

Understanding The Public Sector: Rubric, Risks and Realities

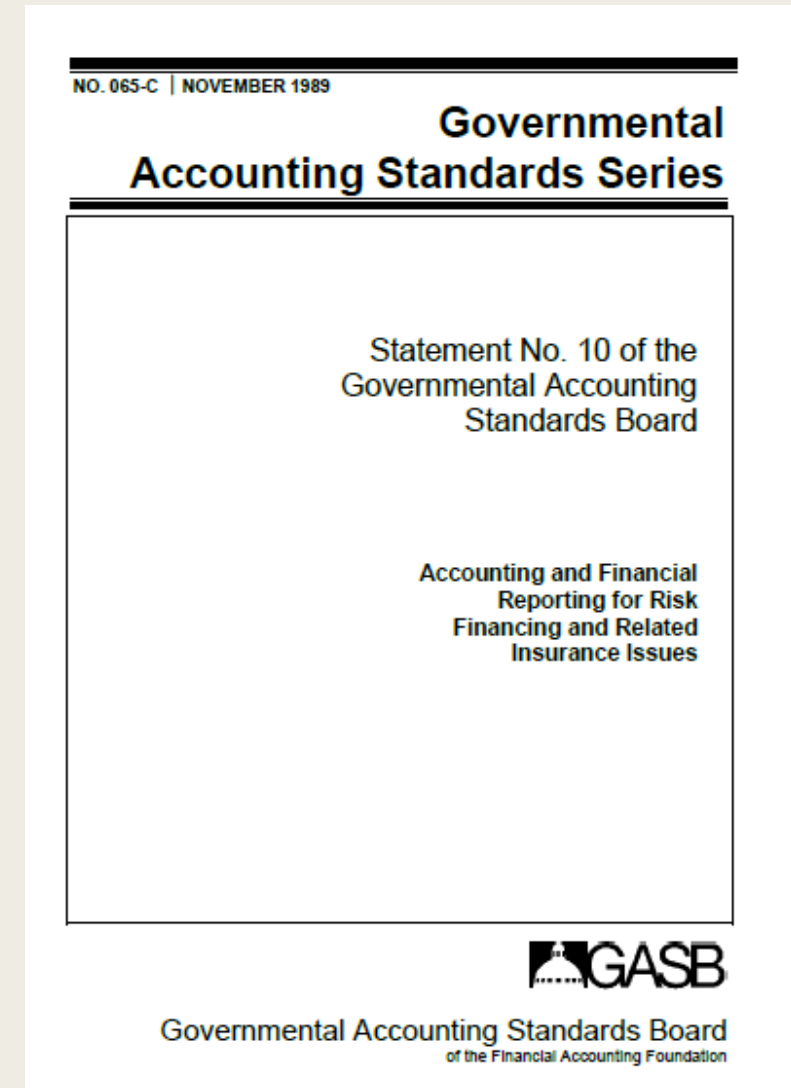
Mujtaba Dattoo, ACAS, MAAA, FCA
Actuary and Director, Aon Global Risk Consulting
Actuarial Practice Leader, Public Entities

Public Sector...Defined

- Revenue is
 - Tax-based
 - User fees, e.g. utilities
 - Not subject to taxation

Accounting Standard Used

- Government Accounting Standards Board (GASB)
- Various Statements
 - Statement 10 applies to casualty risks
 - Statement 45 applies to OPEB



GASB Statement 10 Excerpt

- Accrue liability for **unpaid** claim costs, including **In**curring **But** **Not** **R**eported (**IBNR**) claims
- Liability should be based on:
 - The estimated ultimate cost (including effects of inflation and other societal and economic factors)
 - Using past experience adjusted for current trends
 - Other factors that would modify past experience
(GASB Statement No. 10, Paragraph 22)
- Accrue liability for claims adjustment expenses:
 - ALAE – expenses associated with specific claims (e.g. legal)
 - ULAE – expenses not associated with specific claims (e.g. claims administration)
- Discounting is “neither mandated nor prohibited”
(GASB Statement No. 10, Paragraph 24)

Landscape

- States
- Counties
- Cities
- Schools, Universities, etc.
- Transit agencies
- Special districts: utilities, sanitary, water, etc.
- Underground storage tanks, NFIP, etc.

