

***The Economy and Its Effects upon
California Self-Insurance Joint Powers Authorities***

**Presented to
CAJPA Board of Directors
Strategic Planning Session
April 2010**

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The Economy and Its Effects on JPAs

In 1978 a major financial earthquake hit California's public agencies—passage of Proposition 13. This ballot measure, known as the Jarvis-Gann Initiative, dramatically decreased revenues and changed the sources for local governments—counties, cities, special districts and school districts. County property tax revenues (the main source of revenues for counties, school districts and special districts) were slashed by two-thirds. Cities were also impacted, but less so due to their heavier reliance on sales tax revenues. At the time there were dire predictions for cuts in local services. The worst of these predictions did not come to pass because the State of California was able to step in and take over the funding of various local services. In addition, many special districts began shifting to fees for certain services which were not prohibited by Proposition 13. However, local governments are still constrained by the financial limitations of that monumental shift in the California's public financial landscape.

The Great Recession of 2006-2010 has also impacted the financial underpinnings of local governments in California. Since many local governments became dependent upon State support and local growing sales tax revenues, the recession has had a dramatic impact on both State and local governments. No longer can the State provide financial relief or support since it is distressed due to a precipitous drop in sales tax and income tax revenues. Fees for services have been maximized during the last 30 years, so new revenue sources are limited. Sales tax revenues at the local level also have dropped and remain well below levels in past years. The present and future prospects for improvement appear bleak.

So, what does this mean to self-insurance risk pools? If the past is any indication of the future, here is my best prognosis.

More Reliance on JPAs

The JPA movement gained major impetus after Proposition 13. Local governments actively sought ways to reduce expenditures and to control future costs. Dependence on the commercial insurance market was not considered a wise long term strategy, particularly after the recession in the early 1980's which caused significant investment losses to insurers, which in turn led to the "hard" insurance market. This hard market led to the second wave of JPAs in California and throughout the United States. Again, local governments looked to themselves for creative, cost-effective solutions.

Will local governments once again look to JPAs for answers and support? Definitely. However, this time the form of support will not come as it did in the past, but in two main areas:

1. Staff Support - Local governments are experiencing staff reductions, layoffs, furloughs, and early retirements. Risk management and risk control (safety) staff are being cut. As experienced risk managers retire, they are not being replaced and their duties are being assigned to staff with limited knowledge and experience.

Consequently, the members of JPAs are becoming more dependent upon the staff of the JPAs for technical support and guidance. Many of the risk management leaders of the JPA movement at the member level have retired or are on the verge of retirement. Retirements will be accelerated as furloughs continue, salaries are reduced and workloads increase. These personnel losses will rarely be replaced at the local level. So, it will become more important for JPAs to fill this void with staff of their own who can step in and provide risk management, claims management and risk control functions

2. Financial Relief - Local governments initially formed and joined JPAs primarily for the reasons of greater control and long-term cost stability—not the lowest cost at all times. The severity of the current financial crisis facing local governments has changed the perspective of many JPA members (particularly those board representatives facing daily financial crises). As a result, JPA members will be looking to the JPA to help reduce the cost of coverage and related services. JPAs that do not respond aggressively to present options for lower costs will be at risk of member defection.

Active steps JPAs should take in recognition of the financial hardship of their members include the following:

- Evaluation of rate/funding levels; Consideration of lower confidence level contribution levels
- Consideration of earlier dividend distributions
- Reduction in unnecessary limits purchased when costs were low
- Re-consideration of target funding level; consideration of longer terms to reach financial goals
- Direct financial aid in the form of grants or contributions for needed services such as actuarial studies, claims audits, risk control assessments, claims and litigation support.
- Greater efforts to help members control their underlying claims costs.
- Reduction in discretionary, non-essential spending at the JPA level.

Evaluation of Rates/ Funding Levels; Lower Confidence Levels

Most JPAs are having detailed discussions about the funding levels and rates for FY 2010/11. The conservative positions of many JPAs—setting rates at the 80% to 90% confidence levels—are a thing of the past. Rates set at the expected, or 60%, levels will be more of the norm. Overall funding amounts at 80% and above also may no longer be likely. Members will be requesting release of excess funds to offset premium contributions further.

