

# **REINSURANCE AS GOVERNANCE: GOVERNMENTAL RISK MANAGEMENT POOLS AS A CASE STUDY IN THE GOVERNANCE ROLE PLAYED BY REINSURANCE INSTITUTIONS**

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*Scholars have eloquently detailed the “Insurance as Governance” concept, the potential capacity for reinsurer regulatory influence on insurers, and the many aspects under which these theories may arise. This Article takes the next step in analyzing the complex reinsurer-insurer relationship through empirical research into how carriers are actually influenced by reinsurers, and what effect this has on the parties.*

*As a case study in the governance role played by reinsurance institutions, this Article organizes survey interview responses of senior officials in the governmental entity self-insured risk management pool sector into four distinct discussion areas: (i) how reinsurers influence pools in general and in the key areas of underwriting, claims, and finance/solvency; (ii) the duty of utmost good faith and its effect; (iii) the level to which pools afford accommodation to reinsurers; and (iv) whether reinsurer influence varies based on pool circumstances, or external factors. While analysis of the data collected showed varying degrees of regulation or governance by reinsurers, the Article concludes that not only does a form of reinsurance influence or ‘governance’ clearly exist in the largely unregulated world of self-insured pools, whether characterized as direct, indirect, or regulatory in nature, but also that the governance effect is an open and recognized influence that is accepted by the pools.*

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## I. INTRODUCTION

This Article will discuss, as part of the ‘insurance as governance’<sup>2</sup> debate, to what degree reinsurers can ‘govern’ or ‘regulate’ insurers. Professor Aviva Abramovsky first addressed the impact of reinsurers on insurers in *Reinsurance: the Silent Regulator?*,<sup>3</sup> indicating that reinsurers had a potential contractual influence on the insurance industry, therefore reinsurers must be part of the regulatory discussion.<sup>4</sup> While Professor Abramovsky outlined the potential impact of reinsurers on insurers quite well, it is important to hear from industry officials themselves to confirm the existence of any contractual influence rising to the point of a governance or regulatory role.<sup>5</sup> Since there are many complex issues in the reinsurer-insurer relationship, this Article’s focus will be to answer how the carriers are actually influenced by reinsurers, and what effect this has on the parties.

Evidence gathered for this Article from senior officials in the governmental entity risk management pooling industry, carriers that are largely unregulated by insurance departments in most states, indicated varying degrees of regulation or governance by their reinsurers. However, this governance operates in the foreground, with the open acknowledgment of both pool and reinsurer, much like a homeowner and their neighborhood association. Overall, it is beneficial for both the reinsurer and the insurer.

This Article will examine:

- In Part II, Background—the history of self-funded pooling and typical legal construction; an overview of reinsurance operative concepts;<sup>6</sup> the basic theories of insurance and reinsurance as governance; and the overview of this original research;

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<sup>2</sup> ‘Governance’ is defined as “controlling, directing, or regulating influence; control, sway, mastery.” THE COMPACT EDITION OF THE ENGLISH OXFORD DICTIONARY 1181 (18th ed. 1979). ‘Regulating influence’ and ‘sway’ will be the focus of this Article.

<sup>3</sup> Aviva Abramovsky, *Reinsurance: The Silent Regulator?*, 15 CONN. INS. L.J. 345 (2009).

<sup>4</sup> *Id.* at 405.

<sup>5</sup> The second part of Prof. Abramovsky’s premise, that reinsurers must be discussed as part of the insurance regulatory process because of their regulatory-type influence, is outside the scope of this Article.

<sup>6</sup> Abramovsky, *supra* note 3, at 350–75, has a more detailed overview of the reinsurance process.

- In Part III, Research Survey Methodology—a brief review of how the survey was conducted and the participants chosen;
- In Part IV, Survey Results—the distinct influences of reinsurance on pools, the effect of utmost good faith, the accommodation of pools, and factors affecting reinsurer influence; and
- In Part V, Conclusion—how reinsurers create the governance effect.

## II. BACKGROUND

To frame the discussion accurately, Part II first outlines the history of governmental entity pools, including the Texas model as an example. Second, it provides an overview of reinsurance concepts. Finally, Part II discusses the basic theories of insurance and reinsurance as governance.

### A. BRIEF HISTORY OF GOVERNMENTAL ENTITY POOLS AND THE TEXAS MODEL

Governmental entity pools, which are self-funded cooperatives, operate as ‘insurance’ carriers for most governmental entities today, and are largely not subject to states’ regulation.<sup>7</sup> Although they are not considered insurance, these pools extend nearly identical coverage through similar underwriting and claim activities, as well as provide other risk management services. Though pools are a small segment in the insuring market in terms of capital, their history shows that pools have a growing impact in that market.

The relatively short history of pooling in the United States gives a perspective of how pooling became a viable risk management alternative for governmental entities. Pooling has been defined as “. . . a risk financing mechanism whereby a group of public entities contribute to a shared fund that in turn pays claims for and provides service to the participating entity.”<sup>8</sup>

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<sup>7</sup> Even in states where pools are generally unregulated by their insurance department, like Texas, certain lines of coverage may be individually regulated by statute; e.g., for political subdivision pools regarding workers’ compensation, TEX. LAB. CODE ANN. §§ 504.001 *et. seq.* (West 2006).

<sup>8</sup> Harold Pumford, Address at the 2012 AGRiP Spring Conference (Mar. 5, 2012). A related PowerPoint presentation is available from AGRiP, *available at* <http://www.agrip.org>.

The Governmental Accounting Standards Board #10 describes it as:

A cooperative group of governmental entities joining together to finance an exposure, liability, or risk. Risk may include property and liability, workers' compensation, or employee health care. A pool may be a stand-alone entity or included as part of a larger governmental entity that acts as the pool's sponsor.<sup>9</sup>

In other words, when two or more independent public entities wish to share risk, they may do so by forming a pool, rather than independently going to the market to obtain coverage.

Pools are both risk-finance and risk-transfer mechanisms. The member entities of the pools transfer their exposures (minus a deductible) to the pool, sharing with other entities in the pool the transfer of related risks.<sup>10</sup> The services (underwriters, claim operations, loss prevention/risk management, reinsurance purchasing) are provided by the pool, or by third parties retained by the pool.<sup>11</sup> Pools do not issue an insurance policy, but a similarly functioning document called a 'plan document' or 'coverage agreement' that is a contract for coverage between the member entity and the pool. Under the agreement, the pool will indemnify the member based on the terms and conditions of the coverage agreement in exchange for a 'contribution,' rather than a 'premium.'<sup>12</sup> These coverage agreements operate essentially like insurance policies, with coverage terms, exclusions, exceptions to exclusions, coverage territories, and coverage periods.<sup>13</sup> These agreements typically have coverage for general liability, professional liability, auto liability, property, and workers compensation, utilizing both claims-made and occurrence-based agreements.<sup>14</sup>

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<sup>9</sup> Gov'tal Acct. Stds. Bd., *Statement No. 10 of the Governmental Accounting Standards Board*, in GOVERNMENTAL ACCOUNTING STANDARDS SERIES 49 (Nov. 1989).

<sup>10</sup> Jason E. Doucette, Note, *Wading Into the Pool: Interlocal Cooperation in Municipal Insurance and the State Regulation of Public Entity Risk Sharing Pools—a Survey*, 8 CONN. INS. L.J. 533, 537 (2002).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 537–38.

<sup>14</sup> General liability, auto liability, property, and workers compensation coverages are typically occurrence based, while professional liability is typically

Pools have many advantages over insurers for their members. They tend to protect their members from cyclic insurance rates,<sup>15</sup> offer loss prevention services, offer savings (as they are non-profit organizations and do not lose funds through broker fees), and have focus and expertise in governmental entities not often found in insurers.<sup>16</sup> However, pools' typical disadvantage for their members is that they are generally unregulated. Therefore, their only duties are those outlined in the coverage agreements with their members, and they are not generally subject to prompt payment acts, bad faith claims, or penalties.<sup>17</sup>

Self-insured governmental pooling has its roots in the United States in 1974 after the Texas legislature allowed entities to form pools to self-insure.<sup>18</sup> During this period, public entity officials in all states had concerns

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claims-made based. Occurrence based relies on the date of the occurrence for determining coverage, while claims-made depends on the date the claim is made and reported to the carrier.

<sup>15</sup> George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1529–39 (1987), has an excellent discussion of market cycles and their causes.

<sup>16</sup> Yuhua Qiao, *The New Generation of Public Risk Pools: What Is New?*, 1–2 (on file with author).

<sup>17</sup> It is the author's experience that this tends to be mitigated because pools have limited markets and therefore inherently attempt to service members promptly to maintain their member base. Most operational charters limit the potential membership, so even though a pool has a potential market of 1000 or more members, it is still quite a finite number compared to markets for insurers. Even if entities sign an interlocal agreement it usually does not obligate them to be *in* the pool—it just gives them the option to be in the pool if they pay their annual contribution, so high levels of service are inherently necessary to keep members. See, e.g., App. D. The member potentially may go in and out of the pool in various lines of coverage. *Id.*, at ¶¶ 2–4. However, most pools are organized so the governing boards are comprised of members' representatives. Doucette, *supra* note 10, at 538. This board representation gives pool members direct input as to policy.

<sup>18</sup> The author has found no evidence of a pool's formation prior to January 4, 1974, when the Texas Association of School Boards, Inc., legally formed the TASB Workers' Compensation Self-Insurance Fund, although several pools claim senior status. The formation documents are on file with TASB, Inc. The TASB WCSIF merged into the TASB Risk Management Fund in 1997. *History and Mission*, TASB RISK MGMT. FUND, <https://www.tasbrmf.org/About/History-and-Mission.aspx> (last visited Dec. 27, 2014). While California may claim precursor legislation since 1949 regarding the ability of municipalities to act jointly, risk

that the insurance industry was charging excessive premiums when compared to the exposures,<sup>19</sup> and that coverage and services developed for the private sector did not adequately address public needs.<sup>20</sup> The core reason for the actions taken by the insurance industry was the view that, due to the loss of many governmental immunities throughout this time period, insurers had to increase premiums for governmental entities and limit coverage for ordinary governmental activities, such as providing parks and swimming pools. This led to a choice for governments: pay the higher premiums for insurance, potentially limiting services and raising taxes, or forgo insurance to self-insure, risking bankruptcy from large judgments.<sup>21</sup> Self-insuring was especially difficult for smaller local governments, since the government's local tax base was the source of income. Lacking a sufficiently broad tax base, a small government was in the difficult position of being unable to afford coverage, as well as lacking the ability to pay any large judgments, should it go uninsured.<sup>22</sup>

Pools began their operations by capitalization through member deposits or bond issues; some were not capitalized at all.<sup>23</sup> Coverage was the initial and primary concern for the governmental entities, but these pools also developed loss prevention programs for their members. Public agencies traditionally viewed insurance buying as little more than fulfilling a requirement of a government code, and it was rare for a carrier to offer loss prevention services for a public risk.<sup>24</sup>

Risk pool professionals formed industry associations to assist in the development of this new industry. The Public Risk Management Association's (PRIMA)<sup>25</sup> section on pooling formed in 1978, and

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pooling itself was not authorized in California until 1975. Doucette, *supra* note 10, at 547. Texas prevails, as usual.

<sup>19</sup> See generally James R. Hackney, Jr., Note, *A Proposal for Funding Municipal Tort Liability*, 98 YALE L.J. 389 (1988).

<sup>20</sup> See generally Karen Nixon, *Public Entity Pooling—Built to Last* (2011), <http://www.cajpa.org/documents/Public-Entity-Pooling-Built-to-Last.pdf>.

<sup>21</sup> See Hackney, *supra* note 19, at 389.

<sup>22</sup> Doucette, *supra* note 10, at 534–35 (citing Louis P. Vitullo & Scott J. Peters, *Intergovernmental Cooperation and the Municipal Insurance Crisis*, 30 DEPAUL L. REV. 325, 334 (1981)).

<sup>23</sup> Nixon, *supra* note 20, at 1.

<sup>24</sup> *Id.* at 2.

<sup>25</sup> The Association's mission is to promote effective risk management in the public interest as an essential component of public administration. See *Strategic*

eventually spun off to become the Association of Governmental Risk Pools (AGRiP) in 1998.<sup>26</sup> State insurance regulators, however, were slow to react, and most chose not to assert any regulatory authority over what was largely viewed as self-insurance. While the National Association of Insurance Commissioners<sup>27</sup> eventually began an effort in 1991 to determine if model regulations were needed for pools, this effort was eventually abandoned.<sup>28</sup>

While the complete history of pooling—its rise during the 1980s and 1990s, and the insurance industry’s coincident struggles during the same period—is outside the scope of this Article,<sup>29</sup> pools continued to grow and take market share because insurers were unwilling or unable to fill the needs of increasingly exposed governmental entities. During this period of tort excesses, subsequent tort reform and market instability, insurers lost a great deal of the commercial market insureds, including governmental entities, to alternative forms of risk transfer.<sup>30</sup> Policyholders formed captive

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*Plan*, PUBLIC RISK MGMT. ASS’N, <http://www.primacentral.org/content.cfm?sectionid=9> (last visited Dec. 27, 2014).

<sup>26</sup> Nixon, *supra* note 20, at 2. AGRiP is a national organization and independent trade organization representing public entity pools. AGRiP’s vision statement and organizational mission is: “As the recognized authority on and resource for information on intergovernmental pools, AGRiP is the leading national association for pool management. As a result of our efforts, the pooling community is united to achieve excellence in pool governance, management and services.” *What Is AGRiP?*, ASS’N OF GOV’TAL RISK POOLS, <http://www.agrip.org/whatisagrip> (last visited Dec. 27, 2014).

<sup>27</sup> The National Association of Insurance Commissioners is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. *See generally* NAT’L ASS’N OF INS. COMM’RS, <http://www.naic.org/> (last visited Dec. 27, 2014). While the NAIC sets standards for states to follow voluntarily, it has no inherent regulatory authority. However, it does have a great deal of influence in the insurance industry.

<sup>28</sup> Doucette, *supra* note 10, at 543 (citing the Nat’l Ass’n of Ins. Comm’rs, 1992 Summer National Meeting, Executive Committee 10, \*70–71, LEXIS 1992-2 NAIC Proc. 10).

<sup>29</sup> *But see id.* at 543; *see also* Priest, *supra* note 15; *see generally* Nancy Blodgett, *Premium Hikes Stun Municipalities*, 72-JUL A.B.A. J. 48 (1986); Kenneth Abraham, *The Rise and Fall of Commercial Liability Insurance*, 87 VA. L. REV. 85 (2001). These papers give a fascinating look at the various causes of the insurance crisis, and show how legislatures, regulators, and the judiciary played respective roles during this time.

<sup>30</sup> Abraham, *supra* note 29, at 99–102.

insurers, risk retention groups and pools to provide themselves coverage.<sup>31</sup> These vehicles allowed them to deal directly with the reinsurance market through the closely controlled pools, allowing governmental entities risk diversification services without the need (or cost) of conventional commercial general liability policies as an intermediary.<sup>32</sup> The governmental entity business lost by the commercial market during these years never returned, as the entities learned during this insurance crisis they did not need to rely on the insurance market.<sup>33</sup> Furthermore, because of the skyrocketing premiums,<sup>34</sup> governmental entities came to distrust insurers; as a result, the alternative market of pooling increased its percentage of the market in the ensuing years.<sup>35</sup>

There are approximately 91,000 distinct governmental entities currently operating in the United States, including counties, cities, school districts, townships and special districts.<sup>36</sup> Approximately 500 pools are now in existence providing coverage, in some form, for approximately 75,000 of those 91,000 governmental entities.<sup>37</sup> Pools have differing administrative operations—39% of pools have their own employees, 35% are staffed by third party administrators of varying sizes and 26% are administered by association employees.<sup>38</sup> Pool staffs are small compared with those of insurers: of pools with their own employees, 37% have a staff of five or less, 26% have more than 20 employees, 21% have 11-20 employees, and 16% have 6-10 employees.<sup>39</sup> Annual contributions (premiums) by members to their U.S. pools are estimated to be 13 to 17 billion dollars.<sup>40</sup> The pooling industry, while small compared to the main line insurers, is a substantial sector of the insurance market.<sup>41</sup>

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<sup>31</sup> *Id.* at 101–02 (citing Priest, *supra* note 15).

<sup>32</sup> *Id.* at 102.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 99.

<sup>35</sup> *Id.* at 102.

<sup>36</sup> Pumford, *supra* note 8 (citing 2007 U.S. Census statistics stating that the special districts include health and hospital districts, airport authorities, port authorities, and utility districts).

<sup>37</sup> *Id.*

<sup>38</sup> Nixon, *supra* note 20, at 3 (using 2009 AGRiP data).

<sup>39</sup> *Id.*

<sup>40</sup> Pumford, *supra* note 8.

<sup>41</sup> For a more negative view of pooling versus insurance companies or pools, such as the Missouri Public Entity Risk Management Fund, which operate more



Since laws vary throughout the United States and a survey of the states' pooling laws is beyond the scope and focus of this Article, Texas statutes and case law will be used to assist in the initial understanding of the legal organization and operation of pools. Most states are similar to Texas in that they have little or no regulation of pools since they are not considered insurance carriers by statute or case law.<sup>42</sup> For the purposes of this discussion, their organization is not as relevant as is the cause and effect of reinsurance. But, for those unfamiliar with pooling, here are the basic legal constructs.

Local governments<sup>43</sup> that join in a common purpose<sup>44</sup> under the Texas Interlocal Cooperation Act<sup>45</sup> may self-insure against claims.<sup>46</sup> In

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like insurers, see generally Thomas W. Rynard, *The Local Government as Insured or Insurer: Some New Risk Management Alternatives*, 20 URB. L. REV. 103 (1988).

<sup>42</sup> E.g., *City of S. El Monte v. So. Cal. Joint Powers Ins. Auth.*, 45 Cal. Rptr. 2d 729, 732 (Cal. Ct. App. 1995). CAL. GOV'T CODE § 990.8(c) (West 2010) states "[t]he pooling of self-insured claims or losses among entities as authorized in subdivision (a) of Section 990.4 shall not be considered insurance nor be subject to regulation under the Insurance Code." See also OHIO REV. CODE ANN. § 2744.081(E)(2) (West 2006) ("A joint self-insurance pool is not an insurance company. Its operation does not constitute doing an insurance business and is not subject to the insurance laws of this state"); COLO. REV. STAT. ANN. § 24-10-115.5(2) (West 2008) ("Any self-insurance pool authorized by subsection (1) of this section shall not be construed to be an insurance company nor otherwise subject to the provisions of the laws of this state regulating insurance or insurance companies . . ."); OR. REV. STAT. ANN. §§ 731.036(4), (5) (West 2003) ("[T]he Insurance Code does not apply to any of the following to the extent of subject matter of the exemption . . . (4) Public bodies . . . that either individually or jointly establish a self-insurance fund for tort liability . . . [or] (5) Public bodies . . . that either individually or jointly establish a self-insurance fund for property damage . . ."); FLA. STAT. ANN. § 624.4622 (West Supp. 2007) (which does not subject pools to the Florida Insurance Code, other than some reporting and initial capitalization requirements).

<sup>43</sup> TEX. GOV'T CODE ANN. § 791.003(4) (West 2012) (defining "local government").

<sup>44</sup> TEX. GOV'T CODE ANN. § 791.001 (West 2012) ("The purpose of this chapter is to increase the efficiency and effectiveness of local governments by authorizing them to contract, to the greatest possible extent, with one another and with agencies of the state.").

<sup>45</sup> TEX. GOV'T CODE ANN. §§ 791.001–.033 (West 2012).

<sup>46</sup> *Tex. Ass'n of Sch. Bds. Risk Mgmt. Fund v. Benavides Indep. Sch. Dist.*, 221 S.W.3d 732, 733 (Tex. App. 2007).

accordance with the Interlocal Cooperation Act, Texas law permits any governmental unit<sup>47</sup> to establish a self-insurance fund to protect the governmental unit, its officers, employees, and agents from any insurable risk or hazard.<sup>48</sup> The issuance of available money for a self-insurance fund is deemed a public purpose of the governmental unit and such funds are not subject to the Texas Insurance Code and other laws of Texas relating to the provision or regulation of insurance.<sup>49</sup>

Self-insurance funds themselves are not subject to the Texas Insurance Code pursuant to Texas case law. In *Hill v. Texas Council Risk Management Fund*,<sup>50</sup> the Court of Appeals held that self-insurance funds established by governmental units<sup>51</sup> are exempt from the Texas Insurance Code.<sup>52</sup> The plaintiff in this case brought suit against her employer's self-insurance fund, the Texas Council Risk Management Fund, alleging that uninsured motorist and underinsured motorist insurance should be presumed to exist in her policy because it was not rejected by her in writing as required by the Texas Insurance Code.<sup>53</sup> The Texas Council Risk Management Fund argued that pursuant to Texas Civil Statute Article 715c,<sup>54</sup> because the self-insurance fund was created by money available to the governmental unit, the fund was not subject to the Texas Insurance Code or any other laws relating to the provision and regulation of insurance.<sup>55</sup> The court agreed.

