TO: CITY COUNCIL

ATTN: FINANCE COMMITTEE

FROM: CITY MANAGER

DEPARTMENT: HUMAN RESOURCES

DATE: MAY 4, 2004

CMR: 248:04

SUBJECT: CITY OF PALO ALTO SELF-INSURANCE AND RISK TRANSFER PROGRAM

This is an informational report and no Council action is required.

BACKGROUND

As recommