EIA/CPEIA Restructure Proposal

Frequently Asked Questions
April 26, 2005

1. ***Is the CPEIA / EIA relationship working?***

   Yes. The EIA established the CPEIA and provided access to EIA programs and services to provide greater stability and to reduce costs to member counties. While it was also the desire of the EIA to be able to provide a benefit to other public entities, the sole reason for establishing the CPEIA was for the benefit of our member counties.

   The benefit to member counties of the CPEIA participation has been substantial. As outlined in the Detailed Analysis and Executive Summary on the restructure topic, member counties have realized $41.5 million in economic benefit since the inception of the CPEIA in 2001. In addition, CPEIA members contribute $1.6 million annually to the EIA's general administration budget. In the midst of the hard market, the CPEIA relationship allowed the EIA's PWC and PGL programs to continue with reinsurance support because of the additional buying power.

   The CPEIA members have arguably benefited to an even greater degree by riding on the coat tails of the counties' purchasing power. However, the relationship was established for the benefit of the counties and will only survive and evolve so long as it is in the best interest of the counties.

2. ***So, the CPEIA / EIA relationship has been beneficial to the counties, why do we need to change it?***

   The benefit to the counties is based upon the increased purchasing and pooling power that the CPEIA members bring. If we lose some or all of this volume, the benefit to counties dwindles or disappears. The CPEIA membership is connected to the CSAC-EIA through a contractual arrangement that may be terminated by either party at any time. If the CPEIA were to split off on its own, it is not only of sufficient size to operate independently, it would be considered the fifth largest public entity pool in the nation.

   The CPEIA Board has a firm understanding that this is, and will remain, a county-run organization. At the same time they have expressed a strong desire to contribute to the success of the organization and feel like participants.

   The EIA's success has been built on the loyalty and stability of our membership which allows us to provide long-term risk management solutions. Providing participation opportunities is a key ingredient that is necessary to foster a similar sense of loyalty among the CPEIA membership. Without this participation opportunity, we are in danger of losing key CPEIA members or perhaps even losing the entire CPEIA membership and therefore the corresponding benefit to counties.

3. *What will be different after the restructure?*

Essentially, the only thing that changes is the governance structure of the EIA. We have already determined that it is in the best interest of the counties to share risk on a broader basis. This strategy was implemented four years ago with the development of the CPEIA. It was re-evaluated last year and confirmed that there is compatibility from a risk management standpoint and the mutual benefits are significant. Therefore, the alignment of interests between counties and CPEIA members has already taken place – that is, there is complete risk-sharing, pooling of risk, and co-mingling of funds.

The restructure would add seven (7) Public Entity positions to the current 54-member EIA Board of Directors (61 total votes). The current one county, one vote system would continue. There will be a guaranty that the counties will control no less then 80% of the total votes no matter how large the Public Entity membership grows.

Two voting positions for Public Entity members will be added to the current 9-member Executive Committee (11 total votes).

The County-dominated Executive Committee will continue to control the appointment of members to the various committees. Public Entity members would continue to be guaranteed one voting seat on most committees as specified by the various Program MOUs or as otherwise specified by the Board of Directors.

The CPEIA would cease to exist as a separate legal entity. This will eliminate the possibility of the CPEIA withdrawing from all programs all at once. It also eliminates considerable duplication and administrative expense in maintaining CPEIA as a separate legal entity.

4. *What is the urgency to make the change at this time?*

When it comes to strategic business decisions, the EIA prides itself on being proactive, not reactive. We foresaw the hardening insurance market when we decided to develop the CPEIA alternative. When the market turned shortly after September 11, 2001, the CPEIA mechanism was fully developed and was entertaining new member applications. We were clearly the best option for most applicants and the only option for many. To a large extent, we were fortunate to be in the right place at the right time, but we were only able to be in that position due to our planning and foresight.

Today, we are preparing for a softening in the market, in part due to workers' compensation reform and partly due to the normal market cycles. Alternatives to the CPEIA will soon become available and when they are, it is very important that our membership find a sense of loyalty and belonging to the organization. This restructure will help create that ownership feeling among key CPEIA members that we clearly want to retain. We have a short window of opportunity to complete this process. We know of at least one large member that will be testing the market at the July 1, 2005 renewal. Generally, however, we feel like we will be well positioned if the process is completed by the July 1, 2006 renewals.

5. ***Is this the next step in a series of actions that will result in a diluted county power base? If this is done, what's to stop the Public Entity members from seeking even more power in the future?***

   This restructure is viewed as the final major step in the evolution of the EIA/CPEIA relationship. The EIA has always been a leader and pioneer in the pooling industry and we can expect that the EIA will continue its proactive approach to leadership. It is almost certain that minor changes will be considered in the future to enhance and improve the governance of the organization. However, because the changes being proposed today will be incorporated in the form of a JPA amendment and approved by two-thirds (currently 36) of the member Boards of Supervisors, major changes can not take place without an additional JPA amendment. Following the restructure, it will still take at least 34 county Boards of Supervisors to approve a JPA amendment (based upon current membership of 54 counties). Therefore, if the public entity members do seek more power in the future, it will be up to the counties to determine if it is in the best interest of the organization and if such a change should be approved.

