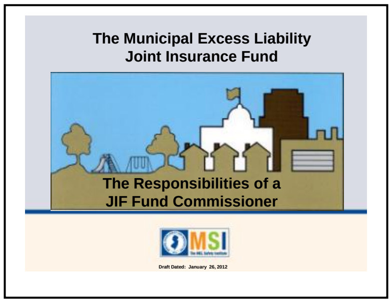
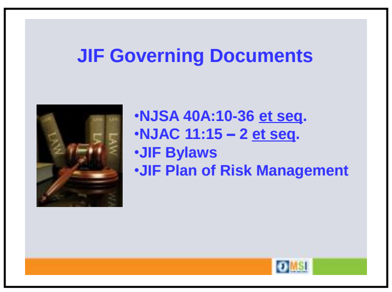
THE RESPONSIBILITIES OF A JIF COMMISSIONER
(Draft dated January 30, 2012)



Slide 1 - This seminar is second in a series of programs to acquaint officials of their responsibilities as a Commissioner of a Joint Insurance Fund. The first seminar discussed the basic principles of local government risk management. This seminar discusses the specific responsibilities of Commissioners in the governance of a JIF.

Slide 2 – What is a Joint Insurance Fund? It is a governmental entity that provides insurance to its member governmental entities. Because it is a governmental entity, it operates according to all of the rules that pertain to governmental entities. Under state law, all JIF Commissioners must be either local elected officials or employees member local entities.



Slide 3 - Every JIF Commissioner should be familiar with four documents:

- NJSA 40A:10-36 et seq. This is the enabling statute. Note that Title 40A is the municipal code. Also note there is a provision that exempts JIFs from Title 17, the insurance code. Joint Insurance Funds are not considered as insurance companies. Instead, a JIF is an inter-local governmental entity that is responsible for the insurance program of its members.

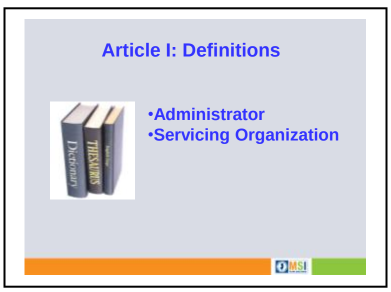
- NJAC 11: 15 – 2 et seq. This is the regulation adopted jointly by the NJ Department of Community Affairs and the NJ Department of Banking and Insurance. While there are JIFs in almost every state, New Jersey has the most comprehensive regulations.

- JIF Bylaws: This document establishes the basic structure of a JIF and must be ratified by the governing bodies of the member local units. As a result, bylaws are rarely amended.

- JIF Plan of Risk Management: This plan fleshes out the details and is adopted each year by the JIF's governing body.

You can find the statute and regulations on the MEL's web site and your JIF should have its bylaws and plan of risk management on its web page. We do not have time in this seminar to review all four of these documents. Therefore, we will focus on the bylaws because this one document includes all of the important provisions of the statute and regulation. Further, the bylaws detail what must be in the plan of risk management. When you become a JIF Commissioner, this is the first document you should read and understand.

Almost all JIFs have bylaws based on the document originally drafted in 1984 for the first municipal JIF and updated as a model in 1998. While there are a few provisions that differ from JIF to JIF, 98% of the bylaws provisions are identical. Therefore, in this seminar we will review the model and point out where there are differences.



Slide 4 – **Article I** is definitions, mostly boilerplate that mirror the regulations. Note the definition of "Administrator" and "Servicing Organization." This is where the founders of your JIF established how the JIF will be managed. There are three ways to administer a JIF:

- Hire employees to operate the Fund;

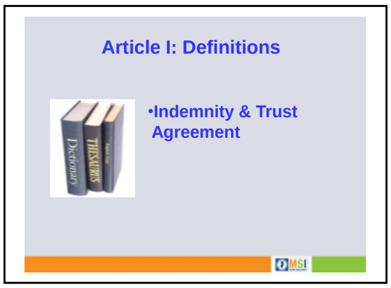
- Allow one member to provide the administration as "Lead Agency"; or

- Retain an outside company to act as Executive Director and contract with other firms to act as "Servicing Organizations" to perform functions such as claims administration, safety, financial services, and etc.

