

In the matter of)
)
CITIES INSURANCE ASSOCIATION OF)
WASHINGTON,) ORDER TO CEASE AND DESIST
)
A non-profit corporation)
)
Ephrata, WA)

TO: Cities Insurance Association of Washington
451 Diamond Drive
Ephrata, WA 98823

Pursuant to RCW 48.62.091(3), Cities Insurance Association of Washington and all other persons acting in cooperation with them (including officers, directors, agents, third party administrators and other affiliates) are each hereby ORDERED to cease and desist from the following violations which have resulted in the Cities Insurance Association of Washington operating in an unsafe financial condition.

BACKGROUND

1. The state risk manager in the Office of Financial Management (OFM), State of Washington, is responsible for ensuring that joint risk pools formed under the authority of 48.62 RCW operate in a financially safe condition.
2. Pools report annually to the state risk manager and State Auditor's Office. Members of the pool (cities, counties, taxing districts and other municipal governments) depend on these reports to monitor the financial condition of the risk pool providing their insurance and risk management services.
3. The Program Administrator for the Local Government Self-Insurance pools informed the state risk manager that there was a large receivable on the 2008 financial statements of the Cities Insurance Association of Washington (CIAW) submitted to the state risk manager and the State Auditor's Office. The third party administrator for the CIAW indicated that the monies due to the pool were to be paid as the result of a stop loss policy. The state risk manager requested copies of the stop loss policies. The stop loss attachment point at which the policies begin to reimburse the pool were \$5.5 million for 2008 and 2007, \$5.2 million for 2006, and \$3.5 million for 2005. The third party administrator for the pool stated it had not reached these attachment points in any of these years, but the pool continued to record an insurance receivable as an asset in its financial statements which increased each year in an amount parallel to the amount of the liability.
4. The Program Administrator from the state risk manager's office conducted a review of the financial condition of the CIAW and determined the pool needed to increase reserves, as noted in the Program Administrator's report of June 3, 2009 (copy attached). The Program Administrator requested the CIAW provide a funding plan as to how and when the pool would increase reserves to financially sound levels. The CIAW did provide a funding plan at the end of the required 90-day period, but the funding plan lacked sufficient details on how reserves would be increased as required. OFM contracted with a nationally recognized independent expert in November 2009 to review the feasibility of the CIAW's proposed funding plan.

5. According to information provided by the independent expert in late December, the CIAW's third party administrator was not able to provide any insurance policies supporting the insurance receivable recorded in the annual financial statements on August 31, 2008, the pool's fiscal year end. This \$7 million receivable included an insurance receivable of approximately \$6,044,849. According to information provided by the independent consultant, the actual amount of the insurance receivable was overstated by \$4,774,849 and required a write off in that amount. The correct amount of this receivable at the end of 2008 should have been approximately \$1.27 million.
6. In September of 2009, the CIAW changed to a reinsurance policy, which requires the pool pay claims in advance and wait for reimbursement from the insurer. This type of policy requires the pool to maintain increased liquid reserves. The CIAW's current reserve levels are not adequate to fund this type of policy. The state risk manager was not notified by CIAW of this significant change and was not able to evaluate the impact on the financial condition of the CIAW prior to the pool implementing the change. The pool did not seek or receive the prior approval of the state risk manager as required.

THIS CEASE AND DESIST ORDER IS BASED ON THE FOLLOWING GROUNDS:

1. Cities Insurance Association of Washington (CIAW) violated RCW 48.62.141 by operating in an unsafe financial condition. The pool does not currently have sufficient assets to cover the program's liabilities. RCW 48.62.141 requires that every joint self-insurance program covering liability or property risks, excluding multistate programs governed by RCW 48.62.081, provide for the contingent liability of participants in the program if assets of the program are insufficient to cover the program's liabilities.
2. The CIAW provided financial reports to the State Auditor's Office and the Office of Financial Management (OFM) which do not accurately portray the financial condition of the CIAW. According to information provided by CIAW's third party administrator to OFM's independent expert about the 2008 financial statements, a \$7 million receivable to the pool included amounts due from a stop loss policy from St. Paul Travelers Insurance. For the 2008 financial statements, no stop loss policy demonstrating that these funds were due was provided to the independent expert upon his arrival at the CIAW for an on-site special review. Instead this stop loss receivable is significantly reduced to \$418,000 in the 2009 financial statement and there is now a large member receivable in the amount of \$3.167 million. Upon review with the CIAW accountant, this member receivable amount is part of the CIAW plan proposed by the third party administrator to increase reserves over the next five years. This is a plan or goal of the organization. As a plan, but not a reality, this is not a recordable asset. A recordable asset would be when the board approves a reassessment against the members. At that date the receivable would be recordable and assessment notices should be sent to members. As of the 2009 financial statement date, no action had been taken by the CIAW Board and no members had been notified of a reassessment.