The Texas Supreme Court solidified the position of pools in *Ben Bolt-Palito Blanco Consolidated Independent School District v. Texas Political Subdivisions Property/Casualty Joint Self-Insurance Fund*,<sup>56</sup> in which the Texas Supreme Court decided the self-insurance fund was its own distinct governmental entity, which entitled the pool to assert

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<sup>47</sup> TEX. GOV'T CODE ANN. § 2259.001(1) (West 2008) (defining a "governmental unit" as a "state agency or institution, local government, or an entity acting on behalf of a state agency or institution or local government.").

<sup>48</sup> TEX. GOV'T CODE ANN. § 2259.031(a) (West 2008).

<sup>49</sup> TEX. GOV'T CODE ANN. §§ 2259.032, .037 (West 2008).

<sup>50</sup> 20 S.W.3d 209 (Tex. App. 2000).

<sup>51</sup> The provision cited by the *Hill* court has since been repealed but is incorporated in TEX. GOV'T CODE ANN. ch. 2259 (West 2008).

<sup>52</sup> *Hill*, 20 S.W.3d at 213.

<sup>53</sup> Cited in *Hill* as TEX. INS. CODE ANN. § 5.06-1. The statute has since been repealed, but is incorporated in TEX. INS. CODE ANN. § 1952.101 (West 2009).

<sup>54</sup> *Supra* note 51.

<sup>55</sup> *Hill*, 20 S.W.3d at 212–13.

<sup>56</sup> 212 S.W.3d 320 (Tex. 2006).

immunity in its own right and enjoy the same immunities as the political subdivisions that comprised the pool.<sup>57</sup> However, even pools waive this immunity when entering into written contractual agreements, such as contracts for coverage with their own members.<sup>58</sup>

Essentially, the legal process works as follows: two or more governmental entities decide to share risk, sign an interlocal agreement stating so, form the pool, fund the pool, and hire personnel to handle the administration of the pool.

#### B. OVERVIEW OF REINSURANCE CONCEPTS

Generally, reinsurance operates identically with pools as it does with insurers. Pools, like insurance carriers, obtain reinsurance for those exposures that are too great to retain. Reinsurance may be defined as a contractual arrangement under which one insurer, known as the primary insurer, transfers to another insurer, known as the reinsurer, some or all of the losses insured by the primary insurer under insurance contracts it has issued or will issue in the future.<sup>59</sup> The primary insurer is sometimes referred to as the ceding insurer, ceding entity, cedent, or reinsured. For consistency, the term cedent (or pool) and reinsurer will be used when referring to reinsurance situations.

In most cases, the reinsurer does not assume all of the liability of the cedent pool. The reinsurance agreement usually requires the cedent to keep a portion of the liability. This is known as the cedent's retention, and may be expressed as a dollar amount, a percentage of the original amount of insurance, or a combination of the two. There is usually an upper limit to the reinsurer's limit of liability.<sup>60</sup>

The primary functions of reinsurance are: stabilization of the cedent's long-term loss experience; giving the cedent large line capacity; cedent financing; cedent catastrophe protection; underwriting assistance; and, allowing the cedent to retire from a territory or class of business.<sup>61</sup>

Discussing the primary functions of reinsurance in order:

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<sup>57</sup> *Id.* at 325–26.

<sup>58</sup> *See id.*; *see also* TEX. LOC. GOV'T CODE ANN. § 271.152 (West 2005).

<sup>59</sup> 2 BERNARD L. WEBB ET AL., INSURANCE OPERATIONS 1 (2d ed. 1997).

<sup>60</sup> *Id.* at 1–2.

<sup>61</sup> *Id.* at 2. Retirement from a territory or class of business is generally not relevant to pooling and will not be discussed here.

Stabilization of Loss Experience—A pool must have a consistent positive underwriting experience in order to increase its capital and surplus to support growth and stability of the pool. Because losses can fluctuate, sometimes widely, a major function of reinsurance is to lessen the impact of large losses through controlled spending of reinsurance premiums.<sup>62</sup>

Large Line Capacity—There are two kinds of capacity in the property and casualty world—large line capacity and premium capacity. Large line refers to a cedent's ability to provide a high limit of insurance on a single loss exposure. A cedent may write a large line by keeping its retention within a reasonable relationship to its capital and surplus and reinsuring the balance. A competitive market environment creates the need for reinsurance;<sup>63</sup> without reinsurance, a carrier could not market to larger exposures, ceding the available market to larger carriers.

Financing—The second kind of capacity is premium capacity, which refers to the aggregate premium volume a pool can write. The common measure of capacity is expressed in terms of contribution-to-surplus ratio. This is because there is a limit to the amount of contributions a pool can write. The limit for any pool is a function of the carrier's surplus.<sup>64</sup> A pool is likely to be considered overextended if its net written contributions, after deduction of contributions on reinsurance ceded, exceeds its surplus by a ratio of more than three to one.<sup>65</sup>

Catastrophe Protection—Property and casualty insurers (and to a lesser extent, workers' compensation insurers), are subject to catastrophic losses that may result in millions of dollars of claims to a single pool. The purpose of reinsurance is generally related to the purpose of stabilizing loss experience, as catastrophes are major causes of the instability.<sup>66</sup>

Underwriting Assistance—Reinsurers deal with a wide variety and a large number of carriers. As a result, they accumulate a great deal of information regarding the experience of various cedents in certain markets. This experience can be helpful to pools, particularly to smaller pools or carriers planning on entering new and unfamiliar markets.<sup>67</sup>

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<sup>62</sup> *Id.* at 2–3.

<sup>63</sup> *Id.* at 4.

<sup>64</sup> Surplus is defined as the amount by which assets exceed liabilities. *Surplus*, INT'L RISK MGMT. INST., RISK & INS., <http://www.irmi.com/online/insurance-glossary/terms/s/surplus.aspx>. (last visited Dec. 27, 2014).

<sup>65</sup> WEBB ET AL., *supra* note 59, at 4.

<sup>66</sup> *Id.* at 7.

<sup>67</sup> *Id.* at 7–8.

As can be seen above, reinsurers have far-ranging functions and benefits in the marketplace.

As to the types of reinsurance, there are two basic forms: treaty reinsurance and facultative reinsurance.<sup>68</sup> Facultative reinsurance is purchased for a specific risk insured by a cedent, such as a particular piece of machinery.<sup>69</sup> Treaty reinsurance, the most commonly used reinsurance in pooling, is an agreement that binds the cedent to cede a specific portion of the risk of an entire class of business, such as all property coverage written by the cedents, to a reinsurer. Through one contract, the treaty reinsurer is required to cover a cedent on an entire book of business, even on business yet unwritten by the cedent.<sup>70</sup>

There are two main duties in the reinsurance relationship with cedents that are relevant to our discussion. The first is a common law duty of “utmost good faith”<sup>71</sup> between the parties.<sup>72</sup> This is defined as the “most abundant good faith; absolute and perfect candor or openness and honesty; the absence of any concealment or deception, however slight.”<sup>73</sup> This common law duty of utmost good faith was viewed as necessary for the very foundation of reinsurance:

Historically, the reinsurance market has relied on a practice of the exercise of utmost good faith to decrease monitoring costs and *ex ante* contracting costs. Reinsurance works only if the sums of the reinsurance premiums are less than the original insurance premium. Otherwise, the ceding insurers will not reinsure. For the reinsurance premium to be less, reinsurers cannot duplicate the costly but necessary efforts of the primary insurer in evaluating risks and handling claims . . .

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<sup>68</sup> There are many sub-types of reinsurance: facultative obligatory and automatic facultative, among others. *Id.* at 10–11.

<sup>69</sup> BARRY R. OSTRAGER & MARY KAY VYSKOCIL, MODERN REINSURANCE LAW AND PRACTICE 2-5 to 2-7 (2d ed. 2000).

<sup>70</sup> *Id.* at 2-4 to 2-5; *see also* WEBB ET AL., *supra* note 59, at 10.

<sup>71</sup> In Latin, *uberrima fides*.

<sup>72</sup> OSTRAGER & VYSKOCIL, *supra* note 69, at 3-4 to 3-6.

<sup>73</sup> *Id.* at 3-4 (citing BLACK’S LAW DICTIONARY 1520 (6th ed. 1990)).

[t]hey are protected, however, by a large area of common interest with ceding insurers and by the tradition of utmost good faith, particularly in the sharing of information.<sup>74</sup>

Because of the nature of reinsurance, the cedent's duty to the reinsurer to disclose information is very broad. The duty of utmost good faith also extends to all of a cedent's business activities, including underwriting and claims handling.<sup>75</sup> However, case law makes it very clear this duty of utmost good faith is a reciprocal one, owed by both cedents and their reinsurers.<sup>76</sup> Reinsurers must appropriately investigate and pay cedent's claims.

The second main duty in this reinsurance relationship is the "follow the fortunes" doctrine. Similar in concept to utmost good faith, this doctrine requires the reinsurer to follow the cedent's underwriting fortunes. In other words, if the pool suffers an underwriting loss due to a large claim, the reinsurer has the duty to suffer a loss by the agreement terms as well, restricting the reinsurer from questioning the validity of cedents' good faith claim payments. Under this doctrine, reinsurers must indemnify cedents for reasonable settlements and judgments.<sup>77</sup> The reinsurer is required to indemnify the cedent for reasonable payments made within the terms of the original agreement with their insured (or member, for pools), even if the claim is technically not covered by it.<sup>78</sup> One purpose of the follow the fortunes doctrine is to allow reinsurers to avoid the

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<sup>74</sup> *Id.* at 3-5 (citing *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049, 1054 (2d Cir. 1993)).

<sup>75</sup> *Id.* at 3-19 (citing *Am. Marine Ins. Grp. v. Neptunia Ins. Co.*, 775 F. Supp. 703, 708 (S.D.N.Y. 1991), *aff'd*, 961 F.2d 372 (2d Cir. 1992) (discussing that a ceding insurer satisfies its duty when it acts "honestly and . . . [with] all proper and businesslike steps")).

<sup>76</sup> *Id.* at 3-6 (citing *Compagnie de Reassurance d'Ile de France v. New Eng. Reinsurance Corp.*, 57 F.3d 56, 88 (1st Cir.), *cert. denied*, 516 U.S. 1009 (1995); *United Fire & Cas. Co. v. Arkwright Mut. Ins. Co.*, 53 F. Supp. 2d 632, 642 (S.D.N.Y. 1999) ("The duty of utmost good faith is a mutual one; it is an obligation of the reinsurer as well as the cedent.")).

<sup>77</sup> *Id.* at 9-3 (citing *Sumitomo Marine & Fire Ins. Co. v. Cologne Reinsurance Co.*, 552 N.E. 2d 139, 140 (1990)).

<sup>78</sup> *Id.* at 9-5 (citing *Christiana Gen. Ins. Corp. v. Great Am. Ins. Co.*, 979 F. 2d 268, 280 (2d Cir. 1992)).

unnecessary expense, delay and risk that would result from duplicative claims handling, and instead rely on the cedent's honesty and competence in adjusting claims.<sup>79</sup> The doctrine also promotes settlements since, without the doctrine, cedents would have to litigate every coverage dispute with its insured or member, or obtain consent from reinsurers to settle on every file. Additionally, reinsurers seeking to deny coverage would then use defenses that the cedents might raise against their insureds or members in coverage disputes. The same coverage dispute would be re-litigated repeatedly upward along the risk transfer chain.<sup>80</sup>

The doctrines of utmost good faith and follow the fortunes are distinguished from other reinsurance topics because, since the mid-1990s, these doctrines appear to be the aspects of the reinsurance framework that received the most scrutiny. As profit margins of the era diminished, and catastrophic claims grew, the acceptance of the historical 'gentleman's agreement' regarding reinsurance seemed to be in peril.<sup>81</sup> The push by both cedent and reinsurer was towards arms-length and sophisticated transactions, instead of relying on treaty certificates of only a few pages, and a degree of faith. The trust factor was diminishing and courts were playing a part in dismantling the doctrines,<sup>82</sup> thus bringing us to the present.

### C. INSURANCE AND REINSURANCE AS GOVERNANCE

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<sup>79</sup> *Id.* at 9-11 (citing *Ins. Co. of the State of Pa. v. Grand Union Ins. Co.*, [1989] 1 Lloyd's Rep. 208, 210 (C.A.)).

<sup>80</sup> *Id.* at 9-12 (citing *N. River Ins. Co. v. CIGNA Reinsurance Co.*, 52 F. 3d 1194, 1204 (3d Cir. 1995)). Reinsurers sometimes have their own reinsurers, known as retrocessionaires. *Retrocessionaire*, INT'L RISK MGMT. INST., RISK & INS., <http://www.irmi.com/online/insurance-glossary/terms/r/retrocessionaire.aspx> (last visited Dec. 27, 2014). Such retrocessionaires would add to the coverage litigation complexity were it not for the 'follow the fortunes' doctrine.

<sup>81</sup> See generally Steven W. Thomas, *Utmost Good Faith in Reinsurance: A Tradition in Need of Adjustment*, 41 DUKE L.J. 1548 (1992). Thomas emphasized environmental claims, which are not usually involved with governmental entities, but also felt large catastrophic claims were a culprit in this distancing of the cedent-reinsurer relationship. It is the author's experience that governmental pools have large exposures as well, usually in the form of property with weather related exposures, such as hail or tornadoes.

<sup>82</sup> OSTRAGER & VYSKOCIL, *supra* note 69, at 3-24 (citing Franklin D. Marsteller, *Uberrima Fides: Reinsurers Take Aim at Lack of Good Faith*, 8 L. DIG. 24 (1988)).

Analysis of the governance role of insurance starts with the basic argument raised by *Insurance as Governance*,<sup>83</sup> in which the authors explored their theory that the insurance industry has a great societal impact, largely invisible and freely accepted, that functions as a form of government beyond the state. The authors examine, first, how the insurance industry is one of the most pervasive and powerful institutions in society, and, second, despite acting in the background, how insurance governs our lives.

*Insurance as Governance* analyzes how society consumes insurance products, becomes part of the product, and how insurers then govern through the maintenance of risk pools of insureds that are large enough to ensure losses are reasonably predictable, thus subject to governance. It points to the economic, social, legal, cultural and political dimensions of insurance as governance, and to the significance of insurance for political sociology. The authors describe insurance as “moral technology,” defining how people should act, and finds that insurance as governance focuses on a form of private regulation of moral risks, all of which are subject to classification and segmentation by insurers.

While a fascinating work regarding insurers as a governance force in society, *Insurance as Governance* did not examine the insurer of insurers, the reinsurers, and how reinsurers’ influence in the marketplace might take the form of governance over insurers, and thus society. While the authors described the reinsurer relationship as one of suspicion, and the reinsurance process as being fraught with moral risk judgments and implications,<sup>84</sup> they did not address the relationship aspect further as to the governance potential of reinsurance.

However, Professor Aviva Abramovsky’s article, *Reinsurance: the Silent Regulator?*, opened the discussion as to the potential for reinsurer governance. She posited that *insurers themselves* might be silently regulated, apart from state regulation, by the influence of reinsurers whose product is necessary to those insurers. Her conclusion was that reinsurance, through private contract, had the capacity to certainly influence, if not directly regulate, insurer behavior. This influence, Professor Abramovsky felt, took forms such as affecting insurer underwriting and claim handling, as well as the potential for reinsurers to support rather than prohibit unfair insurer practices through the moral

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<sup>83</sup> See generally RICHARD V. ERICSON ET AL., *INSURANCE AS GOVERNANCE* (2003).

<sup>84</sup> *Id.* at 114–25, 365.



hazard of reinsuring tortious activity.<sup>85</sup> Because of this ability, she opined, reinsurance influence capacity should be a part of regulatory discussions of the insurance industry as a whole.<sup>86</sup> While Professor Abramovsky demonstrated in detail the *potential capacity* for reinsurer regulatory influence and many aspects under which it might arise, her research did not delve into what was *actually happening* on the ground with carriers and their staff. Were insurers actually influenced by the reinsurer relationship, and if so, to what extent? What did their experience reflect? Field research would be necessary for a fuller understanding of this reinsurer influence concept.

Based on research conducted for this Article, a clear conclusion can be reached that pools, while not regulated *per se* by reinsurers, are substantively influenced in their operations by reinsurers' specific requests, whether pre- or post-engagement. These reinsurers' requests, with consent by the pools, create a form of governance *voluntarily accepted* by the pools. Through varying parameters set forth by reinsurers, pools can individually decide to what degree they wish to have their operations governed. Because of the necessity of reinsurance for some pools, they agree to more oversight; because of the financial strength of other pools, they are able to insist on less governance, or none at all through complete self-insurance. Some pools feel the influence greatly in both underwriting and claims, some in one area or the other, and some only indirectly or generally. Nevertheless, while reinsurance governance varies from pool to pool, and is voluntarily accepted, this research shows that it exists.

This research also indicates, because of these close relationships, that governmental risk pools are a corner of the market where the reinsurance concept of "utmost good faith" still appears to thrive. At least in pooling, utmost good faith is a vital part of the reinsurer-cedent process, and is only growing more necessary for the profitability of the reinsurers, and the operating efficiency of many pools.

Additionally, pools are accommodating to reinsurer's input, although the accommodation levels vary; and several factors affect the level of reinsurer influence, most notably the financial solvency of the pool. Both of these results tie back into the utmost good faith and the voluntary acceptance of the reinsurers' form of governance mentioned above.

No doubt, some readers may disagree with this interpretation of the evidence, and some survey participants may differ regarding the

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<sup>85</sup> Abramovsky, *supra* note 3, at 385–401.

<sup>86</sup> *Id.* at 405.

characterization of their comments. This may arise from the general vision, for good or ill, of ‘governance’ or ‘regulation’ as linked with state power, often in a negative fashion.<sup>87</sup> Additionally, while this research cannot be directly extrapolated to main-line insurers or even give a complete and comprehensive view of the pooling world, it constitutes a waypoint for future research and discussion.

### III. RESEARCH SURVEY METHODOLOGY

Because of the author’s current professional position,<sup>88</sup> the focus of the research was on one small corner of the insurance and risk management world, the governmental entity self-insured risk management pools, as a case study. Limiting the discussion to this segment of the market allowed an examination of a more pure reinsurer-cedent environment. Rather than research with insurers that already felt the effects of state regulators, there was an opportunity to interview carriers that had little or no state regulation. While interviewing insurers would be broader research, it would be more difficult to disentangle the state regulator influence from the initial discussion.

For this research, four pooling industry sources provided suggestions for potential survey participants. These sources eventually became interviewees themselves.<sup>89</sup> The author knew three of the

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<sup>87</sup> *Id.* at 346 (“Yet such a restrictive vision of regulation is simplistic and ignores the capacity of private institutions to regulate the activities of large swaths of social actors.”).

<sup>88</sup> The author is currently Assistant Director, Legal and Regulatory Affairs, for the Texas Association of School Boards, Inc., the third party administrator for the TASB Risk Management Fund, an administrative agency of cooperating local governments. The Fund, based in Austin, Texas, is a self-insured governmental entity risk management pool providing coverage for approximately 1100 school districts, junior colleges, and related educational entities throughout Texas. The Fund is the result of separate funds merging in 1997 to put all lines of coverage under one entity. TASB, Inc., the administrator to the Fund, currently has 450 employees, of which 176 are solely assigned to the administration of the Fund. The Fund has total assets of \$333,764,377 and a members’ equity of \$227,923,874 (as of August 31, 2013). Documents on file with TASB, Inc.

<sup>89</sup> This is both fortunate, because of their immense experience, and unfortunate, as they cannot be publicly thanked due to the ethical format rules of publishing survey research. However, they know who they are. The author wishes to thank them all for their guidance through the world of pooling.

interviewees professionally prior to the survey. Because of the necessity for introductions to the rest of the survey group, the survey was not conducted in a purely random manner.<sup>90</sup> While this ‘referral’ method increased the response rate to nearly 100%, the survey lacked a randomness factor and perhaps the size needed for a more scientific survey. However, this referral survey method may have led to greater candor and willingness for detailed responses, even more so for one interviewee whom had recently retired.<sup>91</sup>

Thirteen senior officials with pools from across the country responded to the survey. Their responses were unique to their own pool or experiences; some pools only have one or two lines of coverage, some join with other pools for certain lines of coverage, and some offer all lines of coverage for their members. The pools are distributed geographically across the United States: two pools located in the Midwest, three in the South, three in the East, and five in the West. Additionally, two senior officials, one current and one former, with the Association of Governmental Risk Pools (AGRiP), also responded, as well as a reinsurer underwriter. The two AGRiP officials, having interacted with leaders of over 200 member pools across the country, were probably in the best position to see broad trends, as was the reinsurer underwriter.<sup>92</sup> However, the pooling officials were in the best current position for opining on direct reinsurer effects.

