

April 13, 2005

TO: John Szerlag, City Manager

FROM: John M. Lamerato, Assistant City Manager/Finance & Administration  
James A. Nash, Financial Services Director  
Stephen Cooperrider, Risk Manager

SUBJECT: Agenda Item - Bid Waiver – Workers' Compensation Insurance Renewal for Fiscal Year 2005/2006

**RECOMMENDATION:**

It is our recommendation that City Council approve the renewal of the City's workers' compensation coverage with the Michigan Municipal League Workers' Compensation Fund (MML WCF) for the annual estimated cost for fiscal year 2005-06 of \$444,846. This is a 24.4% overall cost reduction from fiscal year 2004-05.

**BACKGROUND:**

The City's overall cost for FY 05/06 of \$444,846 compares with \$588,653 for FY 04/05 and \$448,289 for FY 03/04.

The MML WCF belongs to a larger non-profit captive mutual insurance company, the National League of Cities Mutual. The member pools own the company. The NLC Mutual Company annually takes competitive bids from reinsurers. As of January 1, 2005 the reinsurers and their Best ratings are: Aspen Insurance UK (A), Hanover Rk (A), Zurich American Insurance Company (A).

In March of 2003, City Management engaged independent insurance counselor, Mr. Angelo Zervos to evaluate the current state of the City's workers' compensation program and provide a recommendation as to the most appropriate action to be taken by the City. Mr. Zervos' report and recommendation is attached for review. His evaluation indicated the MML program would cost the City less than if we were self-insured. This was because the City has received large dividend distribution checks from the MML WCF over the past five years. Mr. Zervos' report is as relevant today as it was then. The dividend distribution check for 2004 was \$179,814. The check received this year is \$107,614.

**ANALYSIS:**

We experienced an increase of 1.7% in our premium; the average increase of the MML WCF was 1.92%. This increase can ultimately be attributed to our increase in payroll. In addition, we are seeing a decrease in our experience modifier from 1.38 to 1.01 for FY 2005-2006.

*(The experience modifier is a factor developed by measuring the difference between the City's actual past loss experience and the expected experience. This factor may either be a debit or a credit. When applied to the standard premium, the experience modification produces a premium that is more representative of the City's actual loss experience.)*

I spoke with Mr. Angelo Zervos regarding this year's renewal. Mr. Zervos concurred with the fact that his 2003 report is as relevant today as it was then. Mr. Zervos said the cost of commercial insurance would be more than what the City is paying to be in the MML WCF. He also indicated that to be self-insured for workers' compensation would not be appropriate either. Mr. Zervos said that the large dividend check and the decrease in the experience modifier provide the City with a good financial position without having the increased risk of being self-insured. Mr. Zervos indicated that from a cost standpoint, being in the MML WCF is where the City currently belongs.

**BUDGET IMPACT:**

Attached is a renewal declaration page from the MML WCF indicating the net estimated premium to the City of Troy for FY 05/06 is \$552,460. After applying the dividend distribution check in the amount of \$107,614 to the net estimated premium; the net annual estimated cost to the City for workers' compensation coverage is \$444,846. Funds are available in the Workers' Compensation Fund.

Troy, City Of  
 Attn: James A. Nash  
 500 W. Big Beaver  
 Troy, MI 48084

Coverage Period 7/1/2005 to 6/30/2006

RENEWAL

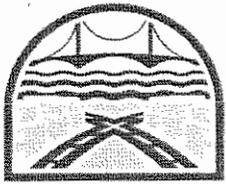
Class Code	Class Description	Estimated Annual Payroll	Rate per \$100 of Payroll	Estimated Annual Premium
0106-00	Tree Pruning	186,000	6.41	11,923
5403-00	Carpentry	250	10.96	27
5509-00	Street Operations	1,500,000	5.44	81,600
7382-00	Transit Authority/Dial-A-Ride Drivers	5,800	3.97	230
7520-00	Water Operations	1,200,000	2.69	32,280
7590-00	Incineration/Recycling Operations	3,000	4.73	142
7704-01	Firefighters	1,200,000	3.05	36,600
7704-02	Volunteer/On-Call Firefighters	64,000	5.29	3,386
7720-01	Police Officers	12,000,000	2.23	267,600
8395-00	Garage Operations	700,000	2.81	19,670
8810-01	Clerical-Office	7,600,000	0.41	31,160
8810-02	Elected Officials	36,400	0.21	76
8810-03	Libraries & Museums: Prof/Clerical	2,140,000	0.24	5,136
8820-00	Attorneys/Judges	460,000	0.26	1,196
8831-00	Animal Shelters	162,000	2.00	3,240
9015-00	Building Operations	630,000	3.26	20,538
9060-00	Municipal Golf Course	500,000	1.41	7,050
9102-00	Parks & Recreation	2,500,000	2.33	58,250
9103-00	Crossing Guards	31,000	2.75	853
9104-00	Lifeguards	330,000	2.02	6,666
9156-00	Theater-Entertainers	3,000	0.75	23
9220-00	Cemetery Operations	18,300	3.07	562
9402-00	Street Cleaning	302,000	3.45	10,419
9410-00	Municipal Employee	4,600,000	1.59	73,140
	Totals:	\$36,171,750		\$671,767

Coverage Amount

Employers Liability: \$500,000  
 Workers' Compensation: STATUTORY

1st Quarter Due:	06/15/2005	\$138,115
2nd Quarter Due:	09/15/2005	\$138,115
3rd Quarter Due:	12/01/2005	\$138,115
4th Quarter Due:	03/01/2006	\$138,115

Total Standard Premium:	\$671,767
Experience Modifier:	x 1.01
Modified Premium:	= \$678,485
Size of Premium Factor:	-\$49,011
Expense Constant	\$75
Expense Constant Credit:	-\$25
Total Estimated Premium:	= \$629,524
(Dividend Credit)	-\$77,064
NET ESTIMATED PREMIUM:	= \$552,460
= Total Due:	\$552,460



# MICHIGAN MUNICIPAL LEAGUE WORKERS' COMPENSATION FUND

April 07, 2005

James A. Nash  
Troy, City Of  
500 West Big Beaver  
Troy, MI 48084 -5285

Dear Mr. Nash:

We are pleased to enclose your workers' compensation renewal package for the coverage period July 1, 2005 through June 30, 2006. Included is the policy declaration and certificate of membership.

The Fund received authorization to distribute \$7 million of surplus from Fund years 7/1/1993-94, 95-96 and 96-97. Members who were members in any or all of the years for which a dividend was declared have received their proportionate share of dividends. Of the \$7 million, your portion of \$4 million has been distributed by check and your portion of \$3.0 million has been applied as a premium credit on your renewal declaration, if applicable. The following summarizes your renewal:

Premium Prior to Dividend Credit:	\$629,524.00
Dividend Credit:	<u>\$-77,064.00</u>
Net Estimated Premium:	\$552,460.00
Dividend Distribution Check:	<u>\$-107,614.00</u>
Annual Estimated Cost:	<u>\$444,846.00</u>

The enclosed policy declaration indicates when payments are due. Subsequent to this mailing you will receive an invoice from the finance department requesting payment. The enclosed policy declaration is not a bill.

The enclosed certificate of membership may be provided to third parties as evidence that the required workers' compensation coverage is in place. If you need additional certificate copies throughout the year, visit our website at [www.mmfund.org](http://www.mmfund.org) and enter your user name and password. Click "Online Forms" on the main toolbar then select "Certificate of Insurance."

If you have questions pertaining to any of the enclosed, please contact Kelli Collins or myself at 800/653-2483. Your cooperation and support are greatly appreciated.

Sincerely,

*Karen Maladecki*

Karen Maladecki  
Senior Underwriter  
Risk Management Services  
Michigan Municipal League

Enclosure  
5000410-05

# CITY OF TROY

---

REPORT PREPARED BY  
ANGELO J. ZERVOS, CPCU, LIC

April 10, 2003

City of Troy  
500 W. Big beaver Road  
Troy, Michigan 48084

Attention: Stephen Cooperrider, ARM  
Risk Manager, City of Troy  
Reference: Workers Compensation Insurance

Dear Steve,

I recommend that the City of Troy renew workers compensation coverage with the Michigan Municipal League Workers Compensation Fund. This is based on the following reasons.

