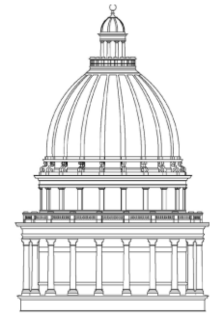
Office of
LEGISLATIVE AUDITOR GENERAL
State of Utah



REPORT NUMBER ILR 2011-B
April 20, 2011

Competitive Business Practices of the Utah Local Governments Trust

A survey of the competitive business practices and operations of the Utah Local Governments Trust (ULGT or Trust) has found that the Trust operates within state rules and established industry norms. We do not believe that any action beyond this survey is currently necessary.

The Trust is exempt from oversight by the Department of Insurance and is overseen by the Utah Labor Commission.

The Trust currently offers competitive rates and aggressively pursues new members for its workers' compensation insurance pool. ULGT, under Senate Bill 48 (passed in the 2002 Legislative Session), while exempt from oversight by the Department of Insurance, is overseen by the State of Utah Labor Commission. As such, ULGT is allowed to pool government entities while acting as a self-insured trust.

The Utah Local Governments Trust was founded in 1974 and is licensed as a public agency insurance mutual. The Trust provides coverage for local government agencies, including cities, towns, counties, special service districts, and school districts. Some of the types of insurance coverage the Trust provides include:

- General liability
- Auto physical damage
- Property
- Workers' compensation

While the Trust provides several forms of coverage, this survey examined the Trust's workers' compensation insurance program. The Trust has offered workers' compensation coverage since January, 2004. They currently have a member pool of 337.

Scope and Objectives

We were asked to address concerns that the Trust was aggressively soliciting members of other public agency insurance mutuals (PAIMs) using unfair competitive business practices, as well as assuring these members who were marketed to, that certain workers' compensation rates would be 25-30 percent lower than the rates they were paying other providers. An additional concern was that the Trust was guaranteeing workers' compensation rates for three years, which concerned competitors because this guarantee requires a large surplus or reserve and did not appear to be a sound business practice, given the uncertainty of future events.

The specific objectives of our survey included the following:

- Determine whether the Trust requires greater public oversight
- Determine whether the competitive business practices employed by the Trust are fair
- Determine whether the reserves for the Trust's workers' compensation line are adequate

To accomplish these objectives, we reviewed relevant ***Utah Code*** provisions, financial documents provided by the Trust. We also spoke to the Department of Insurance, competitors and local entities recent members added to the Trust's membership pool.

Trust Operations Receive Appropriate Oversight

A lack of oversight for the Trust is a concern raised by competitors, citing that the Trust does not have to report to a public agency, specifically, the Department of Insurance. However, there are adequate levels of oversight in place to mitigate financial risk. Statute has instituted controls, and industry controls are in place to bring a reasonable degree of oversight.

The Trust's administration of its workers' compensation benefit seems to be managed effectively within established industry and state guidelines. Sufficient controls are in place to mitigate the Trust's financial risk to their members. The Trust's reserves (funds set aside to cover future liabilities) appear to be sufficient to manage future workers' compensation claims. The rates the Trust offers are competitive and maybe guaranteed for up to three years and the guarantee is contingent on certain criteria being met and maintained.

Trust Appears to Have Adequate Oversight in Place

The Trust is a self-managed government insurance mutual; as such, it is not required to be audited by or report to the Department of Insurance. Though this public oversight has been eliminated, the Trust does have layers of oversight designed to decrease pool members' financial risks.

Layers of oversight include Board of Directors, claims monitoring by reinsurer, and independent financial reviews by a third party.

The layers of oversight the Trust has in place are:

- Board of Directors composed of elected officials and managers from the membership pool, who assist in creating policy for the Trust
- Reinsurer that monitors the claims of the Trust
- Independent auditors that review the Trust's financial statements
- Independent actuaries who set the rates for the workers' compensation benefit
- Utah Labor Commission oversight, that includes annual insurance coverage reporting and reviews to verify sufficiency of the Trust's reserve requirements

While the Labor Commission does not perform an in-depth survey of Trust administrative controls, the reserves and rates are independently evaluated and set, Trust pool members are instrumental forming policy, and claims are independently evaluated. Each of these controls address areas that appear to pose the highest financial and liability risks to the Trust. As a result, we believe the Trust's operations receive adequate oversight.

Trust Adheres To Industry Standards

Premiums are determined through an independent actuary and all claims are administered through a third party.

The Trust gathers workers' compensations premiums from their pool members and allocates them to various purposes. Premium rates are determined by an independent actuary. All workers' compensation claims administration is handled through a third-party administrator. Figure 1 shows how the collected premiums are allocated.

Figure 1 Collected Premiums Fund the Internal Operations for the Trust. Premiums fund the operations of the Trust and are also allocated to reserves and reinsurance to protect against future and high cost claims.

As demonstrated in Figure 1, the Trust must collect sufficient premiums to cover, investments, reserves, current and future claims, reinsurance, and administration costs.

The Trust's Reserves Have Been Verified as Sufficient. Reserves are amounts set aside by the Trust to pay for future claims. Reserve amounts are actuarially determined and must consider factors such as the likelihood of a claim, the severity, and frequency; therefore, predicting these variables must be done as accurately as possible. The Trust's reserves are estimated and certified as sufficient by an independent local actuarial firm.

As of December 2010, the Trust had approximately $22.4 million in projected reserves and $6.2 million in 2010 paid claims. Upon review, neither the Department of Insurance nor the Utah Labor Commission could find issue with the Trust's reserve amounts.