The survey interview was in a written format via email; although one was a telephone interview with follow up confirming emails as to content.<sup>93</sup> The interview was semi-structured in nature, in that interviews began with the same general questions to all pooling official participants, but follow-up questions were individualized based on the types and forms

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<sup>90</sup> Had the survey been completely random, rather than by referral, the response rate would have likely been greatly reduced. Only one person did not respond. Industry officials, on the author’s behalf, contacted several other potential participants, with no response. This number is unknown, but estimated to be less than ten.

<sup>91</sup> Additionally, one other participant was an active official during the survey and retired prior to the completion of this Article.

<sup>92</sup> No other reinsurer representative was willing to participate.

<sup>93</sup> The telephone interview was simply a preference by the participant; he later approved his quotes via email. The initial questions were identical.

of responses.<sup>94</sup> The survey questions were altered for the AGRiP officials and the reinsurer underwriter because of their more industry-wide view.<sup>95</sup> Three appendices of the initial research survey questions are attached. The responses were free form, which resulted in additional contact with most of the survey participants for the purpose of follow-up questions or clarifications. Because of this, the survey results acquired a “snowball” effect, gathering information down the winter path, injecting some degree of randomness along the way. Many interviewees took their own course as to the responses, and did not stay with the original question format. The responses tended to be conversational in nature; while making it more difficult to place in context for this Article, the result was beneficial to this research.

#### IV. SURVEY RESULTS

Having explored the history and legal constructs of pooling, reviewed the purpose of reinsurance, examined the concept of insurance and reinsurance as governance, and outlined the survey mechanics, we arrive at the focus of this Article: to what extent does reinsurance have a governance effect on insurers?

Four distinct discussion areas arose in the survey interviews.<sup>96</sup>

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<sup>94</sup> In retrospect, with the conclusion in hand, there may have been more effective initial and follow up questions (*e.g.*, *infra* note 164). Hindsight is a wonderful teacher.

<sup>95</sup> All of the individuals responding gave the author permission to quote them verbatim, although some minor corrections for any typographical errors and for clarity in the context of this Article were made. The author sincerely thanks all of the respondents for making this Article possible through their extremely generous contributions of time, as well as their patience, with the author’s inquiries. Their assistance was invaluable. The original e-mails are on file with the author. Because some respondents had no opinion on a particular matter, or lacked experience in a particular area, not every respondent answered every question. The survey participants also demonstrated a willingness of several of the participants to share specific underwriting information, which may seem unusual in this proprietary age. However, this is because the pools themselves are public entities using public funds, and as such, their records are open, *e.g.*, the Texas Public Information Act, TEX. GOV. CODE ANN. §§ 552.001 *et seq.* (West 2012).

<sup>96</sup> The four areas materialized through the form of the question, or in the manner in which the interviewees responded.

- How reinsurers influence pools—underwriting, claims, finance/solvency, and generally;
- The duty of utmost good faith and its effect;
- To what level pools afford accommodation to reinsurers; and
- Whether reinsurer influence varies based on pool circumstances, or external factors.

Because of the overlapping nature of some of the answers, many of the responses could apply to several subject matter units and it was often difficult to extricate the comments into singular areas. Therefore, some comments, based on the correlative relationship subject matter, may easily apply to several topics. At some point, interviewees' opinions had to find a home, although some may disagree as to their placement. So, we begin.

#### A. HOW REINSURERS INFLUENCE POOLS

The initial question to the pooling senior officials was straightforward—do you think pools are influenced by reinsurers, and if so, how? The term 'regulated' was not mentioned to the pooling senior officials due to the concern that the term would be interpreted too restrictively and compared directly to state regulation, which pooling officials tend to view as their kryptonite.<sup>97</sup> For initial inquiries directed to

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<sup>97</sup> It has been the author's experience that this general attitude has little to do with specific concerns about regulatory oversight, or apprehension regarding irradiated fragments from exploded planets. It has to do more with the greater ability to be competitive in the marketplace and serve their members more efficiently and with flexibility. As discussed in the pooling background section, pools are extremely transparent in their operations due to their public nature, much more so than private insurers. Because their executive boards are filled with representatives of their own members, it is felt they will 'do the right thing' on their members' behalf without burdensome, and expensive, regulatory oversight. As a senior official with the Texas Association of School Boards, Inc., stated when asked about this issue: "Most pools are outgrowths of their membership and therefore have always thought of themselves as governmental in nature, rather than insurance-like. I think the notion that a governmental self-insurance entity would be subject to insurance regulation just didn't make sense . . . Pools do NOT consider themselves insurance companies, so to be regulated like one would be really anathema to them." E-mail from senior official, Texas Ass'n of Sch. Bds.,

the AGRiP officials and the reinsurance underwriter, the term ‘regulated’ was used, since it was felt they could more easily discern the true intent of the question based on their broader experiences. The overall responses generally reflected that yes, pools are influenced by reinsurers, as suspected. But, how are they influenced, and to what extent? The influence appears to be to the point of reinsurer governance, although freely accepted by the carriers. However, this is only part of the story. The initial responses are broken down into four key areas of influence: Underwriting, Claims, Finance/Solvency, and General/Miscellaneous.

### 1. Underwriting

The survey participants emphasized underwriting as a main area where reinsurers had the most influence and this is where the most specific examples arose. In other areas, examples tended to be less definitive and more conjectural. This is likely because, by its nature, underwriting is more of a science, unlike claim operations, which tend more towards an art form.

A senior official with the Missouri Housing Authorities Property and Casualty, Inc.,<sup>98</sup> discussed underwriting influence due to the necessity of reinsurance and pricing as being key factors. She indicated:

The impact upon the pricing and availability of reinsurance . . . is on my mind, influencing each and every decision that I make . . . [s]ince approximately [one-third] of members’ annual contributions pay for ceded coverage at our pool, it is vitally important to keep the cost down, to the extent that we can. While I am fairly new to pooling, I learned the impact that a major loss can have on reinsurance premium early in my career [as a senior official]. In May, 2011, one of our [m]embers suffered a

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Inc., to Assistant Dir., TASB, Inc. (the author) (Mar. 23, 2013, 8:26 PM CST) (on file with author).

<sup>98</sup> The Missouri Housing Authorities Property & Casualty, Inc., website is available at <http://www.mhapci.org/> (last visited Dec. 27, 2014).

catastrophic loss of life and property.<sup>99</sup> The total incurred loss [for our pool] exceeded \$8,000,000.

When we went out into the reinsurance market for the ensuing policy year, the reinsurance cost increased by 43%, due in part to a 32% increase in the total insured value of our properties, which also resulted from a reinsurance-influenced decision. Following this loss and a couple of other big losses that followed closely on its heels, we learned that on the whole, our members' replacement cost property estimates and property insurance limits were low and that in many cases member properties were inadequately covered. Not only did we notice this, but the issue must also have come to the attention of our reinsurers who, for perhaps the first time in our history, established a margin clause<sup>100</sup> of 100%. In other words, in the event of a loss, the reinsurer would not pay any more than the estimated replacement cost. Following the 2012 reinsurance placement cycle, I went to the Board with a recommendation that the Board hire an insurance valuation company to measure unique buildings and secure a replacement cost valuation for each and every building that the pool covers. This decision resulted in our ability to negotiate a 130% margin clause for 2013 coverage, as the reinsurers were more confident that they were collecting the right amount of premium.

Another example of the reinsurer influence occurred around 2005. My predecessor was informed that blanket coverage would no longer be available and was provided a

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<sup>99</sup> See *Joplin Tornado Event Summary*, NAT'L WEATHER SERVICE, [http://www.crh.noaa.gov/sgf/?n=event\\_2011may22\\_summary](http://www.crh.noaa.gov/sgf/?n=event_2011may22_summary) (last visited Dec. 27, 2014).

<sup>100</sup> A margin clause is defined as, "[a] nonstandard commercial property insurance provision stating that the most the insured can collect for a loss at a given location is a specified percentage of the values reported for that location on the insured's statement of values." *Margin Clause*, INT'L RISK MGMT. INST., RISK & INS., <http://www.irmi.com/online/insurance-glossary/terms/m/marginclause.aspx> (last visited Dec. 27, 2014).

timetable to convert to property scheduling by individual building in order for continued availability of reinsurance by long-standing reinsurance partners. The pool had to go out to the membership and get a listing with square footage and values for each and every building. This was a time-consuming, expensive and controversial proposition that was accomplished to ensure availability of reinsurance. [However,] I have not received any reinsurer . . . suggestions [as to] what coverages to offer or underwriting criterion.<sup>101</sup>

This senior official's experience shows the availability of reinsurance was in danger without substantial action by the pool, which shows a great deal of underwriting influence by a reinsurer. As this official indicated, every decision is influenced by the pricing and availability of reinsurance. Since the pool was willing to do what was necessary to show utmost good faith and transparency in underwriting, the reinsurer also felt confidence in the pool's leadership and agreed to favorable terms moving forward. But their reinsurer focused on the exposure, rather than the individual coverages, so that evidences a belief that, if the base information could be corrected, an agreement could be reached that was beneficial for both.

Similarly, a senior official with the Texas Association of School Boards, Inc.,<sup>102</sup> also discussed direct influence from reinsurers, specifically regarding underwriting of property and workers' compensation coverages, but mentioning other areas in general:

I do think [pools] are greatly influenced . . . by their reinsurers' wishes. That is particularly true for those pools that have very low retentions and therefore pass off most of the risk to their reinsurers. In those instances, claims handling, exposure collection, financial matters, even underwriting criteria can be dictated by the reinsurer. Even with our very high retentions, we experience this from time

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<sup>101</sup> E-mail from senior official, Mo. Hous. Auths. Prop. & Cas., Inc., to Assistant Dir., TASB, Inc. (June 13, 2013, 3:00 PM CST) (on file with author).

<sup>102</sup> This organization's website, as the third party administrator for the TASB Risk Management Fund, can be found at <http://www.tasbrmf.org/> (last visited Dec. 27, 2014).



to time. For example, after [hurricanes] Katrina, Rita and Wilma hit [the Gulf Coast],<sup>103</sup> the reinsurance community became very concerned about the quality of construction of the buildings they were reinsuring. They imposed significantly more detailed reporting requirements on the types of structures we were covering, what they were built out of, how old they were, etc. Where before we were able to just include the address and a general description of our buildings on the schedule of values we submitted to the reinsurers, all of a sudden we were required to obtain very specific COPE<sup>104</sup> information on every building. That required us to significantly change the way we collect and maintain our exposure information.

The second example is the requirement by our [workers' compensation] reinsurer to start providing information on the concentration of risk—the number of employees at any one location. That change was implemented after the Joplin tornado and the Alabama tornadoes hit a couple of years ago. Workers' compensation reinsurers realized that they may not have accurate information on the number of total people exposed to a devastating event, especially if they write several large employers in a single

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<sup>103</sup> See generally *Hurricanes in History*, NAT'L WEATHER SERVICE, <http://www.nhc.noaa.gov/outreach/history/> (last visited Dec. 27, 2014).

<sup>104</sup> COPE is "an acronym that stands for the four property risk characteristics an underwriter reviews when evaluating a submission for property insurance: Construction (e.g., frame, masonry, masonry veneer, superior construction, mixed—masonry/frame); Occupancy (how the building is being used for commercial property and whether it is owner-occupant or renter-occupied for homeowners and the number of families for which the building is designed); Protection (e.g., quality of the responding fire department including whether it is paid or volunteer, adequacy of water pressure and water supply in the community, distance of the structure to the nearest fire station, quality of the fire hydrant, and the distance of the structure to the nearest hydrant); and Exposure (risks of loss posed by neighboring property or the surrounding area, taking into consideration what is located near the property, such as an office building, a subdivision, or a fireworks factory)." COPE, INT'L RISK MGMT. INST., RISK & INS., <http://www.irmi.com/online/insurance-glossary/terms/c/cope.aspx> (last visited Dec. 27, 2014).

community. So now, we are providing information by location and address of the number of employees working at each location.<sup>105</sup>

While her examples mention underwriting influence in both workers' compensation and property, she does feel there is a broader influence, including claims and finances. The examples the official gave were both exposure oriented. Note the reinsurers insisted on detailed information, which they had not previously required, a new parameter for the relationship. It was provided willingly by the pool, since the relationship was more valuable than the expense or trouble to obtain the information. In exchange, the pool retained the necessary reinsurance coverage.

A senior official with the County Commissioners Association of Pennsylvania,<sup>106</sup> emphasized underwriting influence, noting:

We do have lots of discussion [with our reinsurer] about coverage issues and underwriting. A recent example was the conversion of the entire Equipment Breakdown (Boiler and Machinery) section of our Coverage Document, which was outdated and was based on wording provided by a prior [re]insurer. Our current reinsurer assisted us with wording to match their reinsurance coverage, and reviewed the results before we sent the Coverage Document to the membership . . . [we] have our own Coverage Document and we review the changes we would like to make in the document with them. They are trusted advisors.<sup>107</sup>

This official focused on the coverages, and worked with the reinsurer to verify that the reinsurer could use their coverage agreement to follow the carrier's fortunes accurately. The pool accepts their input, even

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<sup>105</sup> E-mail from senior official, TASB, Inc., to Assistant Dir., TASB, Inc. (May 8, 2013, 10:05 AM CST) (on file with author).

<sup>106</sup> The County Commissioners Association of Pennsylvania website is available at <http://www.pacounties.org/Insurance/Pages/default.aspx> (last visited Dec. 27, 2014).

<sup>107</sup> E-mail from senior official, Cnty. Comm'rs Ass'n of Pa., to Assistant Dir., TASB, Inc. (June 13, 2013, 8:50 AM CST) (on file with author).

to the point of considering the reinsurer a business advisor. This appears to be an accepted form of governance as to this pool.

A senior official with the Park District Risk Management Agency<sup>108</sup> indicates underwriting influence as well. Additionally, he makes a specific point that underlies many of the responses—that reinsurer influence occurs over a period of years in the relationship, rather than reinsurers making specific demands. He notes:

For PDRMA, the influence of reinsurers has accumulated over time as opposed to a specific reinsurer telling us that we needed to do certain things in order to procure reinsurance coverage. For example, we have refined the data we collect from our members over the years in order to have the ‘right’ data so that an underwriter can understand our exposures and properly price them. That ‘right’ data varies from reinsurer to reinsurer and can also vary with market cycles, i.e. hard<sup>109</sup> versus soft market.<sup>110</sup>

This points to the same focus as felt by the Missouri pool, although it happened over a number of years. The reinsurer used their influence to get the carrier to obtain the ‘right’ (by that reinsurer’s standards) data. This official also mentions that the data collected can vary by reinsurer or market conditions—regardless, the reinsurer is affecting the pool (by dictating what data is collected), which complies in order to obtain the product.

Other pooling executives felt there was less underwriting influence by reinsurers. A senior official at Ashton Tiffany, LLC, the third party

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<sup>108</sup> The Park District Risk Management Agency website is available at <https://www.pdrma.org/> (last visited Dec. 27, 2014).

<sup>109</sup> A hard market is one side of the insurance market cycle that is characterized by high rates, low limits, and restricted coverage. *Hard Market*, INT’L RISK MGMT. INST., RISK & INS., <http://www.irmi.com/online/insurance-glossary/terms/h/hard-market.aspx> (last visited Dec. 27, 2014).

<sup>110</sup> A soft market is one side of the insurance market cycle that is characterized by low rates, high limits, flexible contracts, and the high availability of coverage. *Soft Market*, INT’L RISK MGMT. INST., RISK & INS., <http://www.irmi.com/online/insurance-glossary/terms/s/soft-market.aspx> (last visited Dec. 27, 2014); E-mail from senior official, Park Dist. Risk Mgmt. Agency, to Assistant Dir., TASB, Inc. (July 6, 2013, 1:38 PM CST) (on file with author).

administrator for the Arizona School Risk Retention Trust, Inc.,<sup>111</sup> mentions the interaction and exchange regarding underwriting. He indicated:

It depends on the maturity of the pool and the experience level of the pool staff, but we have a balanced scale of give and take with our reinsurers. The . . . Trust is a mature property and casualty pool with over twenty years' experience . . . negotiating with reinsurers.

The Trust has our own coverage agreements which are reviewed and adjusted each year based on our claims experience and evolving case law. We forward the draft revised coverage agreement to our lead reinsurance partners and ask for their feedback. Although we do not always incorporate their suggestions, we appreciate and value their feedback. We believe this provides multiple viewpoints on coverage and also creates a solid working relationship with our [reinsurers]. We also ask for their feedback with emerging issues coming from the reinsurers' book of business other than our account specifically. This helps us to be proactive with coverage issues for our members instead of being reactive . . .

As a mature pool, our reinsurers typically do not try to influence us on our underwriting decisions. The only influence our reinsurance carriers have on underwriting procedures is if certain exclusions are adopted into the agreement with the Trust. Recently, we had this very situation arise regarding high-level ropes courses offered by some of our members. One reinsurer wanted to exclude coverage for all ropes courses. We stood firm and reasoned with them that it would require additional time to remove the exposure and, if not removing the exposures, we would provide extensive loss control measures to

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<sup>111</sup> The Arizona School Risk Retention Trust, Inc., website is available at <https://www.svc.the-trust.org/> (last visited Dec. 27, 2014).

reduce the exposure. The agreement resulted in the reinsurer dropping their proposed exclusion.<sup>112</sup>

While this official felt there was minimal influence, he also noted the depth of the relationship necessary to get to that point. It is unlikely a new reinsurer of the Trust would be willing to cede all influence until they were comfortable with the Trust's operation. Additionally, while he feels influence is minimal, it does not appear so. He mentions a fair amount of ongoing interaction between his staff and the reinsurer, as well as the value of their feedback. Feedback that is valued and sought seems to indicate a greater influence than a simple commodity transaction. Note how the relationship is always there, affecting every transaction. While this official might not characterize it as such, this level of interaction appears to be reinsurer governance.

A senior official with the Maryland Association of Boards of Education<sup>113</sup> felt there was less influence in his operation as well. He notes:

Our pools are influenced somewhat by reinsurers . . . Our Pool [School Board Legal] coverage is a manuscript policy. When we first went to this reinsurer they 'blessed' the policy with a couple of minor changes we were fine with and we just handle our claims . . . The only influence was on our School Board Legal policy whereas the reinsurer came on the risk they indicated they would not reinsure an exposure we covered, so we changed our policy to be in conformance with what they wanted. It was actually a small matter which has not caused any specific issues.<sup>114</sup>

While not initially noting influence, it appears that their policies are reviewed by reinsurers to make sure the reinsurer wishes to follow this

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<sup>112</sup> E-mail from senior official, Ashton Tiffany, LLC, to Assistant Dir., TASB, Inc. (June 24, 2013, 10:19 PM CST) (on file with author).

<sup>113</sup> The Maryland Association of Boards of Education website is available at <http://www.mabe.org/insurance-programs/> (last visited Dec. 27, 2014).

<sup>114</sup> E-mails from, senior official, Md. Ass'n of Bds. of Educ., to Assistant Dir. TASB, Inc. (June 14, 2013, 1:37 PM CST, 2:31 PM CST) (on file with author).

pool's fortune. As we will see later, this is not the last word from this official about the importance of the relationship.

A senior official from the Idaho Counties Risk Management Program<sup>115</sup> felt there was little influence. He stated:

Our experience at ICRMP and in my discussion with peers, regarding reinsurance relationships, leaves me with the impression reinsurers do not influence pools directly. We have not had specific requests to amend coverage . . . or otherwise alter our pool operations to fit reinsurer's needs. Certainly there is underwriting exposure data that must be provided such as payroll, property values, and other basic underwriting info and claims must be reported to reinsurers, however, ground level operations are left up to the pool.<sup>116</sup>

While this official felt there was no influence on pools *directly*, he did not say there was none at all. He notes the underwriting data "that must be provided" and considers it ordinary. Nevertheless, these seem to be similar requests made of other pools (perhaps not as detailed) and those officials felt they were influenced by such requests. While this official may feel no direct influence outside the expected underwriting issues, it appears those very underwriting influences form the core of the influence. If the underwriting information were no longer transmitted as required, it appears from these comments that reinsurance would no longer be offered. This seems like voluntary governance—if this data is not provided, the reinsurance product will cease to be available, or certainly more costly.

A senior official with the Alabama Trust for Boards of Education<sup>117</sup> self-funded pool mentioned underwriting, stating:

My observations have been that reinsurers influence pool formation and operations in areas of financial management, underwriting, and claims management. [Reinsurers] are . .

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<sup>115</sup> The Idaho Counties Risk Management Program website is available at <http://www.icrmp.org/> (last visited Dec. 27, 2014).

<sup>116</sup> E-mail from senior official, Idaho Cntys. Risk Mgmt. Program, to Assistant Dir., TASB, Inc. (June 17, 2013, 3:47 PM CST) (on file with author).

<sup>117</sup> The Alabama Trust for Boards of Education website is available at <http://www.dwightheater.com/ATBE.html> (last visited Dec. 27, 2014).

. concerned from an underwriting standpoint about nature and scope of coverage, as well as pricing for coverage.<sup>118</sup>

While this official's comments are more general, his impression is that reinsurers do influence pool underwriting operations, mostly from the coverage standpoint, which relates back to the follow the fortunes aspect. The reinsurer has to make sure the cedent's interests align with theirs.

As to reinsurers' underwriting influence, the current senior official of AGRiP indicates a wide range of influence:

Pools absolutely have accepted input from the reinsurers to influence their practices, operations – even policies. This can be very subtle. For example, a reinsurer might ask, when underwriting a pool, if they have policies and procedures for cancelling or non-renewing a member that will not comply with loss control requirements. I have known pools without such formal procedures to develop them, not because their reinsurer 'required' it, but because they recognized [the procedure] as a good proactive [policy], and they wanted to make themselves *more* attractive to reinsurers in the future. Other areas I have seen influenced by reinsurers include rating and pricing; building and holding adequate surplus; better claim management procedures; and coverage issues, to name a few.<sup>119</sup>

These comments appear to verify that even suggestions from reinsurers, because of their broader market knowledge and experience, take on a great deal of influence, even though they were not requirements. This official continues:

Reinsurers . . . have provided pools with general advice through forums, [such as] AGRiP conferences. For example, reinsurers have produced [conference] sessions

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<sup>118</sup> E-mail from senior official, Ala. Trust for Bds. of Educ., to Assistant Dir., TASB, Inc. (June 20, 2013, 2:44 PM CST) (on file with author).

<sup>119</sup> E-mail from current senior official, Ass'n of Gov'tal Risk Pools (AGRiP), to Assistant Dir., TASB, Inc. (Apr. 29, 2013, 11:09 AM CST) (on file with author).

on how to effectively partner with your reinsurer. The sessions gave input on things to include in the underwriting submission, such as: evidence of pool policies that require members to embrace loss control advice or risk being non-renewed; information about rating plans that include experience rating to incent better risk management; [and] operational structures that demonstrate an alignment of incentives between staff or vendors with the goal of reducing losses, as opposed to a managing general underwriter structure where the vendor is incented to grow the top line with no skin in the game for the bottom line.<sup>120</sup>

These conference programs appear to be the first truly indirect form of reinsurer influence discussed by a participant.<sup>121</sup> While understandably, reinsurers give such presentations to assist pools in becoming more efficient and more able to be reinsured (and to raise the reinsurers' visibility), they are also attempting on a broader scale to influence pools in general. This training potentially makes the reinsurance market more accessible to pools, and more expansive and profitable for reinsurers.

As to underwriting, the former senior official with AGRiP indicated:

[Underwriting] suggestions generally are subtle 'strong hints', such as reinsurers indicating they could lower the premium by X dollars if members were required, under the coverage agreement, to confer with a pool designated defense counsel before taking any adverse employment actions. Or, for example, if coverage excluded diving boards over five meters high. Or, if coverage excluded playground equipment on hard surfaces such as asphalt or concrete.<sup>122</sup>

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<sup>120</sup> E-mail from current senior official, AGRiP, to Assistant Dir., TASB, Inc. (June 10, 2013, 7:11 AM CST) (on file with author).

<sup>121</sup> Arguably, these presentations take a similar form as the "University of Farmers" insurance commercials.

<sup>122</sup> E-mail from former senior official, AGRiP, to Assistant Dir., TASB, Inc. (May 24, 2013, 2:26 PM CST) (on file with author).



All of the examples are incentive-based; while assisting the pool in having fewer losses, they also minimize severity, and the chance the reinsurers' thresholds are broken. However, this appears to be the same type of influence as when your local government offers lower water rates per gallon for more frugal usage. Also, note the use of the term 'subtle' by both AGRiP officials. This will be seen next as well.

A reinsurer underwriter for the Government Entities Mutual, Inc.,<sup>123</sup> indicated reinsurers did have a substantive impact on pools. He focused on the underwriting influence:

I would say over time, reinsurers are moving from direct influence to indirect influence. This seems to be a function of the market conditions, and in this extended soft market (since post-9/11), reinsurers' demands of their reinsureds are becoming more and more requests. This is, of course, related to not wanting to give up market share [or] being perceived . . . that [reinsurance] coverage is based on a set of operational demands.

[As to influence], Government Entities Mutual, Inc. has a pricing methodology that includes schedule credits which reward/penalize our member pools for practicing 'good' risk behavior and not practicing 'bad' risk behavior. A little more about this: the [reinsurance underwriting] categories allow up to +/-15% debits/credits. The several categories are both subjective and relatively objective. The metrics for each category are definitely subjectively chosen by GEM staff. For instance: being AGRiP 'recognized'<sup>124</sup> affords -1% off the written premium. GEM has determined that going through the self-evaluation process of the AGRiP recognition process is an indicator of a good risk pool. Remember, GEM is assessing the risk of the pool, while pools are assessing the risk of its members. So, the fact that we have correlated risk with

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<sup>123</sup> The Government Entities Mutual, Inc., website is available at <http://www.gemre.com/> (last visited Dec. 27, 2014).

<sup>124</sup> See *generally* ASS'N OF GOV'TAL RISK POOLS, [www.agrip.org](http://www.agrip.org) (last visited Dec. 27, 2014) (for a detailed discussion of debits and credits).

AGRiP recognition is relatively objective, but the metric of -1%/0/+1% [for varying categories] is subjective.

Speaking outside of GEM, I know that reinsurers pricing models have a lot more ‘wiggle’ room than GEM’s +/-15%. Some up to 40%. The rationale for this is the limited ability of their experience and exposure based pricing methods, usually blaming the pool’s lack of experience in the reinsurance layers [for] not being able to credibly predict risk and therefore [being able to] predict pricing. Each reinsurer has their own ‘wiggle’ methodology, but ultimately they are looking to assess the soft risk elements versus the cold, hard black and white of the losses and exposure counts. Specifically, I know other reinsurers collect a lot of the same soft data that GEM collects, such as claims audits, tort climates, and underwriting guidelines.

Specific input might come in the way of reinsurer audits. For instance, most reinsurers want at least a claims audit and underwriting audit of the reinsured before they write the business. Within the audits are pros and cons of the reinsured’s operations, as well as ways to improve. When subsequent audits are performed, the first thing an auditor usually looks at are the ‘management recommendations’ from the previous audit. These point to whether management has been responsive to the reinsurers recommendations. The majority of the reinsurers want financially solvent pools, so they target the major contributors to that end. Underwriting and claims are the biggest two, followed by loss control and accounting. Because a well-functioning pool has [their own] long term underwriting and rating standards, and [these pools] attempt to minimize claims payouts by proactively defending frivolous and calamitous claims.<sup>125</sup>

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<sup>125</sup> E-mails from reinsurance underwriter, Gov’t Entities Mut., Inc., to Assistant Dir., TASB, Inc. (Apr. 30, 2013, 11:12 AM EST and May 9, 2013, 3:08 PM CST) (on file with author).

This underwriter outlines a very good overview of how reinsurer incentives operate. Reinsurers want to give premium discounts, as this assists reinsurers in their influence of pools. Reinsurers are attempting to influence pools to have lower loss ratios, since, under the follow the fortunes doctrine, this is optimal for both parties, although more so for the reinsurer. This underwriter seems to encourage transparency and good faith in the underwriting process for the benefit of both. This appears to be a very substantial argument for reinsurer underwriting influence on pools.

As to the underwriting influence overall, the general characterization of reinsurer influence was characterized by the participants as ‘indirect.’ However, while the influence is not as direct as it could be, being influenced by reinsurers’ suggestions, even subtle ones, appears to be a form of direct influence, unlike the indirect influence of conference programs. There appears to be, direct or subtle, very much a governance aspect to the reinsurers’ actions.

## 2. Claims

The area of claims differs from underwriting in that it is more subjective, from a reinsurer’s standpoint. The reinsurer influence varies based on many more factors in claims, as can be seen from participant’s responses.

The senior official for the Alabama Trust for Boards of Education indicated:

[Reinsurers] are particularly interested in how claims are managed and by whom. They are interested enough in [the pools’] claims management that they typically conduct regular, periodic audits of all claim files that may in any way pose exposure to the re-insurance layer of coverage.<sup>126</sup>

The claim audits are a theme that will arise repeatedly. Because reinsurers can’t get an objective view of claims by reserve numbers or claim counts, they must actually touch the files to ensure that the pool is overseeing the claims in a reasonable fashion. Additionally, pool personnel must meet with reinsurer personnel—this is partly for explanations of files,

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<sup>126</sup> E-mail from senior official, Ala. Trust for Bds. of Educ., to Assistant Dir., TASB, Inc. *supra* note 118.

as well as to investigate the capabilities of the claim staff. These oversight actions are governance (or regulatory) in nature.

The senior official for the County Commissioners Association of Pennsylvania indicated:

In our experience, [influence] is not about specific operational matters and never about specifics of personnel. But it could be about staffing (levels of loss control services for example) and, since we provide claims services, [reinsurers] are interested in our claims staff performance. We provide member satisfaction survey results and copies of claims audits so they can have factual information about our service quality.<sup>127</sup>

Here we see interest in claim staff performance again—the reinsurer wishes to oversee, to some degree, the subjective, and the pool agrees to this oversight.

A former senior official with the Washington Schools Risk Management Pool<sup>128</sup> emphasized some reinsurance influence on claim operations, indicating:

Pools influenced by reinsurers . . . it depends. We take recommendations from any reinsurer claims audit very seriously, especially as it relates to claims industry practices. We just had our two reinsurers complete their annual claims audit and we are following up on a recommendation to tighten up on reserve documentation. The reserve documentation was in the form of a recommendation and not as a strict requirement. But I do think it is important to maintain a good working relationship with our reinsurer and would comply with

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<sup>127</sup> E-mail from senior official, Cnty. Comm’rs Ass’n of Pa., to Assistant Dir., TASB, Inc., *supra* note 107.

<sup>128</sup> The Washington Schools Risk Management Pool website is available at <http://www.wsrmp.com/> (last visited Dec. 27, 2014).

their recommendations if they make good business sense, as the reserve documentation recommendation was.<sup>129</sup>

As this official indicates, they take the audits “very” seriously from their reinsurer, and it appears annual audits are required. The recommendation arising from the audit was not put forth as a requirement. The recommendation was a formal suggestion, and the pool gave it consideration because it made sense, but also indicated acceptance because of the need for a good working relationship. While this official may feel less influence, regularly accepted audits (even if contractually required) and a desire to maintain the relationship (which are not contractually required) indicates a fair degree of influence from the reinsurer.

A senior official with the Montana School Group Insurance Authority,<sup>130</sup> the administrator for the Montana School Board Association’s program, felt both underwriting, in coverage offerings, and claim operations were most influenced, but focused on the claim operations as an example. He said:

Pools are influenced by reinsurers. The right reinsurance partner is critical for the long-term success of the primary pool. The ability to provide stable and competitive reinsurance costs [is] one of the largest pieces of the primary pool’s pricing formula which in turn has a direct impact on [how] competitive the primary pool can be in its membership market space. The other is the right reinsurance products for the primary pool. Often one reinsurance carrier will not provide the right type of coverage, coverage structure, or limits needed. So, to find the perfect fit takes some work on the primary pool’s part. For some pools that is a mono-state arrangement, others it is multi-state, and some are countrywide. The influence a reinsurance relationship has on the primary will drive certain procedural behaviors with regard to both

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<sup>129</sup> E-mails from former senior official, Wash. Sch. Risk Mgmt. Pool, to Assistant Dir., TASB, Inc. (June 12, 2013, 12:09 PM EST and 3:34 PM CST) (on file with author).

<sup>130</sup> The Montana School Group Insurance Authority website is available at <http://www.msgia.org/> (last visited Dec. 27, 2014).

policy and procedural development in the areas that will be impacted by the reinsurance pricing.

The best example is claim handling procedures and related policies. Because the reinsurance submission process is becoming more formalized as pooling development has evolved, the primary pools are much more carefully crafting claim handling procedures and policies which model what they believe to be national best practices in this area. The submission process involves sharing the detailed outside or third party claim audit reports of your operations with your reinsurance partner as well as your own state and local pool claim guidelines and procedures. A reinsurer then analyzes these procedures and compares them with the outcomes seen in the claim data sets acquired from the primary pool as part of the reinsurance submission process. While the reinsurance does not have any direct control over the primary pool with regard to mandates for changes in the primary pool procedures, suggestions are offered. The reinsurers I have worked with provide those based on multiple operations they have worked with and offer what they believe to be the best practices. So, it is the indirect influence or regulator feel provided through the reinsurance relationship that creates certain behaviors in pooling operations. The larger the pool, the more procedures and staff that are involved, [then] the larger the interactions [are] between the reinsurance carrier and the primary pool.

Influence on coverage issues I have still seen [are] driven by the type of reinsurance/excess contract, with the reinsurance style contracts affording the settlement authority to the primary pools. Our pool, as do many, still involve the reinsurer as the claim progresses and even in the final decision making process of settlement versus continued defense. Reporting requirements in the contracts with the reinsurers ensures they get to be involved prior to

the self-insured retention<sup>131</sup> being breached for most instances. We have been involved with several liability claims where we have received very good input from the reinsurance legal group regarding ways to approach and structure defenses for our primary pool members. Our defense counsel for the pool has usually been very receptive to that type of input.<sup>132</sup>

Note how this senior official continues to go back to the benefits of the relationship, the early involvement of the reinsurer, and the claim specific advice. He mentions “suggestions are offered” that “create certain behaviors”; governance creates certain behaviors as well. Regardless of the example of influence he is discussing, or if one would consider it direct or indirect, it is very apparent both parties perceive their relationship to be one of utmost good faith, rather than the arms-length relationship contemplated by some reinsurance commentators previously documented.

A senior official with the North Carolina School Boards Association, the third party administrator for the North Carolina School Boards Trust<sup>133</sup> felt there was reinsurer claims influence:

Yes, [there is influence], at least to some extent. I think the level of reinsurer influence is in part dependent on the sophistication level of the pool staff and also probably the size of the pool.<sup>134</sup> Smaller pools with less experienced, less sophisticated staff are likely to be more receptive to

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<sup>131</sup> A self-insured retention (SIR) is defined as: “A dollar amount specified in a liability insurance policy that must be paid by the insured *before* the insurance policy will respond to a loss. Thus, under a policy written with a SIR provision, the *insured* (rather than the insurer) would pay defense and/or indemnity costs associated with a claim until the SIR limit was reached. After that point, the *insurer* would make any additional payments for defense and indemnity that were covered by the policy.” *Self-Insured Retention (SIR)*, INT’L RISK MGMT. INST., RISK & INS., <http://www.irmi.com/online/insurance-glossary/terms/s/self-insured-retention-sir.aspx> (last visited Dec. 27, 2014) (emphasis in original).

<sup>132</sup> E-mail from senior official, Mont. Sch. Grp. Ins. Auth., to Assistant Dir., TASB, Inc. (June 18, 2013, 10:34 AM CST) (on file with author).

<sup>133</sup> The North Carolina School Boards Trust website is available at <http://www.ncsba.org/risk-management/the-north-carolina-school-boards-trust/> (last visited Dec. 27, 2014).

<sup>134</sup> This factor will be seen again.

reinsurer suggestions on changes to improve internal claim procedures or with handling coverage and reservation of rights issues, or other internal changes.<sup>135</sup>

While this official did not seem to be referring to her own pool, it seems natural that less experienced pools would be more willing to accept guidance from business partners, using reinsurers' governance to their advantage.

The senior official from the Park District Risk Management Agency mentioned claims in detail:

The reinsurers do review our claims procedures, but mainly from the point of view that they want to be confident that we have competent staff, have specific internal controls in place, and the process is documented. While we write our reinsurance agreements so that, in most cases, PDRMA retains the ability to control the claim, we do have specific reporting procedures to the reinsurer and in some cases need written approval prior to settling a claim. We comply with those requirements and try to be much more proactive and cooperative with the reinsurers when they may be paying on a claim.<sup>136</sup>

This certainly is direct influence; the most interesting example is the reinsurer's insistence to go beyond 'follow the fortunes', in that in some instances the reinsurer must sign off on certain settlements. These reinsurer 'requirements' are complied with proactively by the pool, and appear to be behavior changing influence, governing in nature. Again, this influence, or governance, is freely accepted by the pool.

The senior official representing the Arizona School Risk Retention Trust, Inc., discussed the large amount of interaction their claim personnel had with their reinsurer:

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<sup>135</sup> E-mail from senior official, N.C. Sch. Bds. Ass'n, to Assistant Dir., TASB, Inc. (July 8, 2013, 2:48 PM CST) (on file with author).

<sup>136</sup> E-mail from senior official, Park Dist. Risk Mgmt. Agency, to Assistant Dir., TASB, Inc., *supra* note 110.



Our . . . lead liability claims adjuster, along with our lead defense counsel, meets with our reinsurers in person twice a year to conduct intensive case reviews. [The adjuster] also provides updates throughout the year as reserves change. We recently had three large liability claims that reached into the reinsurance layers. The ultimate settlements negotiated by our adjuster were less than the reinsurers reserves amounts by approximately 30% to 50% of the reinsurers' total reserves. These results build our credibility with the reinsurers and illustrate that we do not fall victim to unnecessary influence from the reinsurers.

Our lead property adjuster also has a terrific working relationship with our reinsurers. The Trust members have experienced some substantial and unusual claims in recent years. The lead property adjuster has spent many hours negotiating with our members and with the reinsurer. Arizona is a state that is much different from other states when it comes to weather which results in claims from our members. We recently have had some major hail damage and water intrusion claims that were closed for much less than the reinsurer expected. The lead property reinsurer had to explain how flooding in Arizona, which is typically sheet flooding, is much different than flooding in other states. Having a good working relationship with the reinsurer made for much smoother claims resolutions.<sup>137</sup>

In allowing the heightened interaction to avoid 'unnecessary influence' (and to create a good business relationship), are pools, by this very act, allowing some measure of governance? While this official may not characterize it as such, this ongoing monitoring and level of interaction with the reinsurer appears to be a sign of reinsurer governance.

The senior official with the Maryland Association of Boards of Education felt there was little influence in his operation. He notes:

For the run of the mill claims we handle and know the value will not approach the retention, the reinsurer is

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<sup>137</sup> E-mail from senior official, Ashton Tiffany, LLC, to Assistant Dir., TASB, Inc., *supra* note 112.

uninvolved. And the vast number of claims we handle are well below our retentions and therefore do not involve the reinsurers. We handle the claims, determine the coverage and extend authority without reinsurance involvement. The reinsurer only gets involved when the value of the claim makes it reportable to them or the claim meets certain criteria, sometimes for severity.<sup>138</sup>

This official has seen much less influence in claims, indicating little of the interaction mentioned by others.

The current official with AGRiP noted claim audits and recommendations:

On the specific level [regarding claims], in meetings between the pool management and reinsurers, there is often discussion of specific claims, how they were handled, and how similar claims might be better handled in the future. Through reinsurer claim audits, specific recommendations of better staffing or supervisory models might be given. For example, one reinsurer requested that the pool hire a full time litigation manager to oversee the third party administrator and [outside] legal counsel to control litigation costs and improve outcomes. [Or], in the review of the coverage documents, concerns about interpretation of language might arise. One specific example that has come up several times in my experience relates to the determination of the date of loss and number of ‘events’ in situations such as sexual abuse in a school system, which led to clarification of language. Often the reinsurer might recommend things, and the pool may or may not make the change and the reinsurer may or may not continue to write the account.<sup>139</sup>

This official sees specific claim handling input by reinsurers, even staffing requests. As she indicates, the pool might accept the recommendations or

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<sup>138</sup> E-mail from senior official, Md. Ass’n of Bds. of Educ., to Assistant Dir., TASB, Inc., *supra* note 114.

<sup>139</sup> E-mail from current senior official, Ass’n of Governmental Risk Pools (AGRiP), to Assistant Dir., TASB, Inc., *supra* note 120.

might not, but if it does, it seems to be accepting a form of governance in the process.

The former AGRiP senior official gave a response that showed not only the method of influence, the pool's effort in a claims setting towards utmost good faith:

A secondary influence is what [reinsurers] establish as thresholds for reporting claims to them; and how reinsurers influence claims adjustment at the pool level. Reinsurers influence can be limited at times. For example, reinsurers seem to have a hard time understanding why public entity pools are willing to spend more money on defense than [third party] claim payments.<sup>140</sup> I remember years ago [at a previous employer] having a study done of our in-house Oklahoma Municipal Assurance Group<sup>141</sup> litigation management program. The consultants said we were not doing a very effective job because we were spending \$7 for litigation for each \$3 in losses; when it should have been the other way - \$3/\$7. When I asked about how much we spent in total compared to others they replied, 'Oh, about one-third.' I was very pleased that our strategy was working so well.<sup>142</sup>

This official, while acknowledging reinsurers can manipulate claim reporting and how claims are adjusted, also showed that by a pool demonstrating utmost good faith, the influence is lessened. Here, the pool showed their institutional reasoning and success in the defense of claims, and the reinsurer appears to have been accepting, showing utmost good faith in kind. But the governance is still present.