- 1) Comparison of historical costs demonstrated that the Michigan Municipal League Workers Compensation Fund was lower in cost than self-insurance.
- 2) The Michigan Municipal League Workers Compensation Fund has special expertise in governmental insurance.
- 3) Existing claim handling and loss control by Meadowbrook Insurance is of a high quality.

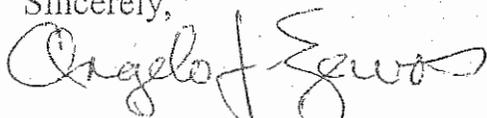
The history of dividends has reduced the net premium cost for many years. You are now paying higher premiums that reimburse the Michigan Municipal League for the large losses in 1998, 2000 and 2001. This is a normal part of the insurance premium cycle.

I also looked at the alternative of self-insurance and large deductible plans. These plans can cost the City of Troy more in premium than the dividend plan that you have selected.

I do not recommend that you go out to bid at this time. Commercial insurance choices would be limited to self-insurance or large deductible plans that increase the amount of risk taken by the City. Competitive bidding would not benefit the City because the historical cost of the fully insured programs would be higher than the current dividend plan.

If there are other questions about this report then I would be happy to clarify any of the sections.

Sincerely,

A handwritten signature in cursive script that reads "Angelo J. Zervos". The signature is written in dark ink and is positioned above the printed name.

Angelo J. Zervos, CPCU, LIC

## INDEX

General Information	Page 1
Self Insured Plans	
Large Deductible Plans	
Dividend Plans	
Terrorism Insurance	Page 2
Stability in Rate and Service	Page 2
Historical Information on Fund	Page 3
Interviews with Insurance Agents	Page 4
Interviews with other Municipalities	Page 5
Administrative costs of Self Insurance or Deductible Plans	Page 6
Claims costs of Self Insurance or Deductible Plans	Page 6
Net Cost of the Michigan Municipal League Insurance	Page 6
Summaries of Averages from Past Experience	Page 7
Actual Dollars in Premium and Incurred Claims	Page 8
Appendix	
History of Premium, Dividends and Incurred Losses	
Worksheet estimating premium for 2003-2004	

There are many types of workers compensation insurance plans. In this report I have focused on three types of plans. This information uses many industry specific terms that I want to clarify.

#### SELF INSURED PLAN

In this plan the City of Troy pays all workers compensation claims. There is usually catastrophic claims protection called Reinsurance. Reinsurance protects the City in the event of multiple deaths or a year of higher than usually frequency. In a self insured plan there is an independent company that negotiates and settles the claims called a Third Party Administrator. This same company usually offers safety services as a part of the program, called Loss Control Services. Self Insured Plans lower the upfront cost to the City and increase the risk taken by the City.

#### LARGE DEDUCTIBLE PLAN

In this plan the City pays all workers compensation claims up to a designated deductible. The City assumes the risks and gets the benefits of self insurance without the administrative costs that apply to Self Insured Plans. It also avoids the burden of becoming state approved to have a self insured plan. It is usually more expensive than self insurance but the City assumes less risk.

#### DIVIDEND PLAN

In this plan the insurance company pays all workers compensation claims. The insurance company accumulates dividends that are distributed to policyholders. When claims experience is better than expected these dividends can be substantial. The dividends are distributed by the premium size of the client. The premium rates are set for all members based on payroll. The individual policyholder rates are adjusted by an experience modification that adjusts rates based on prior experience. Dividend plans give the security of full insurance protection at a reduced premium.

The City of Troy employees have an exposure to terrorist acts. This affects the workers compensation insurance because insurance companies have taken different positions about the extent of coverage. For example the Michigan Municipal Workers Compensation Fund has taken the position that allergic reaction to smallpox vaccines will be covered as an employment related event for police, fire and emergency services workers. No benefits would be available for non-emergency personnel who suffer a reaction after receiving a vaccine on a voluntary basis. I made some inquiries about terrorism coverage and many of the insurance sources had not taken any position. The advantage of working with an insurance company that specializes in governmental risk management is that they will be proactive in addressing these new developments. I am especially concerned about reductions or exclusions in coverage by insurance companies who are protecting against catastrophic claims for self-insured municipalities.

#### STABILITY IN RATE THROUGH SERVICE

Self Insured plans, deductible plans and the dividend plan from the Michigan Municipal League have dramatic fluctuations in cost. This makes it difficult to budget for the workers compensation cost. The reason for the fluctuations is that workers compensation insurance is influenced directly by the claims that occur. Keeping claims costs stable evens out the rate fluctuations. For this reason the quality of the claims handling and loss control services needs to be evaluated as part of any comparison of plans. Meadowbrook Insurance provides claims handling and loss control services for the City of Troy. Meadowbrook is one of the top three agencies in the Detroit Area. I interviewed them about their procedures and was impressed with their professionalism. They were candid about the strengths and weaknesses of the current program. A strength worthy of note was their belief that the City of Troy was proactive in handling all the claims. A weakness was that claims reporting by departmental supervisors are in need of improvement. In interviews with Stephen Cooperrider of the City of Troy I received positive comments about the claims and loss control services of Meadowbrook Insurance. Any change in plan would require a new company to service the claims and loss control services. I was concerned that a change could result in a lower level of service and higher claim costs. The current system is definitely working well.

## HISTORICAL INFORMATION ABOUT THE MICHIGAN MUNICIPAL LEAGUE WORKERS COMPENSATION FUND

The Michigan Municipal League Workers Compensation Fund was started in May of 1977. It is a non-profit group self-insurance pool. The dividends have been larger than any other group self-insurer program in Michigan. It arose out of a need to create an insurance company that specialized in governmental risk management. During the late seventies it was very difficult for governmental entities to purchase insurance.

There are 810 members of the Fund in Michigan. The Board of Trustees is made up of members. This means that the governmental units that pay the premiums directly influence the management of the Fund.

The Fund recently received an award from the Bureau of Workers and Unemployment Compensation. This award was for excellence in the claims handling process. The third party claims administrator is Meadowbrook Insurance. They have been the administrator since 1995.

The Fund is financially stable. It has over 108 Million in assets and over 63 Million in Surplus. To protect the assets on the Fund they purchase catastrophic reinsurance from NLC Mutual.

The Fund has been successful in keeping losses lower than expected. Accumulated dividends given to the City of Troy have been consistently high during the five years that I made the comparison. The City of Troy has been with the Michigan Municipal League Workers Compensation Fund for many years.

Since this is a non-profit self-insured fund the City of Troy receives lower costs without the financial risk of self-insurance.

If you want additional information you can visit their web site at [www.mmlfund.org](http://www.mmlfund.org).

Crain's Business lists three agencies as being the top business insurance agencies in the Detroit Area. Meadowbrook, Marsh and Aon. Meadowbrook currently handles the Third Party Administration for Troy through the Michigan Municipal League program.

I talked to Marsh and they were interested in representing the City in the purchase of insurance. Marsh has over \$8,000,000 in municipal business in the Detroit Area. They were interested in selling all lines of coverage.

Aon also has an active list of municipal clients. They have a subsidiary Cambridge Integrated Services that operates as a Third Party Administrator. Aon has a large national network of personnel in governmental insurance.

A few of the municipalities interviewed talked about the advantages of going direct rather than selecting a broker. The process of limiting the brokers to qualified firms was administratively difficult for these municipalities. Since these are professional services it is important that only qualified firms represent the City. The municipalities that went directly to the insurance company liked the ease of doing business. These municipalities had risk management departments that were capable of representing the City professionally. They also appreciated the reduction in costs by going directly to the insurance company.

I interviewed seven municipalities about the type of workers compensation plan they were using. Below is a summary.

CITY	ADMINISTRATOR	TYPE OF PLAN
-----	-----	-----
Royal Oak	Citizens Management	Self Insured
Farmington Hills	Michigan Municipal League	Dividend Plan
St. Clair Shores	Citizens Management	Self Insured
Sterling Heights	Accident Fund	Self Insured
Southfield	Great American	Large Deductible
Pontiac	RISKCO	Self Insured
Dearborn	Accident Fund	Self Insured

The majority of these municipalities have a self-insured plan. While this is popular it does not necessarily mean lower costs. My review showed that self-insurance would have been more expensive for Troy the last five years.

I contacted the Third Party Administrators about their services. I also contacted the insurance companies and interviewed them about the availability of coverage. They would all be interested in providing services or coverage to the City of Troy. This does not imply that the services would be better than the current plan. Meadowbrook has provided a high level of service in claims handling.

The Accident Fund offers two year and three year plans. Citizens Management also offered a multi-year plan. Citizens offered to do a cash flow analysis of the benefits of selecting self insurance over the current insurance program. The City of Dearborn is currently engaged in a review process and is finding the insurance marketplace competitive. Some of them require an agent and others let you write insurance directly.

## ADMINISTRATIVE COSTS OF SELF INSURANCE OR DEDUCTIBLE PLANS

There are administrative costs to a self-insurance plan. These consist of Agent Fees, Reinsurance, Third Party Administration Fees, Loss Control services and State Assessments. The City of Sterling Heights was willing to share these costs with us for this report. The City of Sterling Heights averaged \$73,000 per year over a five-year period. A deductible plan offers an insurance cost that I estimate would average around \$150,000.

## CLAIMS COST OF SELF INSURANCE OF DEDUCTIBLE PLANS

The claims costs are not less under these plans. Internal factors of claims staffing and safety planning are critical to reducing loss severity and frequency. The City of Troy incurred \$1,699,428 in workers compensation claims over a five-year period. This averaged at \$339,886 a year.

## NET COST OF THE MICHIGAN MUNICIPAL LEAGUE INSURANCE

The biggest advantage of staying with the Michigan Municipal League has been the history of large dividends. The Net Estimated premium over a five-year period was \$1,586,245. This averaged at \$317,249 a year. Over a five-year period they refunded \$743,646. This averaged at \$148,729 a year. A history of the premium, dividends and incurred losses is in the appendix at the end of the report. The net cost after all dividends over the last five years totaled \$842,599. This averaged \$168,520 a year.

A key reason for selecting the Michigan Municipal League has been their experience of the last 5 years. The net cost is substantially lower than the cost would have been if self-insurance had been in effect during the same period. Below is a model based on the averages that were calculated on the prior page. I used averages so that the costs could be viewed on an annual basis.

Type of Cost of Self Insurance	Five-year averages
-----	-----
Self Insurance administrative costs	\$ 73,000
Claims Costs	339,886
	-----
Net cost with self-insurance	\$362,650

Type of Cost of the Fund	Five-year averages
-----	-----
Actual Premium	\$317,249
Actual Dividends (Refunded)	148,729
	-----
Net cost with dividend plan	\$168,520

The financial review demonstrated that based on the past five years self-insurance would have cost more than the Michigan Municipal League Workers Compensation Fund during the same period of time.

The actual dollars demonstrate that the Michigan Municipal League has four out of the last five years received claims that exceeded premium.

1998 Annual Est. Cost 65,976  
Incurred Losses 524,638

1999 Annual Est. Cost 8,387  
Incurred Losses 134,421

2000 Annual Est. Cost 53,522  
Incurred Losses 433,656

2001 Annual Est. Cost 129,988  
Incurred Losses 497,255

2002 Annual Est. Cost 584,727  
Incurred Losses 109,458

It is important to note that the incurred losses are estimates based on the likely resolution of the outstanding workers compensation claims. It is expected that the 2002-2003 information on losses is still incomplete.

Based on the fact that they lost money for so many years it was inevitable that they would ask for higher premiums in 2002. I asked the Michigan Municipal League to estimate how long the premiums would stay at these levels. We estimated that it would continue until the July 2005 year. If there are no large losses in the next three years then you can expect the premium to significantly reduce in July 2006.

Year	2002-03	2001-02	2000-01	1999-00	1998-99
Standard Premium	528,753	484,222	487,388	510,641	551,690
Experience Modifier	1.71	0.73	0.56	0.60	0.62
Total Est. Premium	838,280	328,921	254,419	285,354	318,342
Dividend Credit	77,063	77,327	42,282	138,483	103,916
Net. Est. Premium	761,217	251,594	212,137	146,871	214,426
Div. Distr. Check	176,490	121,606	158,615	138,484	148,451
Annual Est. Cost	584,727	129,988	53,522	8,387	65,975
Incurred Losses	109,458	497,255	433,656	134,421	524,638