The School Board Association administers its JIF with employees. The problem with this approach is that the JIF board must become involved in all of the personnel matters required when hiring employees. Further, this approach requires the JIF be started at a relatively large size to justify hiring people to perform all of the various functions. Only one municipal JIF has an employee, and even that JIF retains outside contractors to perform most of the administrative functions.

No JIF has adopted the Lead Agency approach because the administration of a JIF is far too specialized. No local entity in this State has the expertise to take on this role.

Under the third approach, the Board hires an outside firm as Executive Director and other firms to perform some or all of the other functions. This approach has the advantage of insulating the board from the personnel issues associated with employees and also has the advantage of allowing a JIF to begin at a relatively small size. Note there is nothing in the law or the regulations that prohibit the firm selected as executive director from responding to a RFQ for some of the other functions as well.



Slide 5 - Another critical definition is "Indemnity and Trust Agreement". Each member must agree to be jointly and severally liable for JIF's obligations. This means that if any member defaults, the other members become responsible for the defaulting member's liabilities. This is more theoretical because the last time a New Jersey local unit became bankrupt was in the 1930s. The Division of Local Government Services is authorized to take over a local unit's finances long before the situation reaches that point. However, as a result of this provision, JIFs are not required to hold surplus like regular insurance companies and therefore are less expensive to operate. You do not need to worry about a JIF going bankrupt, leaving claims unpaid because a JIF is backed by the full faith and credit of all of its members.

This definition also limits the term of membership to a maximum of three years. Each JIF can establish it own minimum period of membership, and most JIFs have elected for three years so that there is stability in membership year to year.

Slide 6 - **Article II** concerns membership. Specifically:

- <u>Application:</u> To join, a local unit must apply to the JIF by a resolution that accepts the JIF's bylaws and authorizes the execution of the indemnification and trust agreement we just discussed.

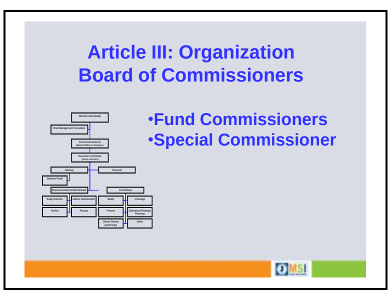
- <u>Acceptance:</u> To be accepted, the application must be approved by a majority vote of the Fund Commissioners or a two-thirds vote of the full authorized membership of the Executive Committee. Therefore, the members, not the professionals, control who is allowed into the Fund.

- Limitations: The prospective member must meet any territorial or similar limitations established in the bylaws. Of the 19 JIFs in the MEL, twelve are limited to a specific territory, generally one or several counties. The rest limit their membership to certain types of local units, for example housing authorities or utilities. These limitations must be established in the bylaws so that they can not be easily changed.

Slide 7 - Article II also discusses membership renewals. Specifically:

- A member wishing not to renew must give notice at least ninety days in advance, which corresponds to the beginning of the Fund's budget process. The reason for this is that a JIF needs to know the size of its membership to establish a budget for the following year. Therefore, if a member fails to provide timely notice, its membership is automatically extended for a year. If the member wants to withdraw at the end of the extended period, it must still give notice 90 days in advance, or its membership is automatically extended again.

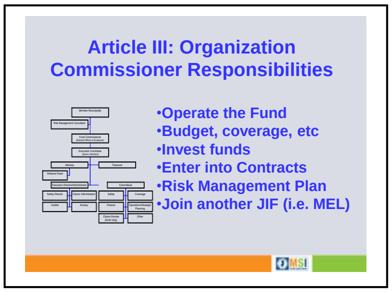
- A renewal application is deemed approved unless rejected for cause by the Fund Commissioners 45 days prior to the end of the membership period. Cause is defined as failure to meet the Fund's risk management or underwriting standards, or other reasons approved by the Commissioner of Banking and Insurance. During the last 25 years, this has happened only a few times.



Slide 8 - **Article III** details the JIF's organization.

- Fund Commissioners are appointed by each member's governing body and must be either an elected official or an employee. Elected officials are appointed for two year terms while employees must be reappointed each year. Members can also appoint an alternate.

- A Special Commissioner is appointed as the tie breaker whenever the number of members is even. The power to appoint the Special Commissioner is determined alphabetically, and while the Special Commissioner must be an elected official or employee of a member, the Special Commissioner does not have to be from the member having the power to make the appointment for that year. For example, in 1985 one town appointed the Council Member from another town to serve as JIF Special Commissioner.



Slide 9 - Commissioners have the following responsibilities:

- <u>Operate the Fund</u> "in the interests of the total membership." In other words, a Commissioner must consider all members, not just the member the Commissioner represents.

- <u>Establish the budget</u> and coverage limits, purchase reinsurance, and determine all other financial and operating policies of the Fund;

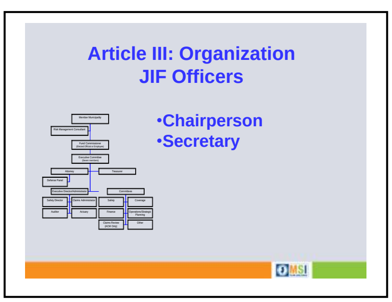
- <u>Invest funds</u> in accordance with the rules for the investment of public monies;

- <u>Enter into contracts</u> in accordance with the public contracts law;

- <u>Adopt the risk management plan;</u> and

- <u>Join a Joint Insurance Fund:</u> This provision permits the local JIFS in the MEL system to join the MEL itself.

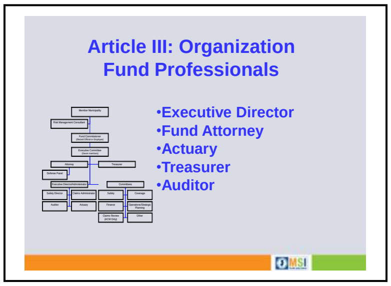
Each Commissioner has <u>one</u> vote. As a general principle, inter local agencies in New Jersey, including JIFs; operate on the principle that each member has one vote even though the members are of different size. One of the few exceptions is the environmental JIF where the stature specifically allows proportional voting. But, that provision only pertains to environmental JIFs.



Slide 10 - At the beginning of each year, the Commissioners have a reorganization meeting where they elect a Chairperson and a Secretary, who is really the Vice Chairman. A few JIFs have three officers: Chairperson, Vice Chairperson and Secretary.

If the membership exceeds seven, the Commissioners must also elect an Executive Committee of seven members including the officers along with a maximum of seven alternates. Some Funds with more that seven members continue to meet monthly as a full Board of Fund Commissioners so that every member has a vote. They are still required to elect an executive committee so that the

Fund can conduct its regular business even if the full Board of Commissioners lacks a quorum.



Slide 11 - Technically, a Joint Insurance Fund can delegate all functions except the independent auditor to employees or to a single outside firm. However, all JIFs in the MEL system have decided to delegate functions to a number of outside firms performing the following functions defined in the bylaws.

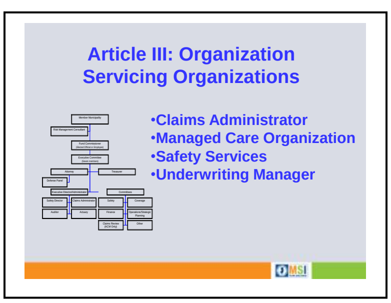
- Executive Director is responsible for the overall operation of the Fund

- Fund Attorney advises the Commissioners on legal matters and oversees the attorneys assigned to defend claims. Most JIFs also permit the Fund Attorney to defend some claims as well.

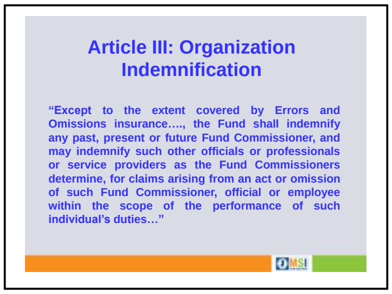
- Actuary certifies the budget and financial reports for soundness.

- Treasurer is the custodian of the Fund's assets. Note that a basic check and balance is that while the Treasurer is responsible for the bank accounts, the Treasurer does not maintain the general ledger. This is a basic check and balance built into the system. Further, the Treasurers of the various JIFs in the MEL make up the Investment Committee that every three years releases a joint RFQ for banking and investment services. This is another basic check and balance.

- Auditor has the same function for the JIF as an auditor has for any other local governmental entity. The annual audit report must be accepted by the Commissioners who must also certify that they have read the comments section at the end of the report.



Slide 12 - The major servicing contracts are for Claims Administer, Managed Care Organization, Safety Service Provider and Underwriting Manager. As we said earlier, there is nothing in the law or the regulations that prohibit the executive director from responding to a RFQ for some of these servicing organization functions as well. However, some Funds place restrictions in their bylaws that limit the other functions that can be provided by the Executive Director or other contractors.

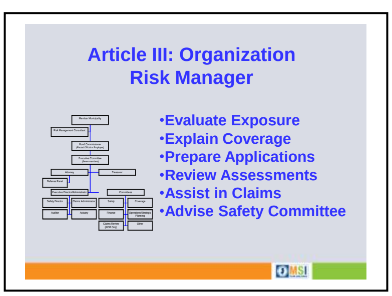


Slide 13 - Under Title 59, a local unit of government is permitted to adopt an indemnification ordinance to protect its elected officials and employees under most circumstances. Because a Joint Insurance Fund is a local unit of government, it is also authorized to enact this indemnification in its bylaws.

While the entire section is quite long, the key sentence is:

> "Except to the extent covered by Errors and Omissions insurance as may be required, as set forth above, the Fund shall indemnify any past, present or future Fund Commissioner, and may indemnify such other officials or professionals or service providers as the Fund Commissioners determine, for claims arising from an act or omission of such Fund Commissioner, official or employee within the scope of the performance of such individual's duties as Fund Commissioner, officials, professional or employee within the scope of the performance of such individual's duties as Fund Commissioner, official, professional or employee."

Slide 14 - The bylaws give the Chairperson the power to establish and appoint advisory committees. All JIFs have a Safety Committee. The number of other committees depends on a JIF's size. Small JIFs usually handle everything as a committee as a whole and only create committees as they grow. Common committees include contracts and finance, coverage, claims review, planning, operations and nominations. Some large JIFs also delegate authority to approve claims to a Claims Committee rather than review the individual claims at the monthly business meeting.



Slide 15 – With rare exceptions, towns in New Jersey do not have in house risk management expertise and need professional assistance in this area. Therefore, most JIFs require their members retain a licensed insurance advisor to act as Risk Manager with the following responsibilities:

- Evaluate the member's exposures.
- Explain the various coverages available from the Fund
- Assist in the preparation of applications, statements of values and other exposure data required by the Fund.

- Review of the member's assessment and assist in the preparation of the member's insurance budget.

- Assist in the claims settlement process.

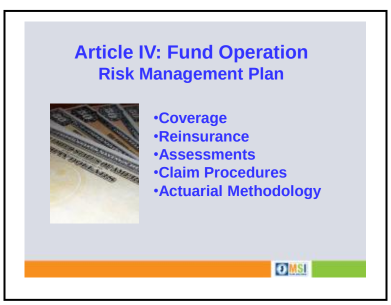
- Advise the member's safety committee.

This insurance advisor must be appointed pursuant to the public contracts law and is subject to the same "pay to play" regulations applicable to the local unit's other professional appointees. There is considerable difference between the various JIFs on how risk managers are compensated. Therefore, you need to refer to your JIFs bylaws on this issue.

Slide 16 - **Article IV** begins with a series of strong provisions that clearly establish that a JIF must be operated to the standards of a public entity. For example:

- The Fund shall be subject to the Local Fiscal Affairs Law (N.J.S.A. 40A:5-1 et seq.), the Local Public Contracts Law (N.J.S.A. 40A:11-1 et seq.) and the various statutes authorizing the investment of public funds.

- All monies and other assets of the Fund shall be under the exclusive control of the Fund Commissioners and the Treasurer must be a certified Municipal Finance Officer.



Slide 17 - The Commissioners are also required to adopt a Risk Management Plan and file it with the state for approval. This plan must detail:

- Lines of coverage, limits, and amount of risk retained by the JIF

- Reinsurance and excess insurance

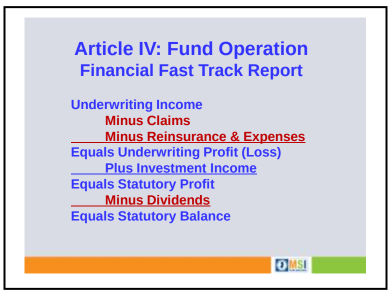
- Methods to calculate member assessments

- Loss adjustment procedures

- Actuarial methodology

The Plan of Risk Management is prepared by the JIF's Underwriting Manager and is adopted at the reorganization meeting each January. This is one of the public documents that must be posted on each JIF's web site.

Slide 18 - The regulations require JIFs to file a financial report with the State twice a year. The year-end report must also be supplemented with the Auditor's report and a report from the Actuary. Most reports use the so called statutory accounting rules required by the Department of Banking and Insurance. The Auditor's year-end report also uses GAAP accounting rules, As a general principle, the fund balance using statutory accounting is lower than the fund balance using GAAP rules. In other words, the Department's accounting rules are stricter. The regulations also require reports to the membership at least quarterly. Most Funds accomplish this with a series of reports known as the "Fast Tracks" that monitor the Fund's performance.



Slide 19 - There are two reports that we will discuss in detail. The first is the Financial Fast Track Report which is a snap shot of the JIF's General Ledger using the Statutory Accounting.

- Underwriting Income: Income is recorded when it is earned, not when it is actually received.

- Claims: This is the sum of three numbers: Paid Claims, Reserves for unpaid claims and IBNR (Incurred but not Reported). This is a calculation by the actuary that estimates the value of claims that have occurred, but are still unreported. It also takes into consideration reported claims that are under-reserved. It is often difficult for a claims adjuster to know how serious a claim will really become over the years until it is finally settled. The Actuary estimates the value of this under-reserving using historical patterns

- Expenses: This includes administrative expenses and premiums for excess and reinsurance.

- Underwriting Profit (Loss): This is underwriting income, less claims and expenses.

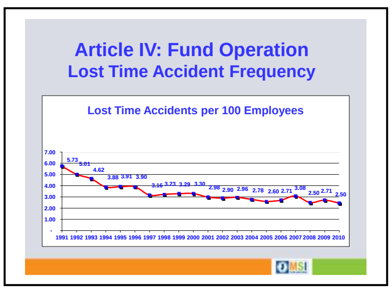
- Investment Income: JIFs hold millions of dollars in claims reserves and surplus. This item records the interest earned.

- Statutory Profit (Loss): This is the sum of the Underwriting Profit and Investment Income.

- Dividends: This line item records the amount of dividends approved by the state. Later we will discuss the dividend process.

- Statutory Balance: This is the statutory profit less dividends.

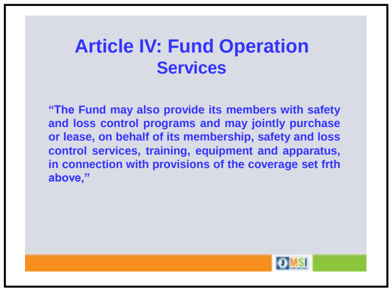
The fact track report also divides the statutory balance by fund year and provides claim details by fund year. All items report the current balance, the balance as of the end of the previous year, change this month and change year to date.



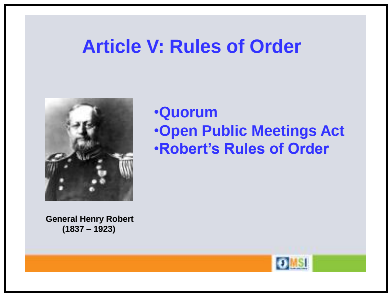
Slide 20 - The other report is the Lost Time Accident Frequency. This report compares the current safety record as compared to the previous two years. The frequency is defined as the number of lost time accidents per 100 employees. A frequency of 2.5 means that 2.5% of all employees incurred a lost time accident during the year. To compute this:

- The number of employees comes from the underwriting data provided by all members at the start of the year. An adjustment is made to account for part time employees and volunteer fire fighters. This number is pro rated by the number of months since the beginning of the year.

- The number of lost time accidents comes from claims adjusters and is simply the number of indemnity claims. PEOSHA requires a more elaborate calculation for their year end report that is often subject to manipulation. The JIF's system avoids that by using data that is independently verified and consistent year to year.



Slide 21 - The last section of this article expands the Fund's authority beyond merely providing insurance. Specifically, the State allows JIFs to provide safety and loss control services, training, equipment and apparatus.

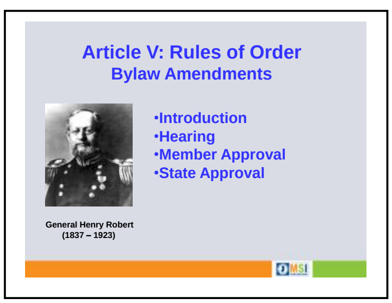


Slide 22 – **Article V** details Rules of Order and has several interesting provisions:

- <u>Quorum:</u> The quorum for a meeting of Fund Commissioners is a majority unless the number of members exceeds 25, in which case the quorum is 13 plus 20% of the number of members in excess of 25. The reason for this is that larger Funds sometimes experience problems getting enough members to attend the reorganization meeting in January. There is also a provision that permits a paper ballot if a quorum is not reached.

- <u>Open Public Meetings Act</u>: All meetings of the Fund shall be subject to the rules and regulations of the Open Public Meetings Act. (N.J.S.A. 10:4-6 <u>et.seq.).</u>

- <u>Roberts Rules of Order</u>: Unless otherwise provided, "Robert's Rules of Order" governs the conduct of all meetings.



Slide 23 - Article V also covers bylaw amendments. This is not an easy process and few amendments have been approved over the years. Specifically:

- <u>Introduction</u>: Any Commissioner may propose an amendment to the bylaws.

- <u>Hearing</u>: Upon receipt of a proposed amendment, the Fund must hold a hearing not more than forty-five (45) days after the amendment was filed.

- <u>Member Approval</u>: To be adopted, the amendment must be approved by at least 75% of the members within (6) months of the hearing. Note: The amendment must be approved by resolution of the member governing bodies, not the Fund Commissioners. Otherwise, the amendment fails.

- State Approval: If the members vote to approve the amendment, it then must be approved by the State.

As we said, it is difficult to amend the bylaws.

Slide 24 – **Article VI** discusses the budget process. The budget consists of three major items:

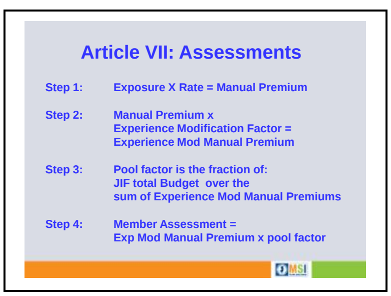
- Claims: This is computed by the Actuary

- Excess Insurance and Reinsurance: This number comes from the Underwriting Manager

- Expenses: This is almost entirely professional services and usually determined by the RFQ process conducted by the Fund's Contracts Committee.

The budget is usually introduced on first reading in October and adopted in November after a public hearing. The budget is then filed with Trenton. This timing allows members to know their insurance numbers in time for their temporary budgets adopted in January.

The JIF's budget must be amended if there is any change that exceeds 5%. Because of the 5% threshold, this rarely occurs.



Slide 25 – **Article VII** details the Assessment process, which can be quite complicated.

- Step 1: Manual Premium: The first step is to compute each member's manual premium. There are manual rates for each line of coverage. The Manual Premium is computed by multiplying each member's exposure data, such as payroll, headcount, vehicle count, values, etc, times the manual rate.

- Step 2: Experience Modified Manual Premium: The JIF also computes an experience modification factor for workers' compensation, auto liability and general liability based on each member's claims experience. A factor of 1.0 means the member's experience is average. A factor of more than 1.0 means the member has higher than normal experience and a factor of less than 1.0 means the member has better than expected experience. The Experience Modified Manual premium is the manual premium (Step 1) times the experience factor.

- Step 3: Pool Factor: Then the JIF adds the experience modified premiums for all members (Step 2) and compares that to the total budget to compute a pool factor. Each member's experience modified premium must be reduced or increased proportionally so that assessments equal the budget. If the total of the experience modified premiums is greater than the total budget, the pool factor is less than 1. If the total of the experience modified premiums is less than the total budget, the pool factor is greater than 1.

