown in the following table:

Est. Savings By Program	2001/02	2002/03	2003/04	2004/05	Total
Primary Liability	$0	$618,000	$531,000	$310,000	**$1,459,000**
Liability I	$25,000	$2,586,000	$2,102,000	$2,094,000	**$6,807,000**
Liability II	$0	$1,105,000	$2,641,000	$2,687,000	**$6,433,000**
Primary W.C.	$0	$15,660,000	$22,491,000	$14,891,000	**$53,042,000**
Excess W.C.	$95,000	$15,830,000	$21,586,000	$11,402,000	**$48,913,300**
All Programs	**$120,000**	**$35,799,000**	**$49,351,000**	**$31,384,000**	**$116,654,300**

The saving of more than $116 million clearly shows why the CPEIA has seen such substantial growth. In addition, the CPEIA members benefit from the flexibility of the programs. This flexibility is apparent in the choice of retention levels, choice of limits and the lack of multiple year commitment requirements, in most programs.

IV. EIA / CPEIA STRUCTURE

The CPEIA was organized as a separate joint powers authority pursuant to Government Code 6500 et seq. Governing documents consist of a Joint Powers Agreement and Bylaws. All members of the CPEIA are required to execute the JPA Agreement as a condition of membership. The CPEIA is governed by a Board of Directors consisting of 11 voting members including 9 members elected by the CPEIA membership and 2 members appointed by the EIA Executive Committee (currently the President and Vice President of the EIA). The president of the CPEIA (and the Vice President as alternate) is provided an ex-officio (non-voting) seat on the EIA's Executive Committee.

The CPEIA and the EIA are two separate legal entities that have entered into a contractual agreement that allows members of the CPEIA to participate in the EIA's insurance programs and to receive all services, except internet subsidies, as are provided to county participants. The agreement between the two entities specifies that the EIA staff including Treasurer and Auditor serves as the staff of the CPEIA. From a financial standpoint, the CPEIA is treated as a component unit within the financial statements of the EIA. Therefore, the CPEIA participation becomes part of the EIA budget and overall financials and there are not a separate CPEIA budget and financial statement. CPEIA as an entity has no assets and no liabilities.

When CPEIA members join an EIA Program they are treated as full participants in that program with the same rights and obligations as county members (other than voting rights). Contributions of CPEIA members are fully pooled and co-mingled with contributions of EIA members. CPEIA members have the same dividend potential and assessment risks as county members and are governed by the same allocation formulae when determining premium. Upon distribution of assets in the event of termination of the EIA, CPEIA members would participate in the same manner as EIA members. The only difference in premium development is that CPEIA members pay an additional one-half percent participation fee that county members do not pay and CPEIA members pay a special broker fee to Driver Alliant that counties do not pay. The broker fee is required because Driver staff have been tasked with the responsibility of servicing CPEIA members in a more direct way to be certain that the level of service provided to county members by EIA staff is not reduced due to CPEIA involvement.

The CPEIA Board has full authority to act on behalf of the CPEIA membership; however, they have been given <u>no</u> authority in matters relating to the operation and administration of EIA Programs. The CPEIA Board acts to approve new members into the CPEIA, but does not consider membership in any programs nor funding decisions related to programs. The EIA, working through its various committees and Board, retains the sole authority to decide all matters relating to its programs including underwriting and rating decisions affecting county and CPEIA members.

The growth and success of the CPEIA in four years has been nothing short of phenomenal! Membership statistics are attached indicating CPEIA annual premium volume approaching $100 million. In some programs, CPEIA premium volume actually exceeds EIA premium volume. CPEIA members understood when joining the EIA programs that while there is risk-sharing between CPEIA and EIA members, they were joining a county run and controlled program and the intention was, and is, to remain under the control of the counties who formed the EIA. Nevertheless, as the CPEIA membership grew it was important to provide CPEIA members with opportunities to participate in the administration of the programs. As a result of a March 2003 strategic planning retreat, the EIA began the process of designating one seat for a CPEIA representative on each of the key program committees. Some committees expanded the number of committee seats in the process and other committees designated one of the existing seats for CPEIA membership. In this fashion, the EIA was able to involve a very important and significant constituency without relinquishing control over the programs and organization.

The EIA conceived of this rather convoluted structure for a number of reasons. In the spring of 2000 we were concerned about having the flexibility to meet the needs of our county membership in a changing environment that included the transition of the courts away from counties and the creation of such entities as In-Home Support Services and Children and Families First (First 5) Commissions. We also foresaw a hardening insurance market that would bring certain risks and opportunities. Opening the programs to membership beyond counties to take advantage of a broader, more diverse membership base was the obvious answer. The two obvious strategies to accomplish this goal were to 1) develop the CPEIA structure, or 2) amend the EIA JPA Agreement to allow direct membership in the EIA.

