



CITY AUDITOR 345 6th Street, Suite 100, Bremerton, WA 98337-1873 & Phone (360) 473-5369

April 17, 2018

To: Audit Committee Members

Leslie Daus, Audit Committee Chair and Council Member
Pat Sullivan, Council Member
Deborah McDaniel, Audit Committee Vice-Chair, Citizen Member
Darryl Riley, Citizen Member
Dennis Treger, CPA

Re: Risk Management Review

Dear Audit Committee Members:

At your request and based on the information available to date, I am submitting my findings regarding the Risk Management Review.

SCOPE

I was asked to compare insuring City of Bremerton (“City”) property and liability risk through our current insurance program versus through a risk pool. My review and this report do not include a comprehensive review of coverage nuances, sublimits, and exclusions. At your request, additional details can be provided in a supplemental report. My work included the consideration and/or analysis of certain records including:

1. City property declaration from 2018 policy period;
2. City liability declaration from February 1, 2017 to February 1, 2018 policy period;
3. [WCIA pricing indication for the City for 2018 calendar year](#);
4. [WCIA Self-Insured Coverage Document #CT-2018](#);
5. [WCIA 2017 Annual Report excerpt regarding claims statistics](#);
6. City loss history data provided by Thelma Swem;
7. [Interlocal Agreement creating the Washington Cities Insurance Authority](#);
8. December 13, 2017 Compensation Study prepared by Arthur J. Gallagher & Co.; and
9. Miscellaneous research: a) [WCIA Summary](#) b) [WCIA 2016 Annual Report](#)

Additionally, I discussed various aspects of risk management with the following individuals:

Thelma Swem, City Risk Management Specialist,
Roger Lubovich, City Attorney,
Risk managers from numerous public entities,
Eric Larson, WCIA Deputy Director,
Ann Bennett, WCIA Executive Director



BACKGROUND

The City of Bremerton (“City”) currently protects its property risk through a commercial property insurance policy and its liability risk through a public entity self-insurance liability policy. Unlike most cities in Washington that are members of risk pools, Bremerton purchases its insurance through an insurance broker, Willis Towers Watson (“Willis”).

Thelma Swem is the City’s Risk Management Specialist. Ms. Swem was hired by the City as a paralegal in 2002 and was promoted to Risk Management Specialist in 2010. Ms. Swem is moving out of state and is planning to terminate her City position in April 2018.

Due in part to Ms. Swem’s planned departure, the City is researching its insurance options. In particular, the City is considering whether to continue purchasing insurance through a broker, in which case the City would need to hire someone with like-kind expertise to replace Ms. Swem. Alternatively, the City is considering whether to join a risk pool. If the City joined a risk pool, some of Ms. Swem’s more technical risk management duties would be performed by the pool; her less technical duties could be shifted to existing personnel and/or a new hire who would not need the same qualifications as Ms. Swem.

BREMERTON LIABILITY CLAIM HISTORY¹

The City currently has a \$500,000 self-insured retention (“SIR”) on its liability policy. The SIR is per occurrence. If the City joins a risk pool, the City could change its deductible. Premiums quoted from the pool include \$500,000 and \$250,000. The pool could also quote a \$100,000 deductible but currently has not.

From 2007 through 2017 the City had 14 claims that exceeded \$500,000. These claims totaled approximately \$185.2 million². The City paid approximately \$427,000 on four of the 14 claims, including outside legal and related expenses. Nothing was paid on the other ten claims that exceeded the SIR. Notably, one claim was for \$160 million; the City denied this claim and paid nothing.

From 2007 through 2017, the City had four claims that ranged from \$251,000 to \$500,000, which totaled \$1.6 million². The City paid \$230 on one of these claims, including outside legal and related expenses. Nothing was paid on the other three claims.

During the same 11-year period, the City had ten claims from \$101,000 to \$250,000, which totaled \$1.9 million². The City paid approximately \$149,000 on three of these claims, including outside legal and related expenses. Nothing was paid on the other seven claims.

During the same 11-year period, the City had 417 claims under \$100,000 totaling \$2 million². The City paid approximately \$739,000 in total on 208 of these claims, including any legal and related expenses. Nothing was paid on the other 209 claims.

¹ The liability claim history statistics are from a Closed Claim Report provided January 23, 2018. The statistics could change as open cases continue to close. It is not known if such changes would materially affect the table below.

² In situations where no dollar amount was associated with a claim, these calculations assume the claim amount is equal to the amount paid.



The table below summarizes the City’s liability claims history from 2007 through 2017, as described above:

Demand	Demand Cases and Amount	Cases with Costs and Amount Paid
Over \$500,000	14 \$185,216,870.89	4 \$427,470.85
\$251K-\$500K	4 \$1,625,000.00	1 \$229.94
\$101K-\$250K	10 \$1,866,438.30	3 \$149,459.26
Under \$100,000	417 \$2,031,873.38	208 \$738,734.94

WASHINGTON MUNICIPAL RISK POOLS

There are three self-insured municipal risk pools in Washington. As shown in the table below, in terms of number of city members and population, Washington Cities Insurance Authority (“WCIA”) is by far the largest of these risk pools, followed by Cities Insurance Association of Washington (“CIAW”) and Association of Washington Cities (“AWC”) Risk Management Service Agency (“RMSA”). The self-insured cities include Washington’s nine largest cities³ plus Bellingham, Redmond, Bremerton, and Montesano.

	Number Of Cities	Total Population
WCIA	102	2,022,359
CIAW	50	333,789
RMSA	47	172,576
Self-insured	13	2,000,481

Four of the self-insured cities left WCIA between 2010 and 2017 and one self-insured city left WCIA in 1983. It appears the remaining self-insured cities have never been in a risk pool. Details are shown in the table below:

Appears Never In Pool	Left WCIA	
	In 1983	2010-2017
Seattle	Everett	Kent
Spokane		Renton
Tacoma		Federal Way
Vancouver		Montesano
Bellevue		
Bellingham		
Redmond		
Bremerton		

The only pool considered for purposes of this report is WCIA.

³ Seattle, Spokane, Tacoma, Vancouver, Bellevue, Kent, Everett, Renton, and Federal Way.



WCIA

Utilizing Chapter 48.62 RCW (self-insurance regulation) and Chapter 39.34 RCW (Interlocal Cooperation Act), nine cities⁴ originally formed the WCIA on January 1, 1981. The WCIA was created for the purpose of providing a pooling mechanism for jointly purchasing insurance, jointly self-insuring, and jointly contracting for risk management services. In addition to cities, WCIA membership includes other municipal corporations such as transportation benefit districts⁵, 911 communication entities, park and utility districts, and others.

New members initially contract for a three-year term, and thereafter automatically renew on an annual basis. A one-year withdrawal notice is required before membership can be terminated.

COVERAGE LIMITS

The City's current coverage limits and WCIA's proposed coverage limits each have numerous categories of sublimits that are provided in the WCIA Pricing Indication, City Liability Policy Declarations, and City Property Policy Declarations. Below is a table that summarizes the general coverage limits without regard to the multitude of sublimits and nuances:

Coverage	Current Limits		WCIA Limits		
	Occurrence	Aggregate	Occurrence	Aggregate	
Property	\$ 100,000,000	NA	\$ 300,000,000	NA	
Liability	10,000,000	12,000,000	25,000,000	Layers 3-5	\$7M+
Crime	1,000,000	NA	2,500,000	10,000,000	
Earthquake	50,000,000	50,000,000 annual	150,000,000	150,000,000 Pool	

Additionally, cyber coverage would increase from the City's current coverage limit of \$250,000 per occurrence to \$1,000,000 in the pool subject to a \$10,000,000 aggregate limit for the pool. In addition to the coverages noted in the table above, the pool also provides boiler and machinery coverage with \$100 million property damage/equipment breakdown, \$10 million business interruption, and \$1 million extra expense. The City's current boiler and machinery coverage limit is \$5,000,000 with \$1 million service interruption.

The WCIA liability coverage includes a \$4 million sublimit (per occurrence and annual aggregate per Member) for terrorism, and a \$5 million sublimit (per occurrence and annual aggregate per Member) for Land-Use Planning and Land-Use Regulation, zoning, and any other land use and permitting process. The City's liability coverage does not have these sublimits, i.e. such losses would have \$12 million limits with the City's current coverage.

⁴ Des Moines, Everett, Kent, Lacey, Marysville, Mercer Island, Mountlake Terrace, Olympia, and Kirkland.

⁵ Most transportation benefit districts' WCIA membership terminated when their districts disbanded following passage of a 2015 bill codified as Chapter 36.74 RCW, which authorizes a city to assume the rights, powers, functions, and obligations of a transportation benefit district established by a city.