6. ***Due to our size advantage, won't the existing EIA/CPEIA programs always be the lowest cost alternative? If so, won't the CPEIA members be motivated to remain in the program based solely on price even though there would not be a sense of loyalty?***

   The EIA programs have proven to be the lowest cost, broadest coverage programs for our members on a long-term basis. In the short-term, it is possible to be undercut on a case-by-case basis by a market trying to gain market share. This pricing advantage is not sustainable on a long-term basis. We are much more susceptible to this "buying the market" strategy in a soft market environment.

   Price is generally the most important factor influencing the purchase decisions, but it is not the only factor. Other factors include program services, customer service, breadth of coverage, stability, and for many of our larger entity or pool members, a sense of partnership with an organization that will be responsive to their needs. The closer the price of an alternative is, the more important these other factors become.

7. ***Why is the proposed governance structure superior to the existing structure and why wasn't it done this way from the beginning?***

The proposed structure is expected to be better than the current two-entity relationship because of its simplicity. It is very difficult for members and stakeholders to understand the current relationship including what level of authority each party has. The one-entity, two-class system is neat and clean and very obviously defines the county members as the controlling party. The CPEIA membership will be comfortable with having a limited voting role since this model is closely aligned with the industry standard for pools with large membership – that is, electing a representative board, as opposed to allowing each member a vote. This new structure will promote unity as we will have one organization, one vision, and one voice.

When the CPEIA was created in 2001, we were uncertain as to the level of participation by public entities and whether or not it would be appropriate to provide governance participation on a permanent basis. At the time, we wanted to be sure that we could reverse course if the projected benefits to counties did not materialize, or if unforeseen negative factors outweighed the positive benefits. It was necessary in the early stages of development to create this arms-length relationship with CPEIA to protect the counties' interests while the success of the relationship was being evaluated. Four years later we can say with certainty that the pooling of resources with other public entities is providing tremendous benefits for our counties, and it is our desire to strengthen and continue this relationship. This new structure represents the natural evolution and progression of the EIA.

8. ***I thought this was a county organization. Counties, cities, schools and special districts have very different interests. Why shouldn't the counties be concerned about this?***

The CSAC-EIA's mission is to provide the best possible risk coverage programs and risk management services to our members. In terms of our mission, the interests of counties, cities, schools, JPAs and other special districts are in perfect alignment. Special underwriting and rating considerations have been developed to recognize the differences between the various types of entities. These considerations ensure that all members are treated fairly.

It is true that the various types of public entities do have varying political and social interests, however, when it comes to the business of risk management, we all share a common interest. At the same time, there are bound to be issues of disagreement that will arise in the years to come. If these issues divide themselves along political lines, the governance is structured such that the counties will have the ability to control the outcome of any vote.

9. Isn't it a disadvantage to bring in outsiders (outside the county family) to sit on the board?

Providing voting positions for public entity members on the Board and Executive Committee is actually viewed as a positive development that can only strengthen the organization. Corporate America has long recognized the value that diversity of views and experience brings from outsiders sitting on their corporate boards. In our situation, we have the added advantage that these are not impartial outsiders, but committed members with as much at stake in the success of the organization as any county member. There is a wealth of knowledge and experience in the pool of candidates that may be selected for the EIA Board. These candidates will only serve to supplement and enhance the existing Board of Directors.

10. How will the counties still retain control of the EIA?

The CSAC-EIA has always been, and will continue to be, a county-run organization. The counties will continue to control the organization by retaining an overwhelming majority of voting rights. The county members are guaranteed no less than 80% of the eligible votes on the Board. This is a minimum guaranty and is in no way influenced by the number of Public Entity members or the amount of premium volume they generate. It is simply a function of the number of county members. If the number of county members reduces, so will the number of Public Entity voting seats so that the minimum 80% county majority is maintained. Initially, the county majority will be over 88.5% (54 out of 61 votes).

On the Executive Committee, county control is at 81.8% (9 out of 11 seats). The Executive Committee appoints members to all other committees. Public Entity members are guaranteed one seat on all program committees; however, the Executive Committee could choose to appoint additional Public Entity representatives.

If there is a future amendment to the Joint Powers Agreement, only the seven voting Public Entity members of the Board along with every member county Board of Supervisors are eligible to vote, thereby ensuring the counties at least an 80% majority eligibility. A vote on termination of the EIA operates the same way.

If there is a Board vote that affects only one program, only the members of that program vote. In this event, Public Entity Board members are eligible to vote to the extent there are Public Entity participants; however, they are limited to no more than the number of votes representing 20% of the program membership. Please note this could result in Public Entity members' control of a program vote in a situation where

Public Entity members have the vast majority of the members. This is rare since most program votes are controlled by program committees and/or the programs are dominated by county members.

11. At some point, doesn't the CSAC EIA become too large to attract some insurers / reinsurers which may limit competition and ultimately be detrimental to the counties?

In terms of pooling of risk, bigger is <u>always</u> better. In terms of attracting insurance/reinsurance partners, bigger is <u>usually</u> better. Because of our size, some insurers will not be interested in partnering with us. These insurers tend to be the smaller companies that we might not have found acceptable anyway. It is believed that the county-only volume is large enough to limit these markets and we have not lost any additional markets as a result of CPEIA growth.

On the contrary, there is much more of an upside to volume growth. We are better able to assume more risk internally which is more efficient for our members. We can then purchase reinsurance at higher levels making our risk more attractive to many markets. In addition, there are certain markets that we will look attractive to, simply because of our size.

Finally, there is nothing in the restructure that will prevent us from packaging sub-groups of members if there is an advantage. This might be similar to the "tower" concept that we currently utilize in our Property Program to obtain multiple limits.