- Step 4: Individual Member Assessment: This is the member's Experience Modified Manual Premium (Step 2) times the pool factor (Step 3).

Slide 26 - The problem with this system is that it can result in considerable changes in any given member's assessment caused by changes in its experience modification factors as well as its exposure numbers. Therefore, most JIFs have a provision that caps the maximum amount a member's assessment can change from year to year. There are many different formulas, but usually these programs provide that no member's assessment can increase more that the Fund-wide average plus a swing factor. Swing factors can be as low as 1% or as high as 20% or more. Obviously, if there is a cap on changes, the other members must contribute more so that the total of the assessments equals the budget. These formulas can become very complicated and you should talk with your JIF's Executive Director about the formula used by your particular JIF.

Slide 27 - Article VII also details supplemental assessments.

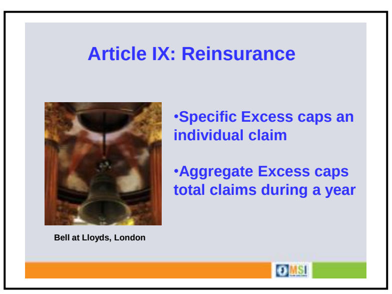
- General Supplemental Assessments: If a fund year is in an overall negative position, the Fund can adopt an additional assessment to cover the deficit. General additional assessments are chargeable to all members who participated in the JIF during the year of deficit. Usually, additional assessments are spread over a number of years starting in a subsequent year. Many JIFs avoid additional assessments by adopting

"Closed Fund Year Accounting" where each member's share of an additional assessment is automatically offset with that member's share of the surplus balances in other years.

- Individual Member Supplemental Assessments: Some Funds have also adopted rating plans where individual members can be charged additional assessments up to a cap based on that member's own experience. These are called mini-maxi programs and are used to reduce initial assessments. The objective is to motivate members to improve safety and claims control by making them more accountable for their own results. If an additional amount is due, it is payable over a number of years beginning in a subsequent year.

Talk with your JIF's Executive Director about your JIF's policies concerning general supplemental assessments and individual member supplemental assessments.

Slide 28 – **Article VIII** discusses the procedures to return surplus to members. The State has promulgated a formula that caps dividends based on the amount of unpaid claims. Therefore, the JIF must file a dividend application for Trenton's approval. Dividends are payable to all members who participated in the JIF during the year that generated the surplus.

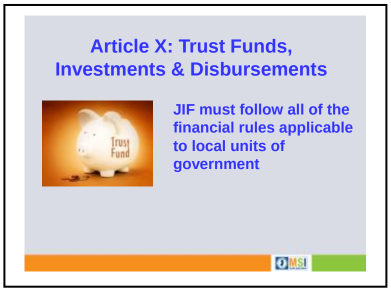


Slide 29 – Under **Article IX**, all JIFs are required to secure excess or reinsurance to cap claim liabilities. There are two types of excess or reinsurance:

- Specific Excess caps an individual claim. The State promulgated a formula to determine the maximum per claim exposure a JIF can self insure.

- Aggregate Excess caps the total amount that a JIF can retain for all claims. Most JIFs are large enough that they are exempt from this costly requirement.

The majority of JIFs in New Jersey meet these requirements by belonging to the Municipal Excess Liability Joint Insurance Fund (MEL). The advantage of this approach is that the MEL is large enough to self-insure some of this risk itself and can purchase excess and reinsurance at a lower rate because of its size.

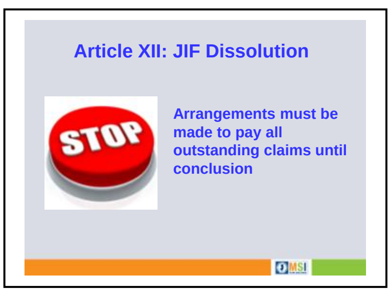


Slide 30 - **Article X** provides that a JIF must follow all of the financial rules applicable to local units of government. As indicated earlier, each JIF has a Treasurer who must be a certified municipal finance officer. During the meetings, the Treasurer presents a bills list for adoption and reviews a standardized financial report. It is exactly the same as the typical meeting of a municipality or a utility.

Slide 31 - **Article XI** is also simple:

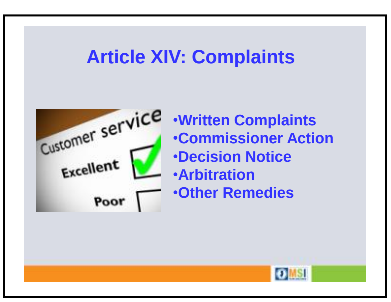
> "All officials or employees of a member local unit or any members of the family of such officials or employees shall comply with the "Local Government Ethics Law".

JIF Commissioners are strongly encouraged to complete a course on the Local Government Ethics Law. The MEL has a model course on its web site.



Slide 32 – Under **Article XII**, it is difficult to dissolve a JIF because arrangements must be made to pay all outstanding claims. In some cases, claims remain open for decades. Only one property/casualty JIF has ever been dissolved in New Jersey, and this occurred fifteen years after it stopped writing new policies. Under the regulations, a dissolution plan must be voted by the membership after a hearing. Then the application must be filed for approval by Trenton.

Slide 33 – **Article XIII** is boilerplate and basically provides that the Commissioners must approve any claims settlements that exceed the authority they grant to the claims adjusters.



Slide 34 - **Article XIV** establishes procedures to complain about the decisions of the Commissioners or the professionals.

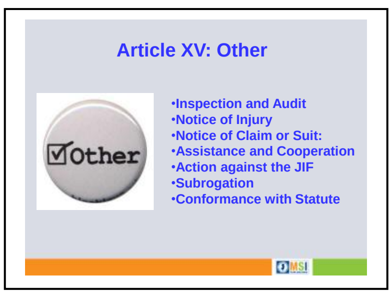
- Written Complaints: Whenever a complaint is received, the Executive Director must send a copy to the Commissioners and place it on the agenda for the next meeting.

- Commissioner Action: The Commissioners are required to consider the complaint and render a decision.

- Decision Notice: The findings must be communicated in writing to the complaining party as well as the Commissioner from the member affected by the complaint. The written notice may include an opportunity for a hearing before the Commissioners.

- Arbitration: Parties that are dissatisfied with the decision may appeal to the independent appeal organization or arbitrator designated by the Fund annually.

- Other Remedies: Parties that are dissatisfied with the determination of the independent appeal agency or arbitrator may exercise any other remedies provided by law.



Slide 35 - The final article (**XV**) includes the following provisions:

- Inspection and Audit: The Fund has the right to inspect each member's facilities and records.

- Notice of Injury: Members are required to report any injury to the JIF as soon as practical.

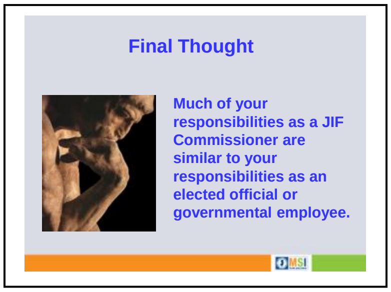
- Notice of Claim or Suit: They are also required to report any claim or suit to the JIF as soon as practical. Failure to comply with this provision could nullify coverage under some circumstances.

- Assistance and Cooperation: Each member must fully cooperate with the JIF in adjusting and defending claims.

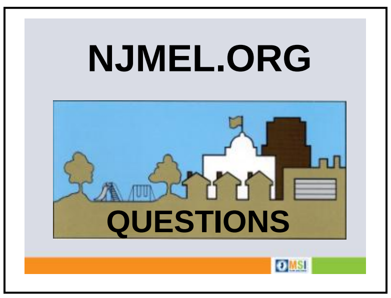
- Action against the JIF: A member can not sue the Fund until complying with all provisions of the bylaws.

- Subrogation: If the JIF makes a claim payment, it shall be subrogated to all of the member's rights of recovery, and

- Conformance with Statute: If any bylaw provision is in conflict with any law, the applicable law shall supersede these bylaws.



Slide 36 - This may all seem very complicated. It really is not. Much of your responsibilities as a Commissioner are similar to your responsibilities as an elected official or local unit employee. It involves sound governmental process. Even the technical insurance aspects are not difficult with a little experience.



Slide 37 – Questions?