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CITY OF SACRAMENTO

DEPARTMENT OF GENERAL SERVICES

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DIRECTOR

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FACILITY MAINTENANCE DIVISION
RISK MANAGEMENT & INS. DIVISION
SUPPORT SERVICES DIVISION

August 11, 1982

APPROVED
BY THE CITY COUNCIL

AUG 17 1982

OFFICE OF THE
CITY CLERK

City Council
Sacramento, California

Honorable Members in Session:

SUBJECT: RISK MANAGEMENT AND INSURANCE FUND

The attached report is being forwarded to City Council for information purposes only at the request of Budget and Finance Committee Chairman Lloyd Connelly and does not require Council action.

Respectfully submitted,

for: Frank Mugartegui
Director of General Services

FOR CITY COUNCIL INFORMATION

Walter J. Slipe, City Manager

FM:RP:82083

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July 28, 1982
GS:82072:FM:RP

Budget & Finance Committee
Sacramento, California

Honorable Members in Session:

SUBJECT: RISK MANAGEMENT AND INSURANCE FUND

SUMMARY

This is a report back on the current projected status of the Risk Management and Insurance Fund requested by the Committee on June 22, 1982.

BACKGROUND

The Risk Management Fund is an Internal Service Fund that serves as the City's Insurance Company, if you will, providing financing for the following self-funded and insured programs: 1) Public Liability; 2) Property, Equipment, and Other; 3) Worker's Compensation; 4) Group Benefits; and 5) Unemployment Benefits.

Budget Report No. 6 (Revised 6/9/82) forecasted that the Risk Management Fund Equity at the close of Fiscal Year 1981-82 would be in a deficit position of $1.5 million. The primary factor attributing to the Fund's deficit status was the declaration of a $1.5 million dividend in May of 1981 with insufficient information at the time for a one-time fix to balance the FY 1981-82 budget. Also, the January 1982 budget fix which reduced contingency reserves $1 million impacted the Fund's equity, reducing interest income by approximately $60,000.

Additionally, 1981-82 program expenditures exceeded premium revenue by $951,098 as explained below:

PROGRAM	PROJECTED REVENUE	PROJECTED EXPENSES	VARIANCE
Auto & General Liability	$ 900,090	$1,426,878	+$526,788[1]
Group Benefits	4,368,191	4,368,191	-0-
Unemployment Insurance	138,463	424,550	+ 286,087
Worker's Compensation	2,096,777	2,235,000	+ 138,223
Total	$7,503,521	$8,454,619	+$951,098

Note: 1 - Major cause being 2 claims that costs increased by $474,000.

DISCUSSION

There are two (2) methods for handling loss funding and risk financing of self-insured programs -

- Appropriations from current revenue; and
- Self-insurance fund.

The first is totally inappropriate. It has proven unsound (not consistent with sound management principles) and is today given no consideration. The second calls for a reserve fund which should be based on the experience as determined by adjusters and the level of authorized retentions. A careful analysis of losses must be made constantly to assure program stability.

There are two important elements of risk management:

1) Treatment of expected or predictable losses (loss funding); and

2) Risk financing ("Risk" meaning: uncertainty).

The City's Risk Management Program provides for both elements in that we are covering the predictable losses annually and have fronted our retention levels through establishment of contingent liability reserves. Our approach of risk financing assures maximum stability and minimum costs.

To date, although our experience reflects a growing increase in losses, it is not the result of severity (high-cost claims) but a combination of frequency (low-cost claims) and inflation. However, our experience may change! With all the care, caution, and expertise of casualty actuaries, underwriters, and legal talents, there is the unknown, the unpredictable, that must be provided for.

The funds reserved for open case liabilities (reported but not paid) and contingent risks (catastrophic loss and incurred but not reported (IBNR)) serve several significant purposes:

- Financial stability of the program. Protect the City's assets from any severe fluctuation annually due to an unanticipated major loss.
- Most economical method of financing risk. Fronting the levels of retention with Contingent Liability Reserves instead of insurance, thereby satisfying the insurance requirements of bonding covenants, contracts, and agreements.
- Interest income. Reserves held by the Risk Management Fund are invested, defraying $842,540 of program costs for all activities, as follows:

    1. $296,800 relief to activity budgets for Worker's Compensation administration.