The \$150 million earthquake limits in the pool is a pool aggregate, whereas the \$50 million City earthquake coverage is for specific City assets. Because earthquakes are regional events, the pool aggregate could be insufficient in the event of a major earthquake. The City currently only insures three properties for earthquake and flood damage:

1. Sewage Treatment Plant at 1600 Oyster Bay Avenue
2. Kitsap Conference Center; 3rd Floor Conference Center Improvements and Waterfront Plaza, Fountains and Pump House at 100 Washington Avenue
3. PSNS Memorial Plaza; Fountains and Pump House at 201 Pacific Avenue

In terms of the Casad Dam, both the City’s insurance and WCIA provide liability coverage for ensuing damages in the event of a dam failure but no property coverage for the dam.

PREMIUMS

WCIA premiums are higher than the City’s current premiums, as summarized below:⁶

Coverage	Premium		
	Current	WCIA	Change
Property	\$ 338,806	\$ 417,521	\$ 78,715
Liability	169,158	330,457	161,299
Crime	3,773	3,100	(673)
Total	\$ 511,737	\$ 751,078	\$ 239,341

The amount shown for property premiums includes automobile physical damage and boiler and machinery coverage.

The WCIA premiums include pre-defense review, WCIA training and education, WCIA risk management and consultation, and field property appraisals for locations valued \$1 million plus. The City currently has in-house legal counsel perform pre-defense review; Ms. Swem obtains some of her training through WCIA but has to pay for it whereas it is free for Members; Ms. Swem performs the City’s risk management function; and the City would need to pay for property appraisals.⁷

WCIA liability premiums include defense costs (i.e. attorney fees) that exceed the City’s deductible. Defense costs erode the overall WCIA limits as well as the City’s deductible. The City would reimburse WCIA for the attorney fees within the deductible and it would count toward satisfying the deductible. Inside and outside adjuster expenses are not allocated to individual claims (except first party property) and therefore not the responsibility of the City. Since the City currently uses in-house legal staff for most of its risk management legal needs, joining a pool would likely increase the City’s outside legal expense.

⁶ The associated deductibles are discussed in the next report section.

⁷ Ms. Swem used a program on the Internet to estimate fire station property values. For other property values, Ms. Swem generally increases the prior year value by construction inflation.





DEDUCTIBLES

As shown below, WCIA’s deductibles are lower than the City’s SIR/deductibles for property and crime.

Coverage	SIR/Deductible		
	Current	WCIA	Change
Property	\$ 100,000	\$ 25,000	\$ (75,000)
Liability	500,000	500,000	-
Crime	25,000	10,000	(15,000)
Total	\$ 625,000	\$ 535,000	\$ (90,000)

If the City opted for a \$250,000 deductible with WCIA, the annual liability premium would increase \$58,166. From 2007 through 2017, the City incurred total expenses of \$230 related to claims from \$251,000 to \$500,000. If history repeats itself, reducing the deductible would not be fiscally prudent.

CLAIM CONTROL

A significant difference between handling claims with self-insurance versus in a risk pool is the party controlling the claim. Currently, Ms. Swem controls claims that fall below the SIR: she investigates, evaluates, and resolves self-insured liability claims presented against the City. Coordinating with claim investigators and adjusters if needed, Ms. Swem assesses liability and evaluates the amount owed to the claimant. She also works with the City’s legal counsel and/or outside counsel when claims are litigated. When it is determined the City has liability, Ms. Swem directs the City to pay the amount owed.

In a risk pool, the pool controls the claims: the pool decides which claims to pay and how much, irrespective of whether the claim amount is above or below the deductible. The WCIA Coverage Document states WCIA, “shall have the absolute and unrestricted right and duty to select legal counsel to defend the member against the claim and pay the costs of the selected defense counsel and; further, shall have the absolute and unrestricted right to settle any covered claim within the limits of the provided coverage. The Authority [WCIA] shall have no obligation or duty to pay for the defense costs of a member for any uncovered or excluded claim.”

To understand the significance of this difference, the following is a hypothetical loss situation under each scenario:

- Currently, if the City had a \$1 million liability claim, Ms. Swem could consult in-house and/or outside legal counsel to assess liability. If it was determined the City had no liability, Ms. Swem could deny the claim. If it was determined the City had liability, Ms. Swem could evaluate the amount due and, based on claims history, potentially direct the City to pay significantly less than the demand. The City with its \$500,000 SIR has at risk the first \$500,000 and controls how that risk will be managed.



- In a risk pool, the fate of the same \$1 million liability claim would be determined by the pool. Assuming a \$500,000 deductible, the City would still have the first \$500,000 at risk but the City would not be deciding how to handle the claim. The pool, which has risk over \$500,000, could instruct the City to pay \$499,000 to settle the claim. Again, this is a hypothetical example presented to illustrate the control factor and does not necessarily represent how the pool would respond to such a claim.