We settled on the CPEIA structure primarily because of the clear lines that were drawn between counties and non-counties by creating a completely separate organization. The only philosophical issue to struggle with was that of risk-sharing between counties and other public entities. Goals of retaining county control, and not disturbing the relationship with our founding organization, CSAC, were accomplished.

In evaluating the other alternative of direct membership, we were not able to conceive of a solution that would preserve county control and maintain our CSAC relationship. It was difficult to forecast the level of participation by public entities and to structure an appropriate opportunity for these outsiders to participate in the governance of the organization. We knew (we thought) that we would start with a few "county-friendly" entities and slowly grow the membership over time. It did not seem practical to create such a major change within the organization as altering the membership criteria for what was expected to be a fairly minor part of our operation, at least initially. An amendment to the EIA's JPA Agreement is a major endeavor and we could only speculate in 2000 what the organization could and should look like depending on the level of outside participation. Today, we are able to accurately assess the level of participation and have reached agreement on the appropriate structure that will ensure county control and provide meaningful participation opportunities for our non-county members.

V. PROPOSED RESTRUCTURE

It is proposed that the CPEIA members be permitted to join the CSAC EIA directly thereby eliminating the need to maintain the CPEIA as a separate legal entity. In order to accomplish this restructure, the EIA JPA Agreement needs to be amended to alter the membership requirements and voting rights. The EIA JPA can only be amended by an affirmative vote of two-thirds of the member counties' boards of supervisors (36 counties). The essence of the enclosed JPA and Bylaw amendments is summarized as follows.

Two classes of membership will be created: Member Counties (those counties that maintain their membership in CSAC) and Public Entities (those public entities in the State of California that do not maintain membership in CSAC). Member Counties continue to each have a voting seat on the Board of Directors via appointment by each member board of supervisors of a board member and an alternate board member. Public Entity members will receive seven voting seats on the Board of Directors and will have three alternate directors that are permitted to vote in the absence of one of the seven. These 10 Public Entity Directors will be elected by the Public Entity membership and will include three designated seats in the categories of cities, schools, and special districts. Currently there are 54 member county directors to which we would add seven Public Entity directors for a total of 61 eligible voting directors. Therefore, the Public Entity membership would control approximately 11.5% of the votes. There is a provision that the Public Entity representation on the board can never exceed 20%.

In addition, the existing Executive Committee will be expanded from 9 voting seats to 11 voting seats. The two new Executive Committee seats will be designated for representatives from our Public Entity membership. The Public Entity members on the Executive Committee will be elected by the 61 member board of directors and must come from the seven representatives that are elected to the board by the Public Entity membership.

There is a provision for the Public Entity membership to conduct an annual membership meeting that will be primarily for the purpose of information exchange and to foster communication among the many entities that do not have voting representation. Once the new structure is put in place, there will be no need to continue with the CPEIA, which will be terminated in due course.

What Does Not Change. The new structure provides limited voting rights on the Board of Directors and Executive Committee to public entity members. Beyond this governance change, all other operational aspects will remain the same. There is still a one county, one vote provision and our relationship with CSAC is still preserved. We will continue to co-mingle and fully pool risks between all participating entities. The rating formulae and dividend and assessment provisions will be the same. We will continue to levy the one-half percent participation fee to public entity members for the benefit of the county members. We will continue to provide one designated seat on key committees for public entity representation. Public Entity members will continue to be required to pay an additional broker fee to ensure that the service provided by EIA staff to member counties does not deteriorate.

VI. PURPOSE AND EFFECT OF RESTRUCTURE

The proposed restructure significantly simplifies this organization that operates as a single risk pool on the one hand, but under the banner of two separate entities on the other hand. Both entities conduct meetings from time to time requiring a duplication of effort that will be eliminated. In addition, other processes and procedures will be simplified such as the accounting function by elimination of the need to report the CPEIA participation as a component unit.