Pools and Captives

- Small/medium sized entities in a state form a risk pool
 - Set up governing boards
 - Act like insurance companies
 - Numerous pools in CA
- Pool coverage layers
 - Primary pools, up to an attachment point (SIR), buy excess ins above SIR
 - Excess pools, e.g. CJPRMA, SELF, County RE, OTRP, etc.
- Some pools/stand-alone entities have been forming captives
 - Primarily to have investment flexibility
 - Shelter the surplus (minimum required by domicile state)

Enabling Legislation

- States have enacted to meet 1980s liability crisis
 - Joint Powers Authority in CA
 - Joint Insurance Funds in NJ
- Some have existed since 1920s, e.g. MA WC
- “Light” to no regulation
 - Onus is on board for self-governance
- Some overseen by state insurance commissioners
 - e.g. Idaho, Wisconsin
 - Comply with NAIC Annual Statements, standards, etc.



Scope of Actuarial Work, *typically...*

- Estimate outstanding losses as of fiscal year-end
- Forecast losses for 2 to 3 upcoming fiscal accident years
- Estimate payouts for 2 to 3 upcoming fiscal years

Additionally estimate:

- Undiscounted and discounted amounts
- At various confidence levels
- Alternative SIRs – to evaluate market offerings
- Allocation by department/pool member
 - Some application of experience modifiers

Coverages, *mostly...*

- WC
- Liability
 - General liability
 - Auto liability
 - Law enforcement
 - Public officials (E&O)
 - Employment practices liability
- Property
 - Property
 - Auto physical damage
- etc.

Timing of actuarial reports

- For financial statement reporting
 - CAFR
- Budgeting
 - Often will use data before year-end valuation and roll forward
 - Some states align with biennial legislative sessions
- May use data valued prior to year-end
 - LDFs may not be at 12, 24, etc. maturities
 - May interpolate LDFs

Actuarial Characteristics

- Mostly standard methodologies
 - Paid/incurred development, paid/incurred B-F, frequency/severity/loss cost
- Limited data
 - Smaller volume (tapas analogy)
- Liability has shorter payout duration than commercial insurance industry
- Large claims may distort payouts
- Tail factors often dampened by low SIRs
- WC for large fully-insured entities can extend beyond 20 years

Some Unique Features

- Tort limits
- Statue of limitations
- WC
 - Salary continuation benefits for public safety personnel
 - PTSD
 - Cancer presumption

Tort Limits

- Tort limits / sovereign immunity
 - Exist in 33 states
 - Limits vary by state, e.g., FL \$200K/\$300K
 - Some states index increase annually, e.g. OR
 - Political pressure to raise/eliminate limits
- <http://www.ncsl.org/research/transportation/state-sovereign-immunity-and-tort-liability.aspx>
- Some states have no tort limits. e.g. CA, WA
 - Liability claims tend to be \$1M+, and creeping up
 - Mega claims make newspaper headlines
- Applies to state actions, not federal torts (e.g. civil rights claims)
- Applies to loss portion only, not ALAE

Claims Handling

- Many hire TPAs
 - Periodic changes in TPAs results in reserving adequacy changes
 - Changes in data coding distorts reconciliation or claims tracking
- Some do in-house adjusting, particularly on liability claims
 - Litigated claims tend to be mostly handled by in-house counsel (e.g., city attorney, county counsel)
 - Data often not updated regularly

Procurement

- Generally bidding process
- Request for proposal (RFP) issued
- Complexity and time commitment to respond varies
 - Simple form and quote
 - Very involved, may include in-person interviews
- Key parts:
 - References
 - Relevant public sector experience
 - Scoring – weight given to above and price

External Stakeholders

- Auditors
- City councils/county commissions
- School boards
- Legislatures (particularly for States)
- Regulators, where regulated (e.g., Idaho, Wisconsin)
- Rarely involves rating agencies

Boards - Pools

- Pools have their own governing practices
- Size varies – from large to each member representation
- Members predominantly non-actuarial types
 - Elected public official, e.g. County Commissioner,
 - City attorneys
 - Risk managers
 - Finance managers
 - School superintendents
- Tip: communicate less technical jargon, more graphics

Public Sector Forums

- Geared to provide education, emerging issues, networking
- Serve various constituencies
- STRIMA – state risk managers and their staff
- AGRiP – government pools
 - Staff and Board members – provide board orientation and training
- PRIMA – national organization for public entities, including state chapters
- CAJPA – CA pools
- PARMA – mostly CA public entities and pools
- IRMIA – higher education
- NLC-RISC – Cities who are members of a city pool, NLC Mutual members
- Broker-sponsored conferences

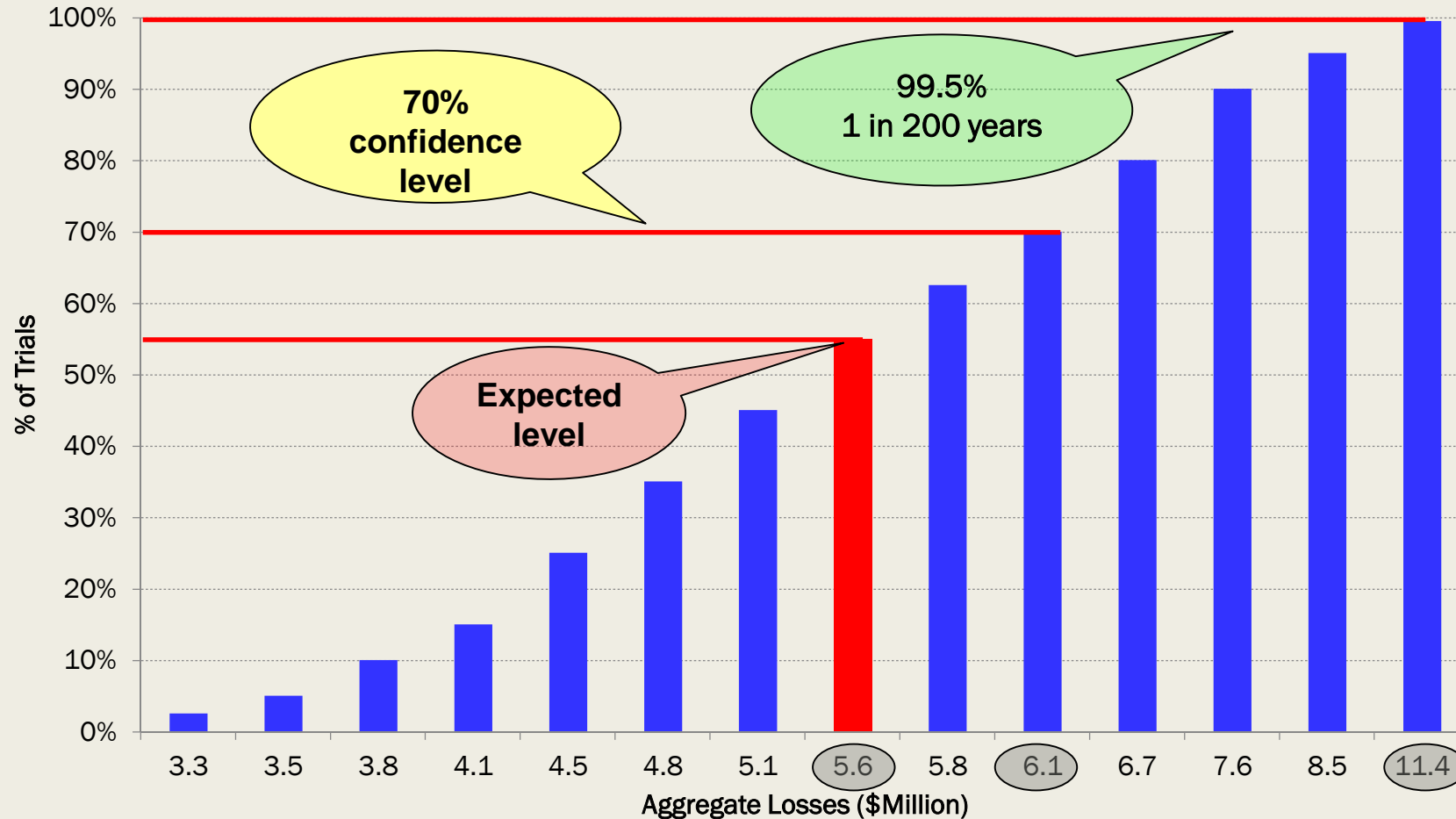
Funding Forecasts

- Greater attention to funding forecasts than outstanding losses
- Stable funding sought – public funds budgeting mindset
- Larger programs tend to be on pay-as-go basis
 - For mature, steady programs the payouts approximate accrual
- Unfunded liabilities exist in large programs
 - Some have plans to gradually reduce this by requesting extra funding
 - Some cities have declared bankruptcy, e.g. Vallejo, Stockton, etc.

Confidence Levels

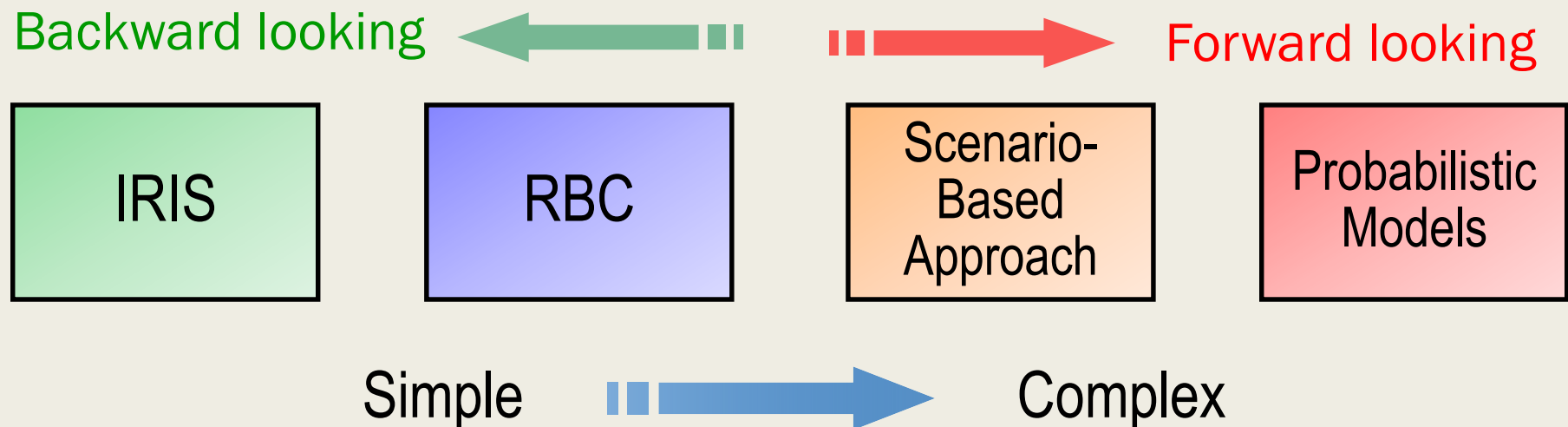
- Risk margins are often evaluated via “confidence levels”
- Public sector usually do not set aside “surplus” to absorb adverse deviation or inadequate funding
 - Funds comingled with general funds/treasury
- Various techniques to estimate these percentiles at 70%, 80%, 90%, etc.
 - Fit loss distribution
 - Use @RISK to simulate aggregate losses based on Poisson frequency and lognormal severity

Confidence Levels



Capital Modeling

- Pools have become vigilant about surplus management
 - Self-governance overseen by boards
- Wide spectrum employed



Benchmarks

- No depository or standard reporting like NAIC financial statements or rating bureaus reporting
- Available benchmarks, e.g., NCCI, ISO, AM Best's LDFs need to be cautiously utilized
 - These databases generally do not contain self-insured or public sector data
 - May not be “fully” representative, but somewhat informative
 - Some public risks are unique, e.g. law enforcement claims
- Tail factors
 - Dampened by SIRs, where applicable
 - Generally shorter durations for liability coverages

Summary

- Public sector is a niche market
 - About 93,000 taxing authorities
- Competitive, bidding process
 - Lower margins, steady revenue
- Annualized studies, generally
 - Seasonal peak workloads
- Mostly standard actuarial processes
 - Some unique features



Questions?

Thank you.

Mujtaba Dattoo, ACAS, MAAA, FCA
Actuarial Practice Leader
Aon Global Risk Consulting
(949) 608-6332
mujtaba.dattoo@aon.com

Thank You!



The Trial of the Pyx is the procedure in the 12th century for ensuring that newly minted coins conform to required standards.

Trials have been held from the twelfth century to the present day since 1282 AD. They are trials in the full judicial sense, presided over by a judge with an expert jury of assayers.

Trials are now held at the Hall of the Worshipful Company of Goldsmiths; formerly, they took place at the Westminster Abbey. Given modern production methods, it is unlikely that coins would not conform, but this has been a problem in the past—it was tempting for the Master of the Mint to steal precious metals.

The term “Pyx” refers to the boxwood chest in which coins were placed for presentation to the jury.