The Trust's Loss Ratios Are Within Industry Accepted Boundaries. A calculated loss ratio is a primary tool use to gauge the financial health of an insurance provider is a calculated loss ratio. The loss ratio is the incurred claims (current and projected expenses for current claims) plus expense, divided by paid premiums. For example, if claims plus expense equal $100 and the premiums paid were $130, then the loss ratio would be 77 percent. The loss ratio can also be used to see if the organization is overcharging premiums, as well. Figure 2 shows the Trust's loss data from 2007 to 2010 for their workers' compensation business line.

Figure 2 Loss Ratios Have Declined Since 2007. Premiums have decreased since 2007 but this appears to be offset by lower claims costs over this time.

	Net Premiums	Claim Count	Incurred Claim Costs	Loss Ratio
2007	$ 7,107,326	1,040	$ 4,381,022	61.6 %
2008	6,758,909	972	4,333,552	64.1
2009	6,159,598	1,133	3,843,475	62.1
2010	6,380,411	1,052	3,383,675	53
Total	**26,436,244**	**4,197**	**15,941,724**	**60.3**

Since 2007, the loss ratio has decreased by 23%, as a result of lower claim costs and lower claims counts.

According to Figure 2, the claim count has increased modestly since 2007, but claim costs, according to our analysis, have decreased by 23 percent since 2007. As a result, the claims ratio has also decreased by about 14 percent since 2007. Increases in claim costs in 2008 and in claim counts in 2009 occurred; however, the loss ratio decreased due to lower claim costs and a lower claim count in 2010. Claim costs and claims can be cyclical and can increase and decrease from year to year. The Trust uses an incurred claim costs method when displaying their loss ratio. These loss ratio numbers do not reflect future losses which are incurred but not yet reported.

The Trust attributes some of their overall loss-ratio decrease to an investment in pool member risk management, claims management, and member involvement; risk management is a program that offers free training to all pool members to help minimize work-related injuries and the resulting insurance liability. One Trust member we interviewed believed that their proactive efforts to address economic concerns also played an in important part in reducing costs. However, since an in-depth review of the Trust was not undertaken, we could not substantiate to what degree risk management offered by the Trust played in the lowering of loss ratios for members.

Competitive Workers' Compensation Rates Are Contingent upon Meeting Certain Criteria. The Trust does offer a three-year rate guarantee for members, which was stated as a concern in the audit request. The concern appears to be unmerited. The guarantee is based on the following conditions:

Three year rate guarantees for members occur if their loss ratios do not exceed 50% and their payroll does not increase more than 10%.

- Pool members' loss ratio must not exceed 50 percent.
- Pool members' payroll must not increase more than 10 percent.

If either condition fails to be met, the Trust can adjust premium rates. The Trust's administration states that a member maintaining a loss ratio above 50 percent are still entitled to rate reductions, if applicable. The Trust stated that they have not had to renegotiate rates solely based on meeting the above rate criteria.

According to the Trust, its rates are competitive due to heavy investment into risk management training, claims management, member involvement and oversight. The Trust's ability to offer competitive workers' compensation rates was documented by Utah and Rich counties.

Utah County administrators stated that they were looking for a better deal for 2009 after their workers' compensation rates increased by 176 percent. The Trust's bid for Utah County's workers' compensation business was 39 percent lower than the next lowest bid. According to Utah County staff, this bid was offered after they provided the same package of information given to each bidder, inclusive of the number of employees that would be covered and their workers categories, payrolls, and job descriptions. Utah County was also allowed to review the Trust's financials to determine if the Trust had sufficient reserves. They also were told that their rates would not increase as long as their loss ratio was below 50 percent and their payroll did not increase by more than 10 percent.

Rich County also received a very competitive offer from the Trust. The Trust offered Rich County a 33 percent lower rate than what they were paying. This rate was based on information Rich County provided to the Trust, specifically, employee categories, payrolls, job descriptions, and previous loss ratios. Rich County stated that their rate was guaranteed for three years as long as their loss ratio did not surpass a particular threshold and their payroll did not increase by more than 10 percent.

The counties reported using or being offered the ability to utilize the Trust's risk management program to some degree, which can assist in reducing the probability of workers compensation claims.

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Agency Response

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Memo

To: Legislative Auditor General – State of Utah
From: Utah Local Governments Trust
Date: May 11, 2011

RE: Management Response to Audit Report Number 2011-959
Competitive Business Practices of the Utah Local Governments Trust

The Utah Local Governments Trust (Trust) is in receipt of the referenced audit report produced by the Office of Legislative Auditor General for the State of Utah.

The Trust appreciates the work of the audit team and its conclusion that in all areas of the audit inquiry, the Utah Local Governments Trust operates within state rules and established industry norms.

The Trust is committed to providing its members the option of participating in a voluntary risk and insurance program that provides a superior solution to what is offered by other for-profit and non-profit providers. Because the Trust's charter is to serve public entities, rather than to make a profit, the Trust's insurance programs provide an economical and financially sound alternative that enables public entities to save taxpayer dollars–savings that can be used to reduce tax burdens or provide needed services to the constituents served by Trust members.

This audit request appears to have been triggered by competitors who are concerned about losing business to the Trust. It is not surprising that other insurance providers would be concerned about our competitive niche in the market. The Trust is on a continual quest to improve efficiencies, increase services and pass savings on to its members. Under the direction of a board comprised of the members we serve, the Trust has been able to identify ways to improve services, decrease costs and implement policies that maintain fiscal responsibility.

Because of the Trust's efficient operations and financial stability, it is able to offer qualified guarantees on rates for limited periods of time. Furthermore, because the Trust has sufficient reserves, it does not have to require members to enter into long-term contracts—the Trust is able to provide its members the opportunity to participate in its programs without threat of penalty for early termination.

Thank you again for the opportunity to work with your team. We appreciate your feedback and look forward to improving the risk and insurance solutions for governmental entities across the great State of Utah.

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