We believe that the elimination of the CPEIA is in the best interest of both the EIA and CPEIA. The proposed restructure will simplify the organizational relationship and actually provide a higher level of control for the member counties. The EIA is the largest public entity property and casualty risk pool in the United States. Based upon its current level of participation, the CPEIA by itself would be considered the fifth largest pool in the United States. Technically, the CPEIA could split away from the EIA and take its purchasing and pooling power with it. Under the current structure, the CPEIA is organized as a single entity which provides considerable clout and leverage to participate in the decision-making process should they choose to apply pressure. Adoption of the proposal will result in the sharing of the decision-making responsibilities under a new structure guaranteeing an overwhelming majority representation by the counties. Future changes to this new structure could only be implemented via an additional JPA amendment controlled by the counties.

At the same time, this is an opportunity to provide a real and meaningful voice and level of participation to our CPEIA membership. The CPEIA members have always understood that they will never gain control over the EIA organization, they do not expect to receive nor do they feel that they deserve organizational control. However, the principles that the EIA was built upon and that have made the EIA so successful – primarily member involvement and member loyalty – apply to CPEIA members as well. Many CPEIA members recognize the benefits of pooling and want to be "participants", as opposed to "purchasers" of insurance. It was never intended by us that the EIA be viewed as an "insurance market" for CPEIA participants.

There was much discussion in the planning and development stages of the CPEIA on how we would be able to ensure that the EIA is not viewed as an insurance market and how we could create and foster a sense of loyalty to the organization. We generally agreed that we could probably never achieve the same level of loyalty and feeling of ownership with our CPEIA members that our County members have, but the goal has always been to promote this sense of belonging which leads to long-term stability for all parties involved. The best way to distinguish ourselves from the insurance market is by promoting this feeling of inclusion and membership in the organization, which is very different from buying insurance. Ideally, we would maximize member loyalty by treating each member equally. Everyone understands this can not, and will not, happen because of the county members' need and desire to retain control. The next best opportunity is to provide a meaningful voice in the operation of the organization. We believe the proposed restructure has found the appropriate balance between county control and meaningful public entity participation.

VII. JPA Amendment Process

The EIA Executive Committee, with input and concurrence from the CPEIA Board, has designed the proposed restructure. The EIA Board reviewed and discussed this restructure at a workshop on Thursday, March 3, 2005. The EIA Board determined on Friday, March 4, 2005 to continue discussing the concept and to hold another board workshop prior to the June board meeting. This workshop was conducted on May 6th and the EIA Board voted on June 3rd to send the proposed amendment for formal review and comment. This proposal was sent to all members and their corresponding County Counsels for a review and comment period ending with the October 7, 2005 EIA Board meeting. There were no legal concerns raised by any of the member County Counsels. At the October Board meeting, the EIA Board made a minor change to the insurance program voting provision and voted to send the JPA amendment to all 54 member boards of supervisors for a vote. The boards of supervisors have until the March 3, 2006 EIA Board of Directors meeting to consider this important vote.

If two-thirds (36) of the county boards vote to amend the JPA Agreement, then the restructure will be completed and the EIA can accept public entity members from that point forward. If the JPA amendment is approved, the Board of Directors will consider the corresponding amendment to the Bylaws at their March 2006 Board meeting. CPEIA members will be required to execute the amended EIA JPA Agreement in order to remain in the EIA's programs, and will have until the next program renewal date to consider this action (March 31, 2006 for Property members or July 1, 2006 for all other members). At some point in the future, when all of the business of the CPEIA has been completed, there will be a vote of the CPEIA membership (three-fourths majority required) to terminate the CPEIA as an entity.

CPEIA Member Units & Premiums

TOTAL GROSS PREMIUMS (Millions)			
Program	**EIA**	**CPEIA**	**Total**
PGL	2.35	1.247	3.598
GL1	14.94	5.718	20.658
GL2	5.412	2.596	8.008
Med Mal	12.232	0.000	12.232
Property	30.011	2.880	32.891
PWC	30.147	43.990	74.137
EWC	28.621	31.309	59.93
EIA Health	29.454	3.208	32.662
Misc.	3.758	1.426	5.184
Total	156.926	92.374	249.3

Gross Premium = Pool contributions plus Reinsurance

Member Units By Program		
Program	**No. of Members**	**Gross Premium (Millions)**
PGL	26	$1.247
GL1	48	5.718
GL2	2	2.596
Med Mal	0	0.000
Property	17	2.880
PWC	22	43.990
EWC	90	31.309
EIA Health	1	3.208
Total	206	$90.948

CPEIA Units by Type of Entity			
Type of Entity	**Stand Alone**	**JPA**	**Total**
City	60	7	67
County Operations	18	4	22
IHSS Public Authority	33	0	33
Schools	17	9	26
Fire	0	5	5
Parks	0	2	2
Special District	48	3	51
Total	176	30	206

5/16/2005