Even if the member receivables are approved by the board and collected over the next 3 to 5 years, the pool does not currently have sufficient assets to fund CIAW's liability of \$4.8 million determined by the pool's actuary as of the 2009 year end. Because CIAW assets are insufficient to cover liabilities of the program as required by RCW 48.62.141, the CIAW is operating in an unsafe financial condition.

3. The Interlocal Agreement between CIAW members provides a formula for reassessment. Only 95 of the 250 participants in the CIAW program can be reassessed because the remaining 155 participants are "associate members". These "associate member" participants did not sign the Interlocal Agreement, but instead, signed an "associate member" agreement which exempts them from any further financial responsibility for additional assessments in the event the pool has insufficient funding. This leaves only 95 participants assuming responsibility for the \$4.5 million deficit in funding. According to RCW 43.09.210, each local government participant must pay the true value of these services provided by the pool. Instead, the associate member agreement does not require all participants to be responsible for liabilities of the CIAW program.
4. WAC 82-60-031(3) states that the claim financing levels and liabilities must be determined annually by an actuary or, in lieu of a determination from an actuary, pools can purchase annual aggregate stop loss insurance and fund the self-insured portion to the stop loss insurance attachment point. The CIAW did not fully fund the stop loss as required, but, according to the third party administrator, funded only seventy percent of the stop loss.
5. In September of 2009, the CIAW made a significant change in their purchased insurance by changing from excess insurance to a reinsurance policy. RCW 48.62.091(5) states that no self-insurance program requiring the state risk manager's approval may engage in an act or practice that in any respect significantly differs from the management and operation plan that formed the basis for the state risk manager's original program approval unless the program first notifies the state risk manager in writing and obtains the state risk manager's approval. The pool did not request approval for this significant change.

ORDER TO CEASE AND DESIST

Based on the foregoing, IT IS HEREBY ORDERED, that you, and each of you, whether corporation, association, individual, or other form of entity, cease and desist from 1. operating without sufficient financial reserves, resulting in an unsafe financial condition; 2. providing inaccurate financial information to OFM and the State Auditor; and 3. making significant changes in the plan of management and operation of the pool without prior approval by the state risk manager.

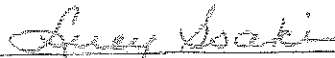
IT IS FURTHER ORDERED that the pool increase reserves to a safe operating level that meets or exceeds the CIAW's liabilities, and obtain approval of significant recent changes to the management and operation of the pool. To increase reserves the CIAW must submit a detailed funding plan to the state risk manager no later than January 25, 2010. Unless the CIAW provides evidence that the pool has fully funded its liabilities, the pool must submit a plan to reassess members. A reassessment plan must include a Board approved resolution authorizing member reassessments, a list of the members to be assessed, the amount due from each member, and a date by which the reassessments are due which may be collected over a 3-5 year period. It is also ORDERED that the pool determine the amounts paid to the insurer/broker for the insurance not received and to recover those amounts from those entities.

Pursuant to RCW 48.62.091(3), if the CIAW violates this order or has not taken steps to comply with the order after the expiration of twenty days after the cease and desist order has been received by the board chair of the CIAW, the pool is deemed to be operating in violation of this chapter and will face further administrative action by the state risk manager, including but not limited to notification to the State Auditor and to the Attorney General.

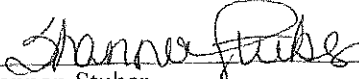
This cease and desist order will remain in effect until such time as sufficient cash reserves are established to satisfy the standards for solvency adopted in rule by the state risk manager. If the program violates the conditions set forth above, the program will be deemed to be operating in violation of 48.62 RCW, and, without further notice, the state risk manager shall take any such other and further action as is authorized by chapter 48.62 RCW.

Finally, IT IS HEREBY ORDERED that the CIAW Board shall attend a meeting with the State Risk Manager on January 29, 2010 at 10:00 am at the Doubletree Hotel, 16500 Southcenter Parkway, Seattle, Washington, to discuss the specifics of this Cease and Desist Order to ensure full understanding of its terms and the financial solvency concerns that led to the issuance of this Order. The Board shall be responsible for all notification requirements of the Open Public Meetings Act as defined in RCW 42.30. The board chair will also distribute to all participants in the pool a copy of the Cease and Desist Order within 72 hours of receipt of this notice.

Dated this 14 day of January, 2010



Lucy Isaki
State Risk Manager
Senior Assistant Director and Legal Counsel
Office of Financial Management



Shannon Stuber
Program Administrator
Local Government Self-Insurance Program
Office of Financial Management