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<sup>140</sup> It is the author's experience this is due to the common interests of pool members. Pools do not want certain types of claims to be settled, no matter how economically feasible because governmental entity settlements are well publicized. Settlements can also cause ripple effects of further litigation against other similarly situated pool members, where members feel there is no liability in a particular situation or members are defending a common policy position, such as dress codes.

<sup>141</sup> The Oklahoma Municipal Assurance Group website is available at <http://www.omag.org> (last visited Dec. 27, 2014).

<sup>142</sup> E-mail from former senior official, AGRiP, to Assistant Dir., TASB, Inc., *supra* note 122.

The underwriter for the Government Entities Mutual, Inc., spoke of claim audits as well:

[W]e determine the effectiveness of a GEM member [pool's] claims operation by assessing [our] claims audit. [W]e correlate the risk to the reinsurance layer to the effectiveness of the claims operation. [In the claims] category, its measure and metric are much more subjective, since all claims operations behave very differently.<sup>143</sup>

The GEM underwriter points out the subjective nature of reinsurance oversight of claim operations. It appears this very subjectivity allows for governance to be asserted and accepted by the pools.

The senior official with the Missouri Housing Authorities Property and Casualty, Inc., noted:

I have not received any reinsurer suggestions on claim procedures, coverage issue handling, or authority . . . these matters are handled in accordance with and subject to the pool's coverage document, which is provided to the reinsurer in advance of its decision to enter into a treaty with the pool.<sup>144</sup>

This appeared to be the least claim influence of those that opined; much less so than the underwriting influence this pool felt.

Due to the subjectivity in the reinsurer oversight of claim operations, reinsurers have more opportunities in claims for governance. Because of the imprecise nature of claim operations—which can vary widely based on claim philosophies, enforcement of those philosophies, experience of the personnel, and workload—reinsurers usually must have a greater hands-on approach when determining the amount of governance to insist upon. As most of the participants indicated, there was a great deal of interaction, which appears to be governance.

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<sup>143</sup> E-mail from reinsurance underwriter, GEM, Inc., to Assistant Dir., TASB, Inc. (April 30, 2013, 11:12 AM CST) (on file with author).

<sup>144</sup> E-mail from senior official, Mo. Hous. Auths. Prop. & Cas., Inc., to Assistant Dir., TASB, Inc., *supra* note 101.

### 3. Finance/Solvency

While not as many comments discussed directly the financial aspect of pooling, or at least not that could be easily unwound from other subjects, the comments given showed finances of the pool and the profitability of the reinsurers as strong motivating factors for reinsurers to assert some form of governance over the pools.

The senior official with the Texas Association of School Boards, Inc., stated:

I also believe that most pools, like any organization, are driven by an inherent desire to survive, so financial viability is a powerful motivator . . . I think reinsurance plays an important part in the financial viability of a pool, but more from a funding and claims protection standpoint than a regulatory standpoint. Although, as stated earlier, reinsurers carry a big stick, so to the extent that they want to impose certain practices by a pool, the pool is likely to comply.<sup>145</sup>

While this official mentions that the important part of a reinsurer's influence is not regulatory in nature, it may only be semantically different. The imposition of certain practices is certainly governance in nature; 'sway' as the Oxford English Dictionary termed it.<sup>146</sup>

The senior official of the Alabama Trust for Boards of Education discussed the reinsurers' interest in the pools' finances:

Because of the obvious financial self-interest, reinsurers are concerned about the financial condition and status of any pool, whether start-up or well-established . . . My personal observations concerning multiple pools of various sizes in multiple states is that, again, due to financial self-interest, re-insurers sometimes have more hands-on involvement and influence in the solvency and success of

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<sup>145</sup> E-mail from senior official, TASB, Inc., to Assistant Dir., TASB, Inc. (April 30, 2013, 9:59 AM CST) (on file with author).

<sup>146</sup> "Governance" definition, *supra* note 2.

public entity pools that any insurance or administrative regulators would have.<sup>147</sup>

As this official obliquely notes, state regulators are concerned about an entity's solvency in an abstract manner. For reinsurers, it is their money and their livelihoods at stake. This greatly increases the incentive to assert influence.

The GEM underwriter also noted reinsurers gaining a greater understanding of pools and an increased interest in writing pools:

Plain and simple: profit. Reinsurers, as any financial institution, [are] looking to make return with their capital. Pools and the risk of public entities have proved profitable. Pools, as an industry, have matured to the point with reinsurers [not being] as skeptical of them as they were at the beginning . . . Perhaps this is indirectly related to the 'suggestions' made by the reinsurers, or just a natural evolution of any industry.

There are new 'shops' set up recently trying to go after pool business. This means it is profitable. This also means that the reinsurance community is becoming more and more enamored of pools . . . [T]here is a comfort level with pools that has grown over time. I would say this is mostly restricted to the domestic marketplace, since on the international scene, most reinsurers are largely unaware of the public entity pooling industry.

Yes, there are strengths and weaknesses of pools just like any other risk. One opinion I have is that the insurance shortage crisis that existed back in the 80's, in which the pools were born,<sup>148</sup> is not likely to return. Insurers and reinsurers are well aware that public sector risk is a good book of business . . . I think this stems from two

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<sup>147</sup> E-mail from senior official, Ala. Trust for Bds. of Educ., to Assistant Dir., TASB, Inc., *supra* note 118.

<sup>148</sup> Due to the insurance crisis, the 1980s saw the greatest expansion of pools, but as discussed above, governmental entity pooling was born in 1974 in Austin, Texas. *See* discussion, *supra* note 18.

components of pools. First, they are mutually owned by public entities, and most of the time are run in the best interest of the actual risk. Second, over the history of pooling, there have been far fewer insolvencies than the commercial insurance industry. As proof, in the last couple of years, there are three new reinsurance shops that have started writing public entity pools around the country. These are private companies who did not formerly write in the space, and it can only be deduced that there is profit to be made.<sup>149</sup>

Based on the underwriter's comments, he believes pools have matured to the point that reinsurers' are interested in this segment of the market, which may be leading to less direct influence, as noted earlier. The more reinsurer competition, the less each reinsurer can assert its direct influence. However, because finances are growing stronger in the pooling industry, the reinsurers have every motivation to keep the pools as efficient as possible. It appears the reinsurers are matching the level of governance influence to individual pools, and the methods can vary as to how they achieve these goals.

Not everyone felt a close pooling-reinsurer relationship in the financial area. The senior official with the Idaho Counties Risk Management Program stated:

For better or worse, I predict pools' relationships with reinsurance . . . markets will continue to be more data driven and less personal. I also believe reinsurers will continue to view pool business more as a market to be in or out of and this will lead to service behaviors more in line with a commodity rather than a personalized financial product priced on the underlying pool's operational competence.<sup>150</sup>

However, it seems clear the reinsurers' approach observed by this official would be less influential—after all, the less engagement,

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<sup>149</sup> E-mails from reinsurance underwriter, GEM, Inc., to Assistant Dir., TASB, Inc., *supra* note 125.

<sup>150</sup> E-mail from senior official, ICRMP, to Assistant Dir., TASB, Inc., *supra* note 116.

the less influence that can be asserted from a distance. If reinsurers were to trend towards less engagement, it would be counter-productive to the overall reinsurance process.

#### 4. General/Miscellaneous

There were a few comments of a more general nature, but enlightening nonetheless.

The senior official with the County Commissioners Association of Pennsylvania said:

Yes, I think this is somewhat natural [that pools are influenced by reinsurers], if pools believe as we do, that reinsurers are partners in our program. There are not a large number of reinsurers interested in public entity exposures, especially some of the more niche coverages like law enforcement (police, jails, probation) and nursing home professional liability. Pools cannot afford to treat reinsurers like they are just another vendor, which can easily be replaced. We expect our members to view our pool as a long-term commitment, and we extend that same philosophy to our reinsurers. We meet with them every year to discuss the renewal, but just as importantly to get their feedback, to find out what is new in the industry.<sup>151</sup>

Note that there is organizational commitment passed through from the member to the pool to the reinsurer. Additionally, this senior official indicates the preference to have reinsurers as partners, rather than as a commodity. Because of their differing roles, a certain amount of influence inevitably occurs when reinsurers have a financial interest in the pools' performances. Much like neighbors looking after each other's houses, there is some inherent interest in making sure all is well.

The underwriter for the Government Entities Mutual, Inc., the reinsurer, indicated:

I don't think it is possible to influence specific behavior of pool employees/third party administrator personnel, but

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<sup>151</sup> E-mail from senior official, Cnty. Comm'rs Ass'n of Pa., to Assistant Dir., TASB, Inc., *supra* note 107.



[reinsurers can influence the] general goals and metrics for the entire company. For instance, we offer a discount on premiums for financial loss ratios being under, say, 100%. There are a number of ways to achieve this, including loss control requirements, claims management procedures, coverage offerings/issues, and/or rate adequacy. So, by offering that carrot, we are incentivizing a steady business model and solvent pools, but how the pool accomplishes that, and with what employees, is their decision.<sup>152</sup>

Again, this is the softer approach that yields potentially broader results by agreement with the pools. But all of his examples are regulatory in nature, even if voluntarily accepted.

As a final note for Part A, the former senior official with AGRiP stated:

As I have observed and worked with pools the past 34 years, I came to the realization that reinsurers do in fact ‘call the shots’ for the vast majority of pools; although a number of pool officials would argue to the contrary. But since most pools assume very little risk they are at the mercy of the reinsurance community when developing coverage terms and rates.<sup>153</sup>

This statement encompasses a great deal of the initial findings for this Part regarding the impact of reinsurers on pools generally, and specifically on their underwriting, claims and finance operations. “Calling the shots”, as this official described it, and the pools’ acceptance of this approach, certainly seems to be reinsurer governance.

In this sub-Part, there were various characterizations by the participants of reinsurers’ influence on pools, mostly in underwriting and claims. However, these interviews, to this author, demonstrate that the governance effect—the behavior changing ability—by reinsurers has been substantively felt among the pooling market. The degree of influence may

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<sup>152</sup> E-mail from reinsurance underwriter, GEM, Inc., to Assistant Dir., TASB, Inc. (May 9, 2013, 3:08 PM CST) (on file with author).

<sup>153</sup> E-mail from former senior official, AGRiP, to Assistant Dir., TASB, Inc., *supra* note 122.

be situational, but seems constant as to most pools. As we will see in this next sub-Part, there is a great deal more consensus as to the core of the relationship, the utmost good faith concept.

#### B. DUTY OF UTMOST GOOD FAITH

A second point, “utmost good faith,” arose from this examination of reinsurer influence. In an era when courts are struggling with the traditional concept of utmost good faith between reinsured and reinsurer, are the parties to reinsurance contracts themselves moving away from the utmost good faith concept of long intertwined relationships built on trust? Are we seeing a move throughout the industry towards an arms-length transaction between two sophisticated parties? Are cedents pushing reinsurers away from simple treaty agreements and towards sophisticated reinsurance agreements?<sup>154</sup> Simply put, are cedents treating reinsurance like a commodity, and moving away from engaging in utmost good faith?

While the term “utmost good faith” was not used in any survey questions, most of the respondents, unprompted, described the transparency, trust and long-term relationships they felt with their current reinsurers, as well as the engagement, education, and assistance they received from their reinsurers—all hallmarks of *uberrima fides*. Utmost good faith still appears to be a vibrant element in pooling. This seems to show that utmost good faith is not only still relevant in this market, but also necessary for the success of the relationship. Additionally, the pools generally had the same high level of transparency and depth with their reinsurers they had with their own members, the same “utmost good faith” in both transactions. While some courts and authors believe that the utmost good faith doctrine in reinsurance has gone past its usefulness,<sup>155</sup> the author’s research with pools indicates the concept of utmost good faith is expanding, and is necessary for both parties to gain from the relationship. Indeed, this advantage goes well beyond financial gain in pooling, for both cedent and reinsurer.

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<sup>154</sup> It seems obvious that reinsurers who suspect their cedents are playing “hide the ball” in violation of the spirit of utmost good faith are later going to take legal steps to *not* follow the fortunes of their cedent.

<sup>155</sup> OSTRAGER & VYSKOCIL, *supra* note 69 at 3-22 (citing Unigard Sec. Ins. Co. v. N. River Ins. Co., 4 F. 3d 1049, 1066, 2d Cir. (1993)). *See also* Thomas, *supra* note 81.

The current senior official of AGRiP said: “Over time, either a good professional relationship of trust and mutual respect emerges, or not, and this influences who does business with who.”<sup>156</sup> Again, while there is reinsurer influence, long-term relationships are what makes this truly beneficial for both parties. This official indicates that if both parties cannot influence the relationship, then perhaps they should not be in business together.

The senior official for the North Carolina School Boards Trust stated:

Another factor that may increase the level of reinsurer influence (which is true in our case) is the length of the reinsurer/pool relationship. We have worked with our current reinsurer for the past six years, and over that timeframe a mutual trust and respect has developed between [the NCSB] Trust staff and reinsurer staff about our programs and processes, as well as reinsurance expectations. Because of the positive working relationship that we have developed, both parties seem interested in helping the other. When we have annual renewal meetings, our reinsurer is very helpful in responding and providing input to our plans for coverage changes and other programmatic changes we might be contemplating, without being too imposing or forcing changes on us. The working relationship has been extremely positive, and even though we initially felt that some of their reporting expectations were a bit onerous, we now have a better understanding of why they require us to report the way we do. Generally, we have found the input from our reinsurer to be helpful, and we try to accommodate them to continue the positive relationship that we have with them. By the same token, I think they try to accommodate us in certain ways because they find the relationship worth the effort.<sup>157</sup>

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<sup>156</sup> E-mail from current senior official, AGRiP, to Assistant Dir., TASB, Inc., *supra* note 120.

<sup>157</sup> E-mail from senior official, N.C. Sch. Bds. Ass’n to Assistant Dir., TASB, Inc., *supra* note 135.

Here, the reinsurer is seen as a valued partner, one with whom there is mutual trust and respect, as well as a source of industry information. This pool came to accept *and understand* the governance exerted by the reinsurer. This realization of understanding the needs of the reinsurer made the pool's acceptance much easier, and led to a better relationship. This greater interaction shows utmost good faith in the flow of information.

The former senior official with AGRiP stated:

[I] have also concluded that most in the reinsurance community who are committed to the long-term success of pools work very hard to appreciate the unique characteristics of public entity exposures and finances. This has developed as a symbiotic relationship, although, in my opinion, reinsurers exert more influence than pool officials generally are willing to concede. In the late 70's and early 80's, I experienced any number of reinsurance business executives who "knew better than the public administrators" as to how to conduct an insurance operation. Perhaps they did, but the public administrators knew how to manage diversity – leading to the long-term success of pooled risk management for public entities, of which the "insurance" is just one component. One of my signature phrases is "public entities cooperating together to manage their risks is what differentiates pooling from traditional insurance."<sup>158</sup>

While mentioning the effect of reinsurer influence again, this is the first mention of the "symbiotic" relationship, a concept that will come up again later. It is this symbiosis that makes this relationship work; requiring utmost good faith, as well as an understanding of each other's business interests.

The senior official with the Maryland Association of School Boards indicated:

We have always thought that providing reinsurers with accurate data on the front-end will make us a pool they can trust and work with. We work very hard to provide them

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<sup>158</sup> E-mail from former senior official, AGRiP, to Assistant. Dir., TASB, Inc., *supra* note 122.

with the data they need, so as to make it easy to write our account.<sup>159</sup>

Again, this official solidifies the notion of trust as being paramount in this relationship.

Transparency, a vital element of utmost good faith, seemed to be very much on the respondents' minds. The underwriter from GEM attributed it to the origin of governmental entity pooling, when asked if pools were more transparent than traditional insurers, from his reinsurance point of view:

Absolutely. The first and obvious reason is that many pools fall under various states' freedom of information acts, while traditional insurers are constantly developing innovative and propriety products to beat their competition. Secondly, although I have only been in pooling for 8 years, it seems the culture of transparency has been around since the beginning. This includes transparency within the membership of each pool, as well as within the pooling community around the country.<sup>160</sup>

It is this transparency that leads to the concept of utmost good faith being not only possible, but embraced.

Transparency was again mentioned by the senior official from the Texas Association of School Boards, Inc. She felt, like others, this transparency began with the basis of pooling, open governments:

I believe most pools started out of a governmental mind-set. They were started either by governmental associations or by government employees. As a result, I think there was an inherent sense of open operations, similar to open government. That awareness that anyone can come in and look at your operations, coupled with a general desire to

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<sup>159</sup> E-mail from senior official, Md. Ass'n of Bds. of Educ., to Assistant Dir., TASB, Inc., *supra* note 114.

<sup>160</sup> E-mail from reinsurance underwriter, GEM, Inc., to Assistant Dir., TASB, Inc. (July 9, 2013, 10:17 AM CST) (on file with author).

‘do good’ resulted in a self-governance mind-set for most pools.<sup>161</sup>

The transparency described is key to utmost good faith thriving—just the knowledge by a reinsurer that the pool has this inherent philosophical outlook builds confidence on the part of the reinsurer.

Probably the most interesting comment on the pool-reinsurer relationship was from the senior official with the Montana School Group Insurance Authority. Perhaps unknowingly, he addressed the doctrine of utmost good faith in his detailed discussion of high-level relationships with reinsurers:

The reinsurers seek what many of the primary pools seek with their members—a long-term relationship with a downstream member (customer) that is willing to listen to the risk and claim management advice of their upstream partner. If all three of the players in the relationship share and deploy best practices with regard to these two disciplines, then the relationship is bound to generate a profitable relationship for all. Having a reinsurer that is willing to get to know the primary pool operations, long-term goals and the management team can go a long way with primary pool reinsurance pricing and willingness to offer needed structural elements to meet the coverage needs. Trust and relationships is as much a part of this level of the business as the raw data sets. Both are important but if you have the trust that your partner will do the right things over the long-term to benefit all parties, many times we can work through some of the years when large claims arise and we get to know our reinsurance partners in a manner closer than sometimes we would like.<sup>162</sup>

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<sup>161</sup> E-mail from senior official, TASB, Inc., to Assistant Dir., TASB, Inc., *supra* note 105.

<sup>162</sup> E-mail from senior official, Mont. Sch. Grp. Ins. Auth., to Assistant Dir., TASB, Inc., *supra* note 132.

This official has embraced the doctrine of utmost good faith, and shown that it has the potential to benefit all, rather than be a burden, as previously indicated by some commentators.

The current AGRiP senior official notes the benefits of this two-way relationship as well:

However, I must note, I likewise know that pools have influenced reinsurers' understanding of, and underwriting requirements for, writing pools. They have had to learn that the pools' mission is to reduce risk, not create underwriting profit, and this has changed reinsurance practices for those who really have a stake in pooling.<sup>163</sup>

This official has seen the broader influence of the utmost good faith effect—an entire section of the market can be better understood by this open communication. This brings more reinsurer interest to pooling, which benefits the pools' members through more reinsurance products and greater competition.

C. HAVE POOLS BECOME MORE ACCOMMODATING TO REINSURERS' INPUT?

A third key finding was regarding whether pools have become more accommodating to reinsurers in the last decade.<sup>164</sup> The general answer was yes. Again, the responses varied, but they leaned towards pools being more accommodating or remaining equally accommodating in the past ten years as the relationships between the two industries matured. There was a true willingness of the pools to open up their operations, not based on just the necessity to obtain reinsurance, but out of a sincere desire to have reinsurers understand their operations *and* missions. This act of openness

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<sup>163</sup> E-mail from current senior official, AGRiP, to Assistant Dir., TASB, Inc., *supra* note 120.

<sup>164</sup> Ten years was used by the author because many officials would not have the experience with any longer period, and any shorter period might not be significant enough, or too subject to market conditions. Additionally, for accuracy (*supra* note 94), the author should have asked the broader question (*see* Apps. A.¶ 2., B.¶ 5., and C.¶ 8): have pools become more *or less* accommodating? However, based on the thoroughness of the responses, there was little indication that pools had recently been less accommodating to the wishes of the reinsurers—only that accommodation had remained constant or increased.

itself is an accommodation, although some officials did not perceive it as such. However, the officials overall wanted their reinsurers to understand they were *not* insurers, but risk management pools. Most participants felt a sense of partnership with reinsurers, cultivated that relationship on a long-term basis and did not feel as though reinsurance was just another commodity.