Each city risk manager that I spoke with that had left the pool cited claim control as a significant benefit of being self-insured.

NEGATIVE FEEDBACK CONCERNING RISK POOLS

Risk managers from multiple cities cited the following negative points associated with being in a risk pool:

1. Lack of control over claims: the risk managers did not agree with some decisions the pool made in terms of liability and/or the settlement amount. This issue appeared to be the chief complaint. As noted above, this issue can have a significant financial impact.
2. Lack of collaboration between the City and the pool in terms of claims handling.
3. Premiums were getting too high, in one case it was stated the premiums were increasing in the double digits. Another risk manager stated his city is saving over \$200,000 annually by being self-insured.
4. Discontented with the WCIA attorneys the cities had to work with. The WCIA attorneys are assigned by the pool to each case and the risk managers were not happy with some of the attorneys.
5. One city with a population under 4,000 left WCIA to become self-insured because it was costing the city more to be in a risk pool.
6. One city with a population under 3,000 left WCIA at the end of 2017 to join CIAW. This city cited higher premiums and mandatory training as the reasons for changing risk pools.

POSITIVE FEEDBACK CONCERNING RISK POOLS

In terms of the more commonly cited benefits of being in a pool, city risk managers noted the following:

1. Outsourcing risk management: Cities too small to warrant an in-house risk manager and perhaps do not have in-house legal counsel stated outsourcing the risk management function to a pool was beneficial. (As noted in Item 5 above, one very small city has found it more economical to be self-insured.)
2. Training: WCIA offers free training to its members on a wide variety of liability exposures such as personnel, land use, police, fire, jails, fleet, volunteers, public works, and parks. Several risk managers praised the quality of WCIA trainings; one city did not like that WCIA training was mandatory. Ms. Swem noted WCIA training is available to non-members for a fee.



3. Networking: a couple risk managers stated they valued networking opportunities with other municipal risk managers.

IN-HOUSE CHANGES IF JOIN A RISK POOL

As previously noted, if the City joins a risk pool, the City would likely need to modify its risk management staffing. The risk pool would assume certain aspects of Ms. Swem's position. The City will need an administrative level person to accept claims and submit them to WCIA. This person would serve as the liaison between the City and WCIA, and could perform some of Ms. Swem's less technical risk management duties. WCIA staff would provide the more technical risk management aspects of Ms. Swem's position.

Ms. Swem estimates one third of her time is spent performing duties that would be assumed by a risk pool, including purchasing property and liability insurance and handling property and tort liability claims. Ms. Swem's remaining responsibilities would need to be replaced by others, whether it is a new employee or allocated to other departments. Other responsibilities include budget development, purchasing workers compensation and pollution insurance, estimating City loss reserves, and managing occupational safety and the workers compensation programs.

A December 13, 2017 compensation study prepared for the City determined that Ms. Swem's duties were equivalent to a Risk Manager (Salary Band 14) yet her compensation and title are that of a lower position, Risk Management Specialist (Salary Band 12). If the City continues self-insuring, Mr. Lubovich believes he will need to replace Ms. Swem with a Risk Manager. The City's 2016 Salary Schedule⁸ annual salary range for each position is as follows:

Risk Management Specialist	\$71,796 to \$87,477
Risk Manager	\$79,249 to \$96,558

Mr. Lubovich stated outside attorney fees would be reduced if the City joined a risk pool. Outside attorney fees incurred from the Risk Management Fund from 2013 through 2017 totaled \$46,579, an annual average of \$9,316. This amount can fluctuate with the extent of litigation and may be higher in the near future.

Mr. Lubovich stated in-house legal staffing needs would not be impacted by switching to a risk pool. Salaries charged to the Risk Management Fund total \$277,200 in 2017 and include the following:

⁸ This is the most recent approved salary schedule.



City Employee	Title	Percent Of Salary
Roger Lubovich	City Attorney	30%
Thelma Swem	Risk Management Specialist	80%
Kylie Purves	Assistant City Attorney II	70%
Melisa Folmer	Legal Assistant II	40%
Total		220%

A more in-depth review of salary allocations would be needed to assess whether the current allocations reasonably represent employee time spent performing risk management functions. At your request, my review can be expanded to assess the reasonableness of risk management salary allocations.