    2. $91,765 relief to activity budgets for employee costs, etc. associated with administration of the City's Risk Management and Insurance Program.

3. $88,965 relief to General Fund for General Services costs associated with administration and security.

4. $365,010 relief to activity budgets for cost of property, fleet, boiler and machinery and other miscellaneous coverages, and self-insured losses (theft, vandalism, etc.).

The Risk Management Fund has sufficient cash to fund the current open case liabilities. However, the projected $1.5 million deficit reduces the contingent liability and Risk Reserve from $3.3 million to $1.8 million for IBNR's, besides reducing interest income bearing the $842,543 expense addressed above.

An insurance company, acting on actuarial experience, would assign reserves to its various insurance categories in anticipation of claims that are considered likely to appear, but which haven't yet, i.e., contingent liabilities. As a self-insurer, the City has followed this practice. In theory, if the City closed its doors and stopped collecting annual billings from the various funds to replenish the Risk Management Fund, it would take an amount equal to the open case liability reserves plus the contingent liability reserves to pay off all current and projected claims over future years.

Therefore, while the existence of a fund equity deficit on Risk Management is of concern and should be monitored in the coming year, it is in no way a crisis calling for immediate action.

FINANCING

Premium rates are based on probability and experience history averaged over a minimum of three (3) years; however, there are given uncertainties that are not predictable. We must be cautious not to overreact yet maintain a financially stable Fund that provides adequately for: 1) fully funded open case liability; and 2) the unpredictable occurrences that may arise. Exhibit I shows the impact on the Risk Management Fund's equity resulting from: 1) the $1.5 million dividend, 2) $1.0 million reduction of contingency reserves, and 3) program expenditures in excess of revenues.

Barring any further "quick fixes" or extraordinary losses in FY 1982-83, the Fund deficiency should be reduced by $241,000, from $1,505,000 to $1,264,000 at the end of FY 1982-83.

CONCLUSION

While the existence of a fund equity deficit in the Risk Management Fund is of concern, there is no crisis calling for immediate action.

RECOMMENDATION

This report is for information only and does not require Committee action.

Respectfully submitted,

F. Mugartegui

Frank Mugartegui
Director of General Services

APPROVED FOR COMMITTEE INFORMATION:

Solon Wisham, Jr., Asst. City Manager

cc: Risk Management & Insurance Committee

RISK MANAGEMENT FUND

FY 1981-82

FUND BALANCE CHANGE

	AS OF 6/30/81	PROJECTED AS OF 6/30/82	CHANGE
Treasurer's Cash Balance	$10,902,000	$8,213,816	<$2,688,184>
Other Current Assets	726,000	-0-	< 726,000>
	$11,628,000	$8,213,816	<$3,414,184>
Reserves & Restrictions -			
Open Case Liability:			
Auto & Gen. Liability	$ 1,695,926	$1,966,786	+$ 270,860
Worker's Comp. (WC)	3,500,000	3,500,000	--
WC-Incurred But Not Reported (IBNR)	750,000	750,000	--
Unemployment Ins.	102,196	202,320	+ 100,124
Sub-Total	$ 6,048,122	$6,419,106	+$ 370,984
Contingent Lia. Res.			
Auto & Gen. Liability	$ 1,000,000	$1,000,000	
Worker's Comp.	2,000,000	1,500,000	<$ 500,000>
Property & Equipment	200,000	200,000	
Money & Securities	100,000	100,000	
Unemployment Insurance	1,000,000	500,000	< 500,000>
Sub-Total	$ 4,300,000	$3,300,000	<$1,000,000>
Encumbrances/Accts.Payable	$ 1,116,878	-0-	<$1,116,878>
Total Reserves & Res.	$11,465,000	$9,719,106	<$1,745,894>
Fund Equity	$ 163,000	<$1,505,290>	<$1,668,290>

Source: Fund Balance Projection Worksheet Dtd 6/2/82, Prepared by Dept. of Finance, Accounting Division.