The senior official from the County Commissioners Association of Pennsylvania answered:

Absolutely [pools are more accommodating]. I think a lot of this is because there are so few [reinsurance] companies to choose from. Once you develop a long-term relationship with a reinsurer, and they know your processes, philosophy and people, you want to be able to continue that relationship. If you have to change reinsurers, you know there will be a large investment of time educating the new reinsurer and working out all the kinks. This is not to say I would remain with a reinsurer if they were overcharging me. Price is important but it is not the be all and end all. We once changed our work comp reinsurer because the pool board was attracted by the shiny objects – a small savings in premium and a two year rate guarantee – and we ended up going back to the reinsurer we left because the shiny objects [reinsurer] did not understand public entities.

[Reinsurer] input is definitely valuable. In pooling we sell the added value of all the pool services, things our members cannot get elsewhere. I expect the same added value from our reinsurers. They provide speakers for our training sessions for our members. They advise us on coverage issues. It is much more than just giving us a reinsurance certificate. And I also think this helps them understand that we are serious about our business and want to do a good job.<sup>165</sup>

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<sup>165</sup> E-mail from senior official, Cnty. Comm'rs Ass'n of Pa., to Assistant Dir., TASB, Inc., *supra* note 107.



Again, we see the same discussion pattern about long-term relationships, and the good faith activity it takes for both parties to get to that comfort level and depth of understanding. But this pool expected some greater accommodation from the reinsurer as well.

The senior official with the Montana School Board Group Insurance Authority indicated for all the reasons he cited as to how reinsurers did have influence, those were the same reasons that pools had become more accommodating in the past ten years.<sup>166</sup> As can be seen, many of these concepts, and the responses to them, can be quite interrelated.

The senior official for the Arizona School Risk Retention Trust, Inc., indicated that the last ten years had not affected the level of accommodation, but attributed that to long-term relationships:

In our case, I would not say we have had to become more accommodating due to reinsurer's input, unless the market absolutely dictated a change was necessary, i.e. higher pricing. The Trust has sought the opinions of our reinsurers for many years because we value their input and in most cases, it has proven to be helpful. With the recent large liability losses our pool has experienced, we were firm in our belief that our reserve numbers were more accurate than what the reinsurers were suggesting. We proved we were correct when the cases settled well below the reinsurers' reserve amounts. This is a factor of our claims staff being more familiar with the local judicial atmosphere and specifically, cases involving our industry (education), than the reinsurers.

Our philosophy and actual demonstration of long-term partnerships makes the Trust attractive to insurers, more so than trying to accommodate reinsurers based on input they provide on how we should operate. One of our reinsurance partners has been with us for over twenty years.

We also believe that if a reinsurance carrier has paid out more in losses than they have received from us in

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<sup>166</sup> This senior official stated, "The answer is yes . . . for the reasons described above." E-mail from senior official, Mont. Sch. Grp. Ins. Auth., to Assistant Dir., TASB, Inc., *supra* note 132.

premium, we will do what we can to remain a partner with that reinsurance carrier so that they are made whole over time. Conversely, due to the recent competitive marketplace with several reinsurers vying for market share, it puts the pool in a powerful position to not necessarily be as accommodating to reinsurer's input, if a particular reinsurer is suggesting unrealistic terms and conditions or rates.<sup>167</sup>

While there was no increased accommodation on his pool's part, it is very clear this was due to an ongoing and developed reinsurer relationship that made further accommodation unnecessary for his pool. Note the willingness to stay with a reinsurer if the reinsurer had sustained losses. This willingness shows a great deal of accommodation—and one that the pool hopes will come back to benefit them. Obviously, it took a great deal of time and effort to get to that point.

Similarly, the senior official with the Maryland Association of School Boards felt that the accommodation level had not increased or decreased:

I do not think that we have become more accommodating over the past 10 years. We have always tried to work together with our reinsurance partners and continue to do that.<sup>168</sup>

Again, there is a commitment from the pool over a period of years. While this does not indicate an increase in accommodation, neither does it appear there a decrease.

The senior official with the Idaho Counties Risk Management Program, however, indicated there was no need to be more accommodating:

We have found our reinsurers being much less demanding than ten years ago so we don't need to accommodate much. I don't know if this experience is true for other

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<sup>167</sup> E-mail from senior official, Ashton Tiffany, LLC, to Assistant Dir., TASB, Inc., *supra* note 112.

<sup>168</sup> E-mail from senior official, Md. Ass'n of Bds. of Educ., to Assistant Dir., TASB, Inc., *supra* note 114.

pools, however, the current reinsurance market seems much less interested in understanding our operations than 10 years ago. I believe reinsurance underwriters today focus more on loss experience and exposure data and less on the personnel and perceived operational competence of the pool than they did a decade ago. Evidence for this is found in the decreasing frequency of personal meetings we have with the markets and the lack of inquiry into anything other than loss runs and exposure data.<sup>169</sup>

This official's experience may be an anomaly, or may be that his pool has run so well that the reinsurer feels no need for greater involvement.

The former senior official with the Washington Schools Risk Management Pool gives his view on accommodation to reinsurers, regardless of their influence:

Pools more accommodating to reinsurers . . . I know we haven't. We left [our previous reinsurer] because they started writing our competition. I told them to choose—us or them, so they chose them and we did not renew. If anything, our current reinsurer . . . has been accommodating to us, seeking our input on head concussion claims, asking what resources they can provide to assist us, and taking part in our annual meetings . . . [As to reinsurers writing our competition,] I view it as an arms dealer who supplies both sides of the war. I do not want my claims/underwriting information leaked out to the other side and I don't trust a vendor who doesn't see a conflict. I also want to maintain a competitive edge, so I want my vendor to give me something the other [pool] can't. The question I've asked myself is, at what point does this become meaningless—do I stop shopping at Wal-Mart just because my competition shops there?<sup>170</sup>

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<sup>169</sup> E-mail from senior official, ICRMP, to Assistant Dir., TASB, Inc., *supra* note 116.

<sup>170</sup> E-mails from former senior official, Wash. Sch. Risk Mgmt. Pool, to Assistant Dir., TASB, Inc., *supra* note 129.

While this official feels that he has limited his accommodation to the point of even terminating a reinsurance relationship, we will see later on that he also strongly believes in the relationship, which may be why he ultimately terminated his reinsurer.

The senior official with the Park District Risk Management Agency did not feel that pools were more accommodating or less accommodating in the last ten years, but felt there was a continued level of accommodation. He stated:

I have only been actively involved in placing the reinsurance for the past 8 years and I haven't seen a significant change in the time frame at PDRMA. I think we have been relatively accommodating/receptive to the reinsurers input and made changes suggested, both because it is useful and because it makes us more attractive to the reinsurers. Two specific examples: Three years ago we undertook a significant project to identify all of the land, including open undeveloped land, that our members own/lease so that we could continue with the pollution coverage we offer to the members. While the program is a commercial insurance policy that we purchase on a group basis with a high deductible, it is similar in concept to reinsurers having influence on the data we collect. We could have continued to procure the coverage without the updated information, but there would have likely been restrictions on the coverage.

Second example is when skate parks became popular in our area about 8-10 years ago, the reinsurers were very concerned that we were going to have large influx of claims from those parks. They wanted specific data on how many parks were in our membership and how the risks were being controlled. The data was easy to collect because we only had a few parks and our loss control staff had been working with the members to develop risk management guidelines so we had what the reinsurers wanted. Fast forward 10 years, there are very few skate park claims and none that have reached the reinsurance

layers so this exposure has become a non-issue and the reinsurers pay little attention to skate parks now.<sup>171</sup>

Here, the PDRMA took the necessary steps required for the reinsurance underwriting, rather than make it a difficult issue for both parties. The cooperation and transparency paid off for the pool in the end. Again, while there is no mention of increased accommodation, it does not appear it has lessened.

The senior official with the North Carolina School Boards Association noted accommodation levels can vary based on circumstances. She said:

I think pools are probably more accommodating of reinsurers input, if they respect their reinsurer. I suppose that in a circumstance where a pool may have no other reinsurance option available, the accommodation of reinsurer input is more out of necessity. Thankfully, that has not been our situation over the last 10 years.<sup>172</sup>

This is another indication of reinsurer long-term relationships being worthwhile for both parties.

A senior official with the Washington State Transit Insurance Pool<sup>173</sup> felt that, because of the growth of pooling, it was the reinsurers that were more accommodating to the pools. He said:

It is more likely that the reinsurers' have moved to accommodate pooling than the other way around. More than 80% of the public entity market is engaged in some pooling relationship. I'm sure the commercial reinsurers realize the significant market pooling is and they need to

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<sup>171</sup> E-mail from senior official, Park Dist. Risk Mgmt. Agency, to Assistant Dir., TASB, Inc., *supra* note 110.

<sup>172</sup> E-mail from senior official, N.C. Sch. Bds. Ass'n, to Assistant Dir., TASB, Inc., *supra* note 135.

<sup>173</sup> The Washington State Transit Insurance Pool website is available at <http://www.wstip.org/default.aspx> (last visited Dec. 27, 2014).

adjust to our process and mindset more than pooling to theirs.<sup>174</sup>

This official's perception, that reinsurers have become more accommodating to pools, is likely true, based on the desire for greater pooling market share discussed previously. However, this did not directly answer if pools, regardless of the reinsurers' positioning, have become more accommodating as well—perhaps a meeting in the middle in this case.

A senior official with the New Hampshire Public Risk Management Exchange<sup>175</sup> discussed less involvement by their reinsurer, but noted their lengthy successful relationship underpinning the views of both parties. This official stated:

Regarding influence, we have not had much involvement by our reinsurer, with whom we have had a long-term relationship. Our reinsurer is looking at our losses from a different lens than we are. . . . [I] think we have had favorable results with our reinsurer from a terms and conditions standpoint, so the influence is minimal, other than when there is a loss that reaches the reinsurance layer. Then our concern is whether we can reach a consensus on the claim with the reinsurer.<sup>176</sup>

Here, it appears the official feels the current need for accommodation has not been at a high level due their favorable results over time.

The AGRiP senior officials, both current and former, had general observations regarding pools being more accommodating in the past ten years. The current senior official stated:

I can't speak for all pools, but the ones I work with certainly have. I believe pools are better served by recognizing that there are partners out there—even for-

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<sup>174</sup> E-mail from senior official, Wash. State Transit Ins. Pool, to Assistant Dir., TASB, Inc. (July 2, 2013, 10:39 AM CST) (on file with author).

<sup>175</sup> The New Hampshire Public Risk Management Exchange website is available at <http://www.nhprimex.org/> (last visited Dec. 27, 2014).

<sup>176</sup> E-mail from senior official, N.H. Pub. Risk Mgmt. Exch., to Assistant Dir., TASB, Inc. (July 2, 11:26 AM CST) (on file with author).

profit reinsurers!—who have expertise to share, along with capital to “rent.” [As for those pools that have not been as accommodating to reinsurers], I believe that some in the pooling industry retain a distrust of for profit ‘vendors’ and the insurance/reinsurance industry, in particular. They have seen [reinsurers] run from the market, withhold claim reimbursements, deny claims, even go under, and the [pool executives] get cynical. Likewise, reinsurers have seen some pools hit them with big claims and [drop their reinsurance coverage] the next year, or [pools] be less than forthcoming and timely with information. There are always examples of bad business practices on both reinsurer and pools’ parts. There are many more examples of excellent, long term partnerships; they just don’t garner as much attention.<sup>177</sup>

In other words, the individual cases of lack of faith are the ones that get discussed, due to lawsuits and lingering bad feelings, but the ongoing and symbiotic relationships do not warrant much discussion individually. She continues:

Yes, I think the influence of all of the service providers/partners vary by pool and individuals employed by the pools and their willingness to engage with their reinsurers as partners. One of the reasons AGRiP seeks to educate pools is so that pools are on a more equal footing with their service providers—reinsurers, actuaries, auditors—because there is much “art” to managing risk and risk financing, and when the pool and the subject matter expert partner as ‘peers’ to solve problems, all are better served. Some pool managers don’t share this perspective; some reinsurance partners don’t embrace it. But, in my experience, pool leaders have overall been evolving toward a more collaborative operating model with their reinsurers (and other partners), and this is a good thing.<sup>178</sup>

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<sup>177</sup> E-mail from current senior official, AGRiP, to Assistant Dir., TASB, Inc., *supra* note 120.

<sup>178</sup> *Id.*

This official notes the necessity for pools' engagement of the reinsurers—to gain a better understanding of the reinsurance process, and to use pool cooperation as leverage for a better reinsurance product. While she mentions being 'peers,' the act of engagement brings the influence of the reinsurer to a greater level. Such an engagement, while done in the spirit of partnership, appears to be concession to governance. This official has seen why accommodations happen, and why they do not.

The former senior official of AGRiP opined about accommodation:

There does not seem to be as much of an adversarial relationship between pool officials and reinsurers as in the first 20 years of pooling. However, some pools have not been as accommodating because they continue to have a bad taste in their mouth due to fraudulent reinsurance schemes they were placed in or because of reinsurer insolvency. Both sides have matured and developed a greater appreciation for their mutually dependent relationships.

[Another reason some pools may not have been as accommodating to reinsurers, and] I realize this is a broad overstatement, but: it seems the greater the influence of elected officials over a pool, the greater the pool considers its importance and wants to operate like a big fish in a small pond. In reality, all pools are small fish in big ponds. The fewer elected officials involved, the more rational the decision-making. But I never SAID this [previously]; just theorized about it.<sup>179</sup>

This official notes why some pools (seemingly in the minority) have *not* been as accommodating, and the reasons seem less than productive. It does appear this official is pointing out both parties must enter into, and continue, the relationship in good faith, act rationally based on their respective positions, and follow through on their commitments.

The reinsurer underwriter with GEM, on recent pooling accommodation, felt that pools continued to mature with the help of

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<sup>179</sup> E-mail from former senior official, AGRiP, to Assistant Dir., TASB, Inc., *supra* note 122.



reinsurers, although some continue to resist. Have pools become more accommodating? The answer, from a reinsurer's standpoint, was:

Yes. I have been actively involved in pooling for eight years and when I first came within the industry, I was amazed at the general naiveté of pools' financial acumen. Some pools were still community rated by non-actuarial practitioners. Some pools felt comfortable reserving until their retention and no more. Some reserved on a stair-stepping basis. These are all simplistic ways to deal with risk transfer, but have become antiquated practices of recent. I can't say it was only reinsurer's influence, but more reinsurers took more pools seriously as their operations become more palatable [to reinsurers].

Some pools remain unfazed (and even annoyed) at reinsurer's 'suggestions.' These fiercely independent pools and pool leaders are clinging on to the purity of pooling back 20-30 years ago. Fortunately for [those particular] pool[s] and [their] members, 20 to 30 years of success permit the incontrovertible argument against fixing something that isn't broken.<sup>180</sup>

Of course, the objective of regulation is to ensure solvency (which can never be guaranteed, regardless of the level or type of regulation), and these 'pure' pools are solvent. They continue to serve their public entity members in the best possible way. And, neither the added cost of government controlled regulation, nor the 'suggestions' of the reinsurers, are changing the level of risk the pool presents to the consumer.<sup>181</sup>

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<sup>180</sup> Of course, lucky is not an excuse for a lack of objectivity and business prudence. As F. Scott Fitzgerald said, "Nothing is as obnoxious as other people's luck." Peggy Hayes, *Letters to Scottie, Letters to Us*, MISCELLANY NEWS, Oct. 2, 1981, at 6.

<sup>181</sup> E-mail from reinsurance underwriter, GEM, Inc., to Assistant Dir., TASB, Inc., *supra* note 149.

This reinsurer seems to feel that the basis for greater accommodation by pools is, through maturation, a greater appreciation by the pools of those benefits the reinsurer can bring.

From the input of the participants documented here, there is general agreement that accommodations do exist, even if there is some dispute about whether it is increasing or not. As the GEM underwriter previously pointed out, reinsurers need to be careful as to the approaches taken pursuing this influence and the desire for pool accommodation, since this market is getting more competitive for reinsurers. It does seem that accommodations appear to be a form of voluntarily accepted reinsurer governance.

D. DOES REINSURER INFLUENCE VARY ACCORDING TO EXTERNAL FACTORS?

Lastly, the evidence showed that reinsurer influence with pools varies, as seen in some of the responses. Financial strength and pool sophistication, two elements often intertwined, were the two greatest factors that determined the level of reinsurer involvement. Did these officials believe reinsurer influence varied based on factors such as financial size or condition, perceived sophistication or experience of the pool administrators, or any other factors? Again, the answers diverged somewhat, but seemed to come back to financial strength of the pool as being the most specific factor. Nevertheless, more interesting was the officials' insistence on speaking to the relationship as the intangible factor that might be the most determinative of all in the debate regarding governance.

First, the senior official with the Texas Association of School Boards, Inc., stated:

I think the influence of the reinsurers varies greatly based on the financial condition, size, age, 'sophistication' and experience of the pool. The smaller, younger, financially weak or more outsourced a pool is, the greater the perceived risk for the reinsurer and the greater their involvement and imposition of certain requirements. For example, I can't remember the last time a reinsurer imposed or even reviewed . . . who [the TASB Risk Management Fund] can write and at what price. That's because we are very well established, have a proven track record and assume a large retention on every risk. So they

tend to leave us alone. However, if we were new, had an unproven track record, weren't as financially solid, the picture would be very different. The reinsurers would impose much greater underwriting and claims oversight than they do for us.<sup>182</sup>

Finances appear to be the pivotal factor as to reinsurer governance, and influence seems to vary based on the relative strength of the pool. Because this pool is very substantial in comparison to its exposures, the reinsurers have fewer concerns or need for influence.

The former senior official with the Washington Schools Risk Management Pool felt that excellent financial condition of the pool lessened influence of the reinsurers:

Influence based on size . . . absolutely; with us self-insuring the first \$1 million and having the surplus to take more if necessary, I think we have more options and flexibility than a small pool with limited surplus and small retention. I think the Texas Association of School Boards has even greater clout with the reinsurance market.<sup>183</sup>

It appears again that, regardless of the perception of reinsurer influence, reinsurers are much more willing to follow the fortunes of a well-managed, financially strong pool using less reinsurer influence.

The senior official with the Maryland Association of Boards of Education had similar sentiments about financial strength, but also sophistication of the administration:

[The] reinsurer would have a lot more confidence dealing with property from a pool that has accurate property values vs. a pool that can only estimate its property values.<sup>184</sup> And a reinsurer is obviously concerned about a pool's

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<sup>182</sup> E-mail from senior official, TASB, Inc., to Assistant Dir., TASB, Inc., *supra* note 105.

<sup>183</sup> E-mail from senior official, Wash. Sch. Risk Mgmt. Pool, to Assistant Dir., TASB, Inc., *supra* note 129.

<sup>184</sup> As the senior official with the Missouri Housing Authorities Property & Casualty, Inc. discovered, and corrected. E-mail from senior official, Mo. Hous. Auths. Prop. & Cas., Inc., to Assistant Dir., TASB, Inc., *supra* note 101.

finances. They obviously would rather write strong well-funded pools than those with inadequate reserves and/or surplus. I spoke with one of our reinsurers who advised me that our program secured great comparative rates because they trusted our submissions knowing our representations of data, claims and resources were accurate and our financial position was strong.<sup>185</sup>

Again, finances, along with trust of the pool's representations, lessened the amount of reinsurance governance necessary. Reinsurers have a larger degree of faith and certainty in pools operating at a high level. This trust comes from the pool's transparency.

The senior official for the Arizona Risk Retention Trust, Inc., said that the factors leading to a well-established pool lessened the influence of the reinsurer:

Yes, the less mature pools may feel they are inexperienced and look to the reinsurer for guidance and advice. The less mature pools may also be less attractive to the reinsurers because of the lack of stability and the financial strength of a more mature pool. The more mature pools may be less influenced by the reinsurer, but may have strong working relationships with them which help keep the pool strong and attractive to other [re]insurers.<sup>186</sup>

This is another example of the inverse relationship between pool strength and reinsurance governance. The stronger the pool, the less the reinsurer is able, or needs to, influence the pool.

The senior official with the Montana School Group Insurance Authority continued on the same theme of reinsurance influence waning as the pools financial strength grew. Can reinsurer influence vary?

Yes again. Size does matter with regard to the primary pool level. The large pools usually have greater depth and put more primary pool effort into the reinsurance

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<sup>185</sup> E-mail from senior official, Md. Ass'n of Bds. of Educ., to Assistant Dir., TASB, Inc., *supra* note 114.

<sup>186</sup> E-mail from senior official, Ashton Tiffany, LLC, to Assistant Dir., TASB, Inc., *supra* note 112.

submission process. While smaller pools rely to a greater extent on the assistance provide by the insurance placement brokerage firm staff for the best items to include [as well as] how to organize the information for the reinsurance carrier. Many brokers will actually ‘pretty up’ the raw data from the smaller primary pool and provide a more organized package or submission for the reinsurance carrier on behalf of their [small pool] client.