POSSIBLE EARLY TERMINATION PENALTY

If the City cancelled its property and liability policies prior to the policy expiration date, it would likely incur a penalty. It is my understanding the liability penalty is 10 percent of the unearned premium. Assuming property has the same penalty and assuming an April 1, 2018 cancellation (as an example), the estimated penalty would be \$39,507, as shown below:

Policy	Term		Premium	Potential Penalty
	From	To		
Property	1/1/2018	12/31/2018	\$ 338,806	\$ 25,410
Excess Liability	2/1/2018	2/1/2019	169,158	14,097
Total			\$ 39,507	

REQUEST FOR PROPOSAL (“RFP”)

Mr. Lubovich and Ms. Swem both stated they have been very happy with the service provided by Willis, which has been the City’s broker for at least the past 25 years. It appears the City has never solicited proposals for an insurance broker through an RFP. If the City decides to continue its self-insurance program, it should consider soliciting premium indications⁹ through an RFP.¹⁰

⁹ Premium indications are a step short of a quote. Getting insurance quotes blocks access to markets so it is generally preferred to get a quote after a broker is selected.

¹⁰ Alliant was noted by some city risk managers as being an excellent broker with a public entity group purchase insurance program that appears well worth exploring.



SUMMARY

If the City joined WCIA, premiums would increase approximately \$239,000 but the City would have higher limits of coverage for most losses and a lower property deductible. With WCIA, the City would have higher Boiler and Machinery limits. If the City does not join a pool, it will likely need to replace Ms. Swem with a higher paid risk manager that could result in an increased annual cost of approximately \$8,300 to the City.¹¹

¹¹ Based on the average difference between the Risk Management Specialist and Risk Manager salary ranges from the City's 2016 Salary Schedule. Does not account for a benefit differential, if any.



In addition to premiums and coverage, the City needs to give due consideration to the potential cost of giving an unrelated party “the absolute and unrestricted right to settle any covered claim within the limits of the provided coverage.” This could lead to an increased number of paid losses and to the extent the losses are below the deductible, this could result in an increased City expense. Additionally, in a pool, the City would likely experience an increase in attorney fees since a portion of in-house legal work would be performed by the pool’s attorneys and charged to the City.

Please contact me if you have questions or need additional information.

Sincerely,

Jennifer L. Sims CPA/CFF, CFE
City Auditor

cc: Mayor Wheeler
City Council
Roger Lubovich, City Attorney
Thelma Swem, Risk Management Specialist
Melisa Folmer, Risk Management Specialist
DeWayne Pitts, Finance Director
Mike Riley, Assistant Finance Director

From: Greg Wheeler
Sent: Wednesday, April 18, 2018 2:52 PM
To: Jenny Sims; Leslie Daug; Pat Sullivan; Deborah McDaniel; Darryl Riley; Dennis Treger; Eric Younger; Roger Lubovich
Cc: Elaine Valencia; Christine Grenier; Thelma Swem; Melisa Folmer; Dewayne Pitts; Mike Riley; Tony Hillman; Richard Huddy; Kevin Gorman; Michael Goodnow
Subject: RE: Risk Management report - final

This is a follow-up to the City Auditors report comparing the City of Bremerton's self-insured program of insuring property and tort liability risk versus being insured for property and liability risk through a risk pool. A preliminary report was issued February 27, 2018 and the final report on April 17, 2018. Following review of these reports, it is administration's position that the City is best served by maintaining its current self-insured program and not by joining an insurance pool. It is cost effective to be self-insured and in the City's best interest to have complete control and decision making authority over all cases from the beginning of the claim to its conclusion. Accordingly, no changes to the current self-insured program are going to be initiated by administration at this time.

Thank you,
Mayor Greg Wheeler

From: Jenny Sims
Sent: Tuesday, April 17, 2018 2:08 PM
To: Leslie Daug; Pat Sullivan; Deborah McDaniel; Darryl Riley; Dennis Treger ;Greg Wheeler; Eric Younger; Roger Lubovich
Cc: Elaine Valencia; Christine Grenier; Thelma Swem; Melisa Folmer; DeWayne Pitts; Mike Riley; Tony Hillman; Richard Huddy; Kevin Gorman; Michael Goodnow
Subject: Risk Management report - final

Dear Audit Committee members, Mayor Wheeler, Eric Younger, and Roger Lubovich,

Attached is the final Risk Management report and cover letter. I apologize for the delay in providing this final report (quorum issues), however, there are no substantive changes from the draft report provided to you on February 27, 2018.

Please contact me if you have questions or need additional information.

Kind regards,
Jenny
Jennifer I. Sims, CPA/CFF, CFE
Bremerton City Auditor
Office: (360) 473-5369