Re-Setting of Target Equity

Many JPAs, at the urging of CAJPA and generally accepted best practices, have set conservative target equity goals. Such targets were set in times of growing economic conditions in California and reflected the general aversion that JPAs and their members have for

assessments. Now members may be more willing to take the risk that assessments might occur in the future in exchange for reductions in funding confidence levels.

Dividend Distributions

JPAs with policies and procedures for dividend distributions and retrospective rating adjustments may need to re-assess the timing and amounts of such distributions. It may be possible to modify permanently or temporarily policies and procedures that were developed in less stressful financial times without jeopardizing the financial strength of the JPA.

Reduction in Limits

JPAs and individual members may be able to reduce costs by eliminating higher policy limits which are not deemed essential for the protection of members. Such limits are often purchased because the cost was so low at the time of purchase, or there was a remote chance of a loss (the coverage is primarily “sleep insurance”). This may be a coverage luxury that should be re-evaluated in such extreme financial times.

Direct Financial Aid to Members

Many JPAs provide subsidies to their members for necessary risk management related services. This practice could be expanded to new risk related services and levels of financial support could be increased to higher levels. This has the benefit of helping the members conserve their own resources, while adding benefit to the JPA by having such services continued instead of eliminated. It also increases the JPA’s value to its membership.

Controlling Underlying Claims Costs of Members

Now, more than ever, members should be focused on claims cost control. This can be done primarily by aggressive loss prevention and active claims management. Members will be hard pressed to find financial support at the local level for such long term financial cost containment efforts. JPAs can be the vehicle to enhance such activities, or at a minimum, provide essential services that are being cut at the member level. In the long run it benefits both the JPA and the member.

Furloughs have had an unusual effect on exposure. Clearly, they’ve decreased payroll, but it’s unclear if claims has really gone down proportionally. At some local governments, many employees have worked through their furloughs. So, there is lower payroll but the same risk of injury. Also, indemnity benefits are based on full (non-furlough) wages. So, indemnity benefits don’t necessarily decrease with the furlough.

It appears that the recession does not necessarily increase claim frequency (contrary to popular wisdom). Indemnity severity trends do slow down (due to lower wage inflation), but medical inflation continues along its merry, double digit way. Hence, medical cost containment efforts should be a focus.

Reductions in Non-Essential, Discretionary Expenses

JPAs must mirror their members to a certain extent. Business as usual would not be a good practice, since members generally expect their JPAs to share their pain, even while they expect more from the JPA. So, boards of JPAs will tend to focus on short term, often minor, cost reduction steps such as:

- Shortening strategic planning sessions from two or three days to one. Changing the venue to less expensive locations;
- Elimination of non-essential programs when the benefits are somewhat intangible, even though everyone knows intuitively they are needed and are beneficial.
- Price increases on all vendor contracts are being rejected and/or price reductions even though justified.
- Lower cost service providers are selected even though such services should be based upon qualitative factors (particularly professional service contracts and service providers with long term relationships with the JPA or members).
- Cost nits and gnats such as elimination of lunches at Board meetings, soliciting “voluntary” contributions from vendors for meal and liquor costs at meetings.
- JPA staff salary reductions and position freezes or eliminations.

Caveats

The recession has severely impacted investment income opportunities for the JPAs. Aside from affecting money for operations, it can have a very big effect on the net present value of claims liabilities (if it causes a change in the discount rate). This effect is particularly significant for excess JPAs with long-tailed coverage (workers compensation and medical malpractice).

JPAs must try to resist the temptation to give away the store and not utilize rates which will be inadequate. And, equity should only be returned when it is safe to do so. JPAs with workers' compensation coverage should have developed equity due to the reforms of 2003 and 2004. This equity should be used wisely and JPAs need to remain prepared for the inevitable increases in workers' compensation costs and the uncertainty with respect to the impact of health care reform.

Workers' compensation continues to be nebulous and seems to be going in the other direction. Counter reform could take place in the next election cycle and there could be another perfect storm of rising workers' compensation costs.

In summary, JPA's need to carefully balance the need for fiscal conservatism with the need and responsibility that JPAs have to help their individual members as much as possible during these tough economic times.