[However], the larger pools often . . . need access to certain reinsurance markets because of specialty risks they need to insure such as Tier 1 wind,<sup>187</sup> Flood zone A<sup>188</sup> & V,<sup>189</sup> or just the raw size of their program limit needed. Thus, not just any reinsurance carrier is going to do, so the [reinsurance] influence, although still indirect, is more present than ever given the factor of primary pool size.<sup>190</sup>

This official points out an interesting diminishing returns dilemma for successful pools. If a pool is successful and needs a reinsurer willing to reinsure large amounts, or a pool specializes in a niche market (which many governmental entity pools inherently must), the market for reinsurance products actually decreases. This can result in the increased influence of the remaining reinsurers on such pools; a greater level of governance because of the increased or unusual exposures and limited selection of reinsurers.

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<sup>187</sup> Those coastal areas are prone to windstorms and hurricanes, thus specialized coverage is needed. For example, in Texas these coastal areas are listed in TEX. INS. CODE § 2210.003(4) (West 2009).

<sup>188</sup> Areas subject to inundation by the one-percent-annual-chance flood event generally determined using approximate methodologies. *Zone A*, FED. EMERGENCY MGMT. AGENCY, <http://www.fema.gov/floodplain-management/zone#0> (last visited Dec. 27, 2014).

<sup>189</sup> Areas along coasts subject to inundation by the one-percent-annual-chance of flood event with additional hazards associated with storm-induced waves. *Zone V*, FED. EMERGENCY MGMT. AGENCY, <http://www.fema.gov/national-flood-insurance-program-2/zone-v#0> (last visited Dec. 27, 2014).

<sup>190</sup> E-mail from senior official, Mont. Sch. Grp. Ins. Auth., to Assistant. Dir., TASB, Inc., *supra* note 132.

The senior official with the Idaho Counties Risk Management Program felt that while reinsurers do exert more or less influence based on varying pool factors, other external factors played a role as well:

I do believe reinsurers are influenced [by financial size or condition, perceived sophistication or experience of the pool administrators]. However, reinsurance markets continue to be driven by financial modeling and national and international corporate strategy rather than by personal perception of individual pools. Allianz<sup>191</sup> provided a large and popular property market for pools until three years ago. ICRMP had been a client for 10 years and was extremely profitable. Allianz's corporate strategy was to exit the public entity market place and resulted in a large number of pools changing property markets. Allianz's decision is an example of a global corporation's market strategy taking precedent over the local underwriter's impressions of an individual pool.<sup>192</sup>

This official's experience was that the pooling market was still not large enough to make an overall impression on large reinsurers. However, it appears other reinsurers are taking their place, as the GEM reinsurer underwriter indicated.

The senior official with the County Commissioners Association of Pennsylvania took a more relationship-centric view to the question regarding various factors affecting influence, and this became a trend in the responses:

I think it [is] more about the philosophy of the management of the pool. This includes the [pool's] board but I would say it is as much about the pool's staff. If the pool's staff believes reinsurance is just a mere commodity, then the relationship will be very different and can even be combative. If the relationship is collaborative, even a rough claims issue can be resolved. We did have one bad

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<sup>191</sup> See generally *Property Insurance*, ALLIANZ GLOBAL CORP. & SPECIALTY, <http://www.agcs.allianz.com/services/property/> (last visited Dec. 27, 2014).

<sup>192</sup> E-mail from senior official, ICRMP, to Assistant Dir., TASB, Inc., *supra* note 116.

situation with a reinsurer who abandoned us because of our [then] financial condition (which is much stronger now). They were new to our pool and did not want to invest the time to see if we would turn the finances around.<sup>193</sup>

Notice the term “commodity” arose, as a definite negative to a pool. It is apparent to this official that the more reinsurance is a commodity for a pool, for whatever reason, the less beneficial the relationship is for the pool, and the less good faith is shown by all.

The senior official with the Park District Risk Management Agency noted:

I do think perceived sophistication/experience and financial conditions can influence a reinsurers’ view of a specific pool. The reinsurers regularly review our financials as part of the annual renewal process and they want to know details about any changes. A pool that significantly under prices exposures for the members may create additional risks for the reinsurers.<sup>194</sup>

In other words, if a reinsurer believes a pool is underpricing its coverage, the reinsurer will charge higher premiums or may walk away altogether. Under-pricing exposures is very detrimental to the creation and maintenance of an atmosphere of utmost good faith, and makes it extremely difficult for a reinsurer to willingly follow the fortunes of the pool. More sophisticated pools are better able to price their exposures accurately.

The former senior official of AGRiP had comments that are more general:

Yes, just as with other insurers or in any other business relationship where there are degrees of separation between “size, perceived sophistication [and] experience, financial condition or other factors” between the parties. But reinsurers, as a general proposition, are seeking long-term

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<sup>193</sup> E-mail from senior official, Cnty. Comm’rs Ass’n of Pa., to Assistant Dir., TASB, Inc., *supra* note 107.

<sup>194</sup> E-mail from senior official, Park Dist. Risk Mgmt. Agency, to Assistant Dir., TASB, Inc., *supra* note 110.

financial success, not just one profitable year at the expense of their clients.<sup>195</sup>

This official notes that while all of those factors are important, the reinsurers generally do not want a one-term relationship. It appears this is much like gambling—reinsurers have to win over time; otherwise, they are dependent upon quick strike luck at pools' expense, and will soon run out of willing clients. The relationship aspect matters most, regardless of what factors drive it and how much governance is necessary.

The underwriter from the reinsurer GEM had this to say—and note his use of the term 'symbiotic relationships,' which is mentioned unprompted more than once by various pooling officials:

GEM is in a unique position on this, since we are owned by pools. Our best interest is our pools best interest, and vice versa. I think a reinsurer's influence does vary, somewhat based on the items you list, but also based on the reinsured's acceptance of "advice." Because reinsurance as a regulator is de facto at best, without legal authority or mandatory regulations, the reinsured needs to both accept and value the suggestions made by the reinsurer. This type of trust is built either by mutual interested (such as with GEM), or long-term symbiotic relationships (as with other commercial reinsurers).<sup>196</sup>

This reinsurance underwriter encapsulates much of the theory of this Article—the cedent has no statutory obligation but willingly accepts operational governing parameters to obtain a product. This governance is best appreciated and grown through long-term symbiotic relationships.

The senior official with the Washington State Transit Insurance Pool continued the symbiotic theme, mentioning the need for these solid relationships, regardless of his feelings on influence:

The questions on the relationship of a reinsurer to the conduct of our pool are mutual. Before we would even

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<sup>195</sup> E-mail from former senior official, AGRiP, to Assistant Dir., TASB., Inc. (July 11, 2013, 12:07 PM).

<sup>196</sup> E-mail from reinsurance underwriter, GEM, Inc., to Assistant Dir., TASB, Inc., *supra* note 149.



entertain the prospect of any engagement we'd make sure they know our business, they are comfortable with our best practices and claims handling and final they share our long term vision.

Pooling as a whole is finally beginning to ideologically move from the mindset of a 'country-club attitude' to a small mutual insurance enterprise. Pools relationship to the mutual insurance world is no different than a credit union is to being a bank.

Our business is one of relationships. Pools need to foster a cohesive, professional and mutual understanding with their respective partners including reinsurers, captives and excess markets.<sup>197</sup>

This is another relationship-centric focused comment that indicates the governance is beyond any one factor of reinsurer influence.

The senior official with the New Hampshire Public Risk Management Exchange emphasized reinsurer relationships as well:

As to the relationship between reinsurers and pools, it is critical. It is critical for the reinsurer to know the pool is proactive in risk management and claims mitigation, and that the pool has the appropriate expertise on staff to deal with that. I think there is work by the claim staff that can be done to keep the loss from ever getting into the reinsurance layer, so staff expertise and skill level is important to reinsurers. From the pool's perspective, it is vital the reinsurer understands the unique nature of public entity pooling and the unique exposures that come with that. The relationship has to be symbiotic, as this is important to enable both parties to succeed.<sup>198</sup>

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<sup>197</sup> E-mail from senior official, Wash. State Transit Ins. Pool, to Assistant Dir., TASB, Inc., *supra* note 174.

<sup>198</sup> E-mail from senior official, N.H. Pub. Risk Mgmt. Exch., to Assistant Dir., TASB, Inc., *supra* note 176.

There is striking continuity in this relationship theme. This official feels that symbiosis is critical for success.

The senior official with the North Carolina School Boards Association felt strongly as well about the relationship aspect:

I think it is helpful to have the reinsurer as a resource of information and to use as a guide in deciding which direction a pool might go with certain programs, if the pool respects the reinsurer and its staff. For example, this year we engaged our reinsurer in discussions about how our pool planned to address the issue of law enforcement liability coverage for our members. Of course, a topic such as this has direct implications on the reinsurer, depending on how the coverage is written, and having them involved in the discussion from the beginning was good for everyone. If the mutual respect/positive relationship does not exist between the reinsurer and the pool, then it is difficult to move forward as a team in planning which way a pool program may decide to go.<sup>199</sup>

The senior official with the Missouri Housing Authorities Property and Casualty, Inc., echoed the same sentiments about the pool-reinsurer relationship:

The pool-reinsurer relationship is a valuable and necessary partnership. I believe that good and timely communication, together with consistency in the handling of claims is key to negotiating the optimal arrangement for future years. Relationships matter a lot.<sup>200</sup>

The current senior official with AGRIP felt that reinsurers gaining a greater understanding of pooling was a key factor—but it often depended on the underwriters:

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<sup>199</sup> E-mail from senior official, N.C. Sch. Bds. Ass'n, to Assistant Dir., TASB, Inc., *supra* note 135.

<sup>200</sup> E-mail from senior official, Mo. Hous. Auths. Prop. & Cas., Inc., to Assistant Dir., TASB, Inc., *supra* note 101.

It depends on the individual [underwriter], more than the reinsurance company. Some individual underwriters at reinsurers that have developed a real understanding of pools will tell you they truly prefer pool partners than other insurance companies. They embrace the mission-driven risk control purpose. They appreciate the stability of the pool's book of business. But underwriters with no such experience really don't know there is a difference. I don't mean to sound philosophical, but I truly believe that pooling, done right, is a different animal—a different paradigm—than insurance. There are underwriters that specialize in pools at a variety of reinsurers who 'get this', and sell [their] senior management on this [concept]. But, that doesn't mean the reinsurance company as a whole prefers pools to insurers; they are just two separate client groups.<sup>201</sup>

Much like the operation of GEM, which is a reinsurer owned by its member pools, the senior official with the County Commissioners Association of Pennsylvania mentioned his own captive reinsurer,<sup>202</sup> a system that creates and encourages the long-standing relationships:

We are members of one of our reinsurers – County Reinsurance Limited (CRL). Two of our pools work with CRL for coverage (work comp and liability). CRL is a Vermont based captive owned by the county pools, which are reinsured by it. This is the next step in pooling, gaining greater control and specificity of knowledge about our exposures. This is working exceedingly well for us.<sup>203</sup>

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<sup>201</sup> E-mail from current senior official, AGRiP, to Assistant Dir., TASB, Inc., *supra* note 120.

<sup>202</sup> See generally Donald J. Riggin, *Things to Know about Captive Insurance Companies*, INT'L RISK MGMT. INST., RISK & INS. (Nov. 2008), <http://www.irmi.com/expert/articles/2008/riggin11-risk-finance-captives.aspx>.

<sup>203</sup> E-mail from senior official, Cnty. Comm'rs Ass'n of Pa., to Assistant Dir., TASB, Inc., *supra* note 107.

While the senior official with the Maryland Association of School Boards previously mentioned he did not feel there was much in the way of influence by reinsurers, he felt the relationship aspect was necessary:

[F]or us, working with reinsurers is just like working with other vendors. Trust, transparency and diligence go a long way to creating a positive mutually beneficial relationship.<sup>204</sup>

The senior official with the New Hampshire Public Risk Management Exchange probably capped this discussion most succinctly:

We need reinsurance. We need that level of protection. Its whether or not the reinsurers will see the opportunity, with what is happening in the market, to stay competitive with small to medium sized risks, like pools.<sup>205</sup>

Towards the end in this last sub-Part, the officials' thoughts were left without this author's comment, as they seemed to speak for themselves. As can be seen, even though the question presented to the officials involved factors that might vary influence (and thus governance), most redirected back to, and passionately argued for, the need for symbiotic relationships over the long-term. Without these close relationships, it appears, reinsurers would have no influence (other than purely contractual) for governance to protect their exposures, and pools would have little incentive to accommodate the reinsurers.

## V. CONCLUSION

Based on this research, it seems clear there is a form of reinsurance influence or 'governance,' in the largely unregulated world of self-insured pools, and it seems to manifest itself mostly in underwriting and claim reinsurer influence. Rather than state regulation, which takes the all too familiar form of statutes, administrative regulations, and litigation, this 'governance' imposed by reinsurers is centered on relationships and the

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<sup>204</sup> E-mail from senior official, Md. Ass'n of Bds. of Educ., to Assistant Dir., TASB, Inc., *supra* note 114.

<sup>205</sup> E-mail from senior official, N.H. Pub. Risk Mgmt. Exch., to Assistant Dir., TASB, Inc., *supra* note 176.

business needs of both parties. Pools are free to unburden themselves from any oversight or influence by reinsurers, and reinsurers are free to not accept pools' risks. Nevertheless, in both doing so, pools lose the opportunity to rent capital to expand their market share or limit risk, and reinsurers lose premium dollars and their own market share.

While some pools feel reinsurers have no real impact, and perhaps some reinsurers might feel they have great control, the reality for both lies more towards the middle. Depending on the pool, the advantage is more likely towards the reinsurer, or, when dealing with experienced and well-funded pools, perhaps more towards equilibrium. Reinsurers currently do not conduct business with pools with a stick, but a carrot—the promise of lower rates and/or more favorable terms if the pools concede to certain reinsurer input or improve transparency. Thus, as many above have put it, the reinsurer is essentially *given* influence on the process by the pools. All pools want lower reinsurance rates to help lower the overall cost to their members. In order to obtain this benefit, the pools willingly accept reinsurer's governance to gain the advantages possible in the relationship.

Moreover, by pools *giving* this influence to their long-term partner reinsurers, this author argues the governance effect is not necessarily 'silent' as Professor Abramovsky labels it, at least in the pooling segment, but an open and recognized influence. Because this concept of 'agreed-upon governance' between cedents and reinsurers is a fairly new one, or at least not well documented, it may be that more pools and reinsurers will have different perspectives on the relationship as time goes on. Even the term 'influence' seems to mean different things to these diverse entities. What one pool views as ordinary underwriting requests by reinsurers might be viewed by another pool as overreaching and burdensome, much in the way some people have varying views of taxation.

However, it appears from this research there is a reinsurer 'governance effect' on pools in this relationship. Since the behavior of the pool changes based on the relationship, the degree of adjustment does not matter for the effect to cross the line into apparent governance, however mild. While there may be a contractual agreement in place among the parties, that cannot change the fact that, if reinsurance was always available and at a set price, pools would likely not alter their behavior, unless forced to do so by other internal or market conditions. Since the majority of pooling officials noted underwriting and claims accommodations, it certainly appears they agree that a form of governance is present, whether they wish to characterize it that way themselves or not.

Therefore, even if pools would prefer not to call it 'regulation' as it makes them think of state administrative regulation and all its negative

implications, this governance effect, even if very subtle compared to state regulation, is there. Reinsurers do shape the approach, to varying degrees, of how most pools operate.

This reinsurance influence does not have to be antagonistic, and as most survey participants agreed, is not. As the pooling officials admitted, they willingly agreed on some issues or bore the expense of more transparency since it helped them run a better business and gain the financial and marketing advantages of reinsurance. The opportunity of reinsurance gives the pools the flexibility to write new markets or expand current ones, limit risk and gain market knowledge—opportunities that might not have otherwise arisen had the pool not engaged in the reinsurance process.

The more interesting finding was the utmost good faith aspect that almost seemed inherent with this segment of the market. While other sectors of reinsurance may indeed be moving away from this concept and focusing on arms-length transactions, pooling seems to be going the opposite direction by embracing the relationship. From this admittedly small sample of the approximately 500 pools currently operating in the United States, it appears that, rather than becoming a commodity to each other, reinsurers and pools are engaging the strengths of each and forging long-term business bonds.

This adherence to the concept of utmost good faith through symbiotic relationships appears to arise inherently here, and, to this author, is the more important finding. This research did not set out to show whether utmost good faith was still abundant; however, the discovery of this is a satisfying underpinning to the main point of reinsurer influence. Does reinsurer governance arise because the concept of utmost good faith is adhered to by the pools, or does inherent reinsurer influence force the concept of utmost good faith onto the pools? In the end, it is neither. Pools *allow* the reinsurer to have influence to the extent necessary in order to obtain the best product and service possible for their members, and pools embrace utmost good faith because it is the most efficient route to that end in the long term.

Based on this research, these industry professionals outline the influence of reinsurers on pools, and the governance that arises from this influence. This regulatory influence, hypothesized by Professor Abramovsky, is demonstrated by this research. This reinsurer governance, whether characterized as direct or indirect, or regulatory or not in nature, is governance ('sway', as the governance definition also called it) accepted by the pools. This acceptance, shown in the form of utmost good faith by the pools, results in utmost good faith being returned by the reinsurers. These interdependent experiences strengthen the relationship, and the prospects, for both cedent and reinsurer, and are possible because of reinsurer governance.

## VI. APPENDICES

### A. INITIAL QUESTIONS TO POOL OFFICIALS

1. Do you think pools are influenced by reinsurers? If so, does this influence get into operational level matters affecting employees' conduct, such as reinsurer suggestions on claim procedures, coverage issue handling, or authority—can you give any specific examples? If it is general influence rather than specific, such as what coverages to offer or underwriting criteria, can you give examples of that?

2. Do you think pools have become more accommodating in the past 10 years to reinsurers' input, either because the input is helpful or because it is necessary to make the pool more attractive to insurers? Or for any other reason?

3. Do you think reinsurers' influence on individual pools can vary based on factors such as the size of the pool, perceived sophistication/experience, financial condition or other factors?

4. Any other comments about the pool—reinsurer relationship from your experience?

### B. INITIAL QUESTIONS TO AGRIP OFFICIALS

Assuming that reinsurance is a vital component of most pools' financial viability:

1. Do you believe pools have practices or operational procedures in place as a result of suggestions or requirements from reinsurers? Or, in other words, do you think pools believe they are directly or indirectly "regulated" in a fashion or largely influenced by their reinsurers' underwriting and examination of their operations?

2. If not, do you think pools believe their inherent financial viability requires them to focus on internal procedures (or to self-regulate without insurance department oversight), or is it more about their fiduciary and contractual obligations to members, rather than the influence of reinsurance? Or is it another reason?

3. As to the type of reinsurance typically taken out by pools, do you see most pools taking out treaty reinsurance or facultative reinsurance? More importantly, do you think most pools take out excess of loss reinsurance versus proportional reinsurance? I have a feeling pools are generally like the TASB Fund, with treaty reinsurance/excess of loss reinsurance.

4. I am very interested in your thoughts into those examples of pools attempting to be more attractive to reinsurers, and the subtle influence of reinsurers suggestions, regarding loss control requirements, claim management procedures and coverage issues. Specifically, I am interested in how reinsurers' input affects the actual conduct of pool/TPA personnel. I am trying to nail down if reinsurers give general input, or does it tend to be more specific on the operational level? Additionally, what kinds of examples have you seen as it relates to claim management or coverage issues? Did reinsurers make suggestions generally about claim management focus, or was it more specific as to daily operations, structure, caseloads, or authority? As to coverage, were the suggestions more general in nature, such as types of coverage offered, or more specific/operational, such as suggestions on coverage question investigations or coverage decisions? Any examples of reinsurer influence you can give me that affect a large number of pools would be helpful.

5. Do you feel that pools have generally become more accommodating in the past decade to reinsurers input, either because the input is helpful or because of the attempt to make the pool attractive to reinsurers?

6. For any pools that have not been as accommodating, do you have any thoughts as to why, and do you think these pools are limiting their ability to grow (with the lack of capacity/capital)?

7. Do you think reinsurers currently feel more of a partnership with pools versus insurers, or is it just different?

#### C. QUESTIONS TO REINSURANCE UNDERWRITER

1. Do you believe pools have practices or operational procedures in place as a result of suggestions or requirements from reinsurers? Or, in other words, do you think pools are directly or indirectly "regulated" in a fashion or largely influenced by their reinsurers' underwriting and examination of their operations?

2. Do reinsurers believe they directly or indirectly regulate or largely influence pools' behavior through underwriting and operations reviews, more so than standard primary carriers?

3. If so, do reinsurers believe this influence is necessary because of the limited regulation or unregulated nature of pools? And is it more about pools' financial stability or operational ability, or other factors?

4. If not, do reinsurers just feel pools are a risk like any other carrier, with inherent strengths and weaknesses?



5. Overall, do reinsurers support pools' efforts to remain outside of governmental regulation, and why?

6. As to the type of reinsurance typically taken out by pools, do you see most pools taking out treaty reinsurance or facultative reinsurance? More importantly, do you think most pools take out excess-of-loss reinsurance versus proportional reinsurance? I have a feeling pools are generally like the TASB Fund, with treaty reinsurance/excess of loss reinsurance.

7. I am very interested in your thoughts into those examples of indirect influence on pools by reinsurers' suggestions. Some areas of influence might be loss control requirements, claim management procedures and coverage offerings/issues. Specifically, I am interested in how reinsurers input affects the actual conduct of pool/TPA personnel. I am trying to nail down if reinsurers give general input, or does it tend to be more specific on the operational level? Can you give me examples of how reinsurers have tried to affect pools' behavior? Any examples of influence that affects the majority of pools would be helpful.

8. Do you feel that pools have generally become more accommodating in the past decade to reinsurers input, either because the input is helpful or because of the attempt to make the pool attractive to reinsurers?

9. For any pools that have not been as accommodating, do you have any thoughts as to why, and do you think these pools are limiting their ability to grow (with the lack of capacity/capital)? Or less accommodating because reinsurers are more interested lately in the public entity pooling market, and pools don't have to work as hard to find reinsurance?

10. As reinsurers gain a greater understanding of pools—reduction of risk versus underwriting profit—do you think reinsurers currently feel more of a partnership with pools versus insurers, or is it just different?

11. Why do you believe there has been renewed interest by reinsurers in writing pools?

## D. SAMPLE INTERLOCAL PARTICIPATION AGREEMENT

**TASB RISK MANAGEMENT FUND  
INTERLOCAL PARTICIPATION AGREEMENT**

Pursuant to the Texas Interlocal Cooperation Act, Chapter 791 of the Texas Government Code, this Interlocal Participation Agreement (Agreement) is entered into by and between the Texas Association of School Boards Risk Management Fund (Fund) and the undersigned local government of the State of Texas (Fund Member). The Fund is an administrative agency of local governments (Fund Members) that cooperate in performing administrative services and governmental functions relative to risk management.

**TERMS AND CONDITIONS**

In consideration of the mutual covenants and conditions contained in this Agreement and other good and valuable consideration, including, without limitation, the agreement of the Fund and Fund Members to provide risk management programs as detailed in this Agreement, the receipt and sufficiency of which are hereby acknowledged, Fund Member and the Fund, intending to be legally bound, and subject to the terms, conditions, and provisions of this Agreement, agree as follows:

1. **Authority.** Fund Member hereby approves and adopts the Restatement of Interlocal Agreement, dated May 20, 1997, which restated the Interlocal Agreement dated July 2, 1974, establishing the predecessor of the Fund. The Restatement of Interlocal Agreement is incorporated into this Agreement by reference and is available from the Fund upon request. This Agreement serves to outline the relationship between the Fund and Fund Member. While the Texas Interlocal Cooperation Act provides the overarching basis for the Fund, certain Fund programs are further authorized pursuant to various statutes, such as Chapter 205 of the Texas Labor Code, pertaining to unemployment compensation; Chapter 504 of the Texas Labor Code, pertaining to workers' compensation; and Chapter 2259,

Subchapter B, of the Texas Government Code, pertaining to other risks or hazards.

2. **Program Participation.** This Agreement enables Fund Member to participate in one or more of the Fund's available programs, including but not limited to, property, liability, auto, workers' compensation, and unemployment compensation coverage. Because this is an enabling Agreement, Fund Member must also execute a separate Contribution and Coverage Summary (CCS) for each Fund program from which it seeks coverage and/or administrative services. Only a valid CCS will confer the right to participate in a specific program and each CCS shall be incorporated into this Agreement. Through participation in any Fund program, Fund Member waives none of its immunities and authorizes the Fund, or its designee, to assert such immunities on its behalf and on behalf of the Fund or its designee.
3. **Term of Agreement.** This Agreement shall be effective from the date of the last signature below and shall remain in effect unless terminated as provided in this Agreement. This Agreement will automatically terminate if Fund Member ceases to participate in at least one of the Fund's programs (due to the expiration of a CCS participation term or the valid termination of same) or fails to meet the membership qualifications of the Fund as provided in this Agreement and as determined by the Fund in writing.
4. **Termination.** Unless this Agreement is automatically terminated as described above, this Agreement, and/or any component CCS applicable to Fund Member, can be terminated as set forth below. However, the termination of any single Fund program under a CCS shall not also result in the automatic termination of another pending CCS, or this enabling Agreement if any other CCS is still in force for Fund Member. Rather, each Fund program can only be terminated as provided in this Agreement.

- a. **By Either Party with 30 Days Notice before Renewal.**  
Any CCS may be terminated by either party with termination to be effective on any successive renewal date by giving written notice to the other party no later than 30 days prior to automatic renewal.
- b. **By Fund Member upon Payment of Late Notice Fee.** If Fund Member fails to terminate a CCS as provided above, it may still terminate participation in any Fund program prior to the renewal date by paying a late notice fee as herein provided. If Fund Member terminates the CCS before the renewal date, but with fewer than 30 days' advance written notice, Fund Member agrees to pay the Fund a late notice fee in the amount of 25% of the annual contribution for the expiring participation term. Fund Member expressly acknowledges that the late notice fee is not a penalty, but a reasonable approximation of the Fund's damages for the Fund Member's untimely withdrawal from the program identified in the CCS. However, once the renewal term of a CCS commences, Fund Member can no longer terminate the CCS by paying a late notice fee; the CCS shall renew and Fund Member shall be bound thereby.
- c. **By the Fund upon Breach by Fund Member.**
  - 1) The Fund may terminate this Agreement or any CCS based on breach of any of the following obligations, by giving 10 days' written notice to Fund Member of the breach; and Fund Member's failure to cure the breach within said 10 days (or other time period allowed by the Fund):
  - 2) Fund Member fails or refuses to make the payments or contributions required by this Agreement;

- 3) Fund Member fails to cooperate and comply with any reasonable requests for information and/or records made by the Fund;
- 4) Fund Member fails or refuses to follow loss prevention or statutory compliance requirements of the Fund, as provided in this Agreement; or
- 5) Fund Member otherwise breaches this Agreement.

If the Fund terminates this Agreement, or any CCS, based on breach as described above, Fund Member agrees that the Fund will have no responsibility of any kind or nature to provide coverage on the terminated Fund program post-termination. Further, Fund Member shall bear the full financial responsibility for any unpaid open claim and expense related to any claim, asserted or unasserted and reported or unreported, against the Fund or Fund Member, or incurred by the agents or representatives of Fund Member.

In addition to the foregoing, if termination is due to Fund Member's failure to make required payments or contributions, Fund Member agrees that it shall pay the Fund liquidated damages in the amount of 50% of the annual contribution for the participation term identified in the terminated CCS.

## 5. Contributions.

- a. **Agreement to Pay.** Fund Member agrees to pay its contribution for each Fund program in which it participates based on a plan developed by the Fund. The amount of contribution will be stated in the relevant CCS and will be payable upon receipt of an invoice from the Fund. Late fees amounting to the maximum interest allowed by law, but not less than the rate of interest authorized under Chapter 2251, Texas Government Code, shall begin to accrue daily on the first day following the

due date and continue until the contribution and late fees are paid in full. If Fund Member owes the Fund payments under this Agreement, including any CCS, the Fund may offset such amounts from any Fund Member funds held by the Fund, regardless of program.

- b. **Estimated Contribution.** In specified situations, the amount of contribution shown in the CCS will be identified as an estimate. The Fund reserves the right to request an audit of updated exposure information at the end of the CCS participation term and adjust contributions if Fund Member's exposure changes during the CCS participation term. As a result of the exposure review, any additional contribution payable to the Fund shall be paid by Fund Member, and any overpayment of contribution by Fund Member shall be returned by the Fund. The Fund reserves the right to audit the relevant records of Fund Member in order to conduct this exposure review.

Upon expiration of each participation period, Fund Member may request a contribution adjustment due to exposure changes. Such request must be made in writing within 60 days after the end of the participation period. Fund Member must provide documentation as requested by the Fund to demonstrate that the exposure change warrants a contribution adjustment.

- c. **Contribution Adjustment.** Should the Fund's underwriting income for any program within a given program year be inadequate to pay the ultimate cost of claims incurred for that year, the Fund may collect an adjusted contribution from any current or former Fund Member if that Fund Member's contribution is inadequate to pay the Fund Member's claims incurred during that year.

6. **Contribution and Coverage Summary.** Fund Member agrees to abide by each CCS that governs its participation. A CCS will incorporate the program specific coverage document, if any, which sets forth the scope of coverage and/or services from the Fund. A CCS for a Fund program will state the participation term. After Fund Member's initial execution of a CCS, the CCS will automatically renew annually, unless terminated in accordance with this Agreement. Any renewal containing a change in the amount of contribution or other terms will be subject to the Amendment by Notice process described in this Agreement.
7. **Loss Prevention.** The Fund may provide loss prevention services to Fund Member. Fund Member agrees to adopt the Fund's reasonable and customary standards for loss prevention and to cooperate in implementing any and all reasonable loss prevention and statutory compliance recommendations or requirements.
8. **Other Duties of Fund Member.**
  - a. **Standards of Performance.** Time shall be of the essence in Fund Member's reporting of any and all claims to the Fund, payment of any contributions or monies due to the Fund, and delivery of any written notices under this Agreement.
  - b. **Claims Reporting.** Notice of any claim must be provided to the Fund no more than 30 days after Fund Member knows or should have known of the claim or circumstances leading to the claim, unless a different reporting requirement is required by law or provided for in the CCS. Failure by Fund Member to timely report a claim may result in denial of coverage or payment of fines or penalties imposed by law or regulatory agencies. If the Fund advances payment of any fine or penalty

arising from Fund Member's late claim reporting, Fund Member will reimburse the Fund for all such costs.

9. **Administration of Claims.** The Fund or its designee agrees to administer all claims for which Fund Member has coverage after Fund Member provides timely written notice to the Fund. Fund Member hereby authorizes the Fund or its designee to act in all matters pertaining to handling of claims for which Fund Member has coverage pursuant to this Agreement. Fund Member expressly agrees that the Fund has sole authority in all matters pertaining to the administration of claims and grants the Fund or its designee full decision-making authority in all matters, including without limitation, discussions with claimants and their attorneys or other duly authorized representatives. Fund Member further agrees to be fully cooperative in supplying any information reasonably requested by the Fund in the handling of claims. All decisions on individual claims shall be made by the Fund or its designee, including, without limitation, decisions concerning claim values, payment due on the claim, settlement, subrogation, litigation, or appeals.
10. **Excess Coverage/Reinsurance.** The Fund, in its sole discretion, may purchase excess coverage or reinsurance for any or all Fund programs. In the event of a substantial change in terms or cost of such coverage, the Fund reserves the right to make adjustments to the terms and conditions of a CCS as allowed by the Amendment by Notice process under this Agreement. If any reinsurer, stop loss carrier, and/or excess coverage provider fails to meet its obligations to the Fund or any Fund Member, the Fund is not responsible for any payment or any obligations to Fund Member from any reinsurer, stop loss carrier, or excess coverage provider.
11. **Subrogation and Assignment of Rights.** Fund Member, on its own behalf and on behalf of any person entitled to benefits under this Agreement, assigns all subrogation rights to the



Fund. The Fund has the right, in its sole discretion, without notice to Fund Member, to bring all claims and lawsuits in the name of Fund Member or the Fund. Fund Member agrees that all subrogation rights and recoveries belong first to the Fund, up to the amount of benefits, expenses, and attorneys' fees incurred by the Fund, with the balance, if any, being paid to Fund Member, unless otherwise specifically stated in the Agreement. Award of funds to any person entitled to coverage, whether by judgment or settlement, shall be conclusive proof that the injured party has been made whole. Fund Member's right to be made whole is expressly superseded by the Fund's subrogation rights. If Fund Member procures alternate coverage for a risk covered by the Fund, the latter acquired coverage shall be deemed primary coverage concerning that risk.

12. **No Waiver of Subrogation Rights.** Fund Member shall do nothing to prejudice or waive the Fund's existing or prospective subrogation rights under this Agreement. If Fund Member has waived any subrogation right without first obtaining the Fund's written approval, the Fund shall be entitled to recover from Fund Member any sums that it would have been able to recover absent such waiver. Recoverable amounts include attorneys' fees, costs, and expenses.
13. **Appeals.** Fund Member shall have the right to appeal any written decision or recommendation to the Fund's Board of Trustees, and the Board's determination will be final. Any appeal shall be made in writing to the Board Chair within 30 days of the decision or recommendation.
14. **Bylaws, Policies, and Procedures.** Fund Member agrees to abide by the Bylaws of the Fund, as they may be amended from time to time, and any and all written policies and procedures established by the Fund (which are available from the Fund upon written request). If a change is made to the Fund's Bylaws, written policies or procedures which conflicts with or

impairs a CCS, such change will not apply to Fund Member until the renewal of such CCS, unless Fund Member specifically agrees otherwise.

15. **Payments.** Fund Member represents and warrants that all payments required under this Agreement of Fund Member shall be made from its available current revenues.
16. **Cooperation and Access.** Fund Member agrees to cooperate and to comply in a timely manner with all reasonable requests for information and/or records made by the Fund. Fund Member further agrees to provide complete and accurate statements of material facts, to not misrepresent or omit such facts, engage in fraudulent conduct or make false statements to the Fund. The Fund reserves the right to audit the relevant records of Fund Member to determine compliance with this Agreement.
17. **Fund Member's Designation of Coordinator.** Fund Member agrees to designate a coordinator (Program Coordinator) for Fund Member on this Agreement or any CCS executed by Fund Member. Fund Member's Program Coordinator shall have express authority to represent and to bind Fund Member, and the Fund will not be required to contact any other individual regarding matters arising from or related to this Agreement. Fund Member reserves the right to change its Program Coordinator as needed, by giving written notice to the Fund; such notice is not effective until actually received by the Fund. Notice provided to the Chief Executive Officer of Fund Member shall also serve as notice to the Program Coordinator.
18. **Security of Documents.** Under this agreement the Fund may grant Fund Member access to sensitive or protected information. Fund Member agrees to assume the responsibility for maintaining the security of this information and to take all reasonable steps to avoid unauthorized disclosure of this information.

19. **Insurance Terminology.** The Fund is not “insurance”, but is instead a mechanism through which eligible governmental entities join together to collectively self-insure and administer certain risk exposures. Any reference in this Agreement to an insurance term or concept is coincidental, is not intended to characterize the Fund as “insurance” as defined by law, shall be deemed to apply to self-insurance, and is not to be construed as being contrary to the self-insurance concept.
20. **Representation.** Fund Member authorizes the Fund to represent Fund Member in any lawsuit, dispute, or proceeding arising under or relating to any Fund program and/or coverage in which Fund Member participates. The Fund may exercise this right in its sole discretion and to the fullest extent permitted or authorized by law. Fund Member shall fully cooperate with the Fund, its designee, and the Fund’s chosen counsel, including, without limitation, supplying any information necessary or relevant to the lawsuit, dispute, or proceeding in a timely fashion. Subject to specific revocation, Fund Member designates the Fund to act as a class representative on its behalf in matters arising out of this Agreement.
21. **Members’ Equity.** The Fund Board, in its sole discretion, may declare a distribution of the Fund’s members’ equity to Fund Members. Members’ equity belongs to the Fund. No individual Fund Member is entitled to an individual allocation or portion of members’ equity.
22. **Entire Agreement.** This Agreement, together with the Restated Interlocal Agreement, Bylaws and CCSs that are in effect as to Fund Member from time to time, represent and contain the complete understanding and agreement of the Fund and Fund Member, and there are no representations, agreements, arrangements, or undertakings, oral or written, between the Fund and Fund Member other than those set forth

in this Agreement duly executed in writing. In the event of conflict between the terms of this Agreement and the Restated Interlocal Agreement, Bylaws or any CCS, the specific terms of the later adopted agreement shall prevail to the extent necessary to resolve the conflict. This Agreement replaces all previous Interlocal Participation Agreements between the Fund and Fund Member. Notwithstanding the foregoing, this Agreement does not supersede any unexpired participation term or pending claim under an existing agreement between Fund Member and Fund.

23. **Amendment by Notice.** This Agreement, including any of its component CCSs or coverage documents, may be amended by the Fund, in writing, by providing Fund Member with written notice before the earlier of (i) the effective date of the amendment or (ii) the date by which Fund Member can terminate without payment of late notice fees or liquidated damages. Unless this Agreement expressly provides otherwise, an amendment shall only apply prospectively and Fund Member shall have the right to terminate this Agreement, or a component CCS to which the amendment applies, before the amendment becomes effective, as provided in this Agreement. If Fund Member fails to give the Fund timely written notice of termination, Fund Member shall be deemed to have consented to the Fund's amendment and agrees to abide by and be bound by the amendment, without necessity of obtaining Fund Member's signature.

The Fund may amend this Agreement or any CCS effective upon renewal. Amendments may be for any reason including changes to the terms or contribution amount.

The Fund may also amend this Agreement or any CCS, effective during the term of a CCS, for any reason including but not limited to the following:

- a. State or federal governments, including any court, regulatory body or agency thereof, adopt a statute, rule, decision, or take any action that would substantially impact the rights or financial obligations of the Fund as it pertains to this Agreement, or any Fund program or CCS.
- b. The terms of the Fund's stop-loss or excess coverage or reinsurance change substantially.

If the Fund exercises the option to amend the Agreement or any CCS during the term of a CCS and prior to renewal, the Fund shall give Fund Member 30 days advance written notice. Fund Member will then have the right during the 30-day period to give the Fund written notice of termination of the applicable Fund program, effective upon the expiration of the 30-day notice period (or longer period if so provided by the Fund in writing).

24. **Severability; Interpretation.** If any portion of this Agreement shall be declared illegal or held unenforceable for any reason, the remaining portions shall continue in full force and effect. Any questions of particular interpretation shall not be interpreted against the drafter of this Agreement, but rather in accordance with the fair meaning thereof.
25. **Governing Law; Venue; Attorneys' Fees.** This Agreement shall be governed by and construed in accordance with the laws of the State of Texas, without regard to the conflicts of law principles of such state. Venue for the adjudication or resolution of any dispute arising out of or relating to this Agreement shall lie in Travis County, Texas, unless otherwise mandated by law. In the event of a lawsuit or formal adjudication between Fund Member and the Fund, the prevailing party is entitled to recover reasonable and necessary attorneys' fees that are equitable and just.
26. **Waiver.** No provision of this Agreement will be deemed waived by either party unless expressly waived in writing by

the waiving party. No waiver shall be implied by delay or any other act or omission. No waiver by either party of any provision of this Agreement shall be deemed a waiver of such provision with respect to any subsequent matter relating to such provision.

27. **Assignment.** This Agreement or any duties or obligations imposed by this Agreement shall not be assignable by Fund Member without the prior written consent of the Fund.
28. **Authorization.** By the execution of this Agreement, the undersigned individuals warrant that they have been authorized by all requisite governance action to enter into and to perform the terms and conditions of this Agreement.
29. **Notice.** Unless expressly stated otherwise in this Agreement, any notice required or provided under this Agreement by either party to the other party shall be in writing and shall be sent by first class mail, postage prepaid or by a carrier for overnight service or by electronic means typically used in commerce. Notice to the Fund shall be sufficient if made or addressed as follows: TASB Risk Management Fund, P.O. Box 301, Austin, Texas 78767-0301, or [tasbrmf@tasbrmf.org](mailto:tasbrmf@tasbrmf.org). Notice to a Fund Member shall be sufficient if addressed to the Program Coordinator or Fund Member's Chief Executive Officer and mailed to Fund Member's physical or electronic address of record on file with the Fund.
30. **Signatures/Counterparts.** The failure of a party to provide an original, manually executed signature to the other party shall not affect the validity or enforceability of this Agreement. Either party may rely upon a facsimile or imaged signature as if it were an original. This Agreement may be executed in several separate counterparts, each of which shall be an original and all of which shall constitute one and the same instrument.

WHEREFORE, the parties agree to be bound by this Agreement by signing below.

**For FUND MEMBER:**

Fund Member Name: \_\_\_\_\_

By: \_\_\_\_\_  
Signature of Fund Member's Authorized Representative

Date: \_\_\_\_\_

\_\_\_\_\_  
Printed Name of Fund Member's  
Authorized Representative

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**For TASB Risk Management Fund Use Only**

**For TASB RISK MANAGEMENT FUND:**

By: \_\_\_\_\_  
Chair, TASB Risk Management Fund Board of Trustees

Date: \_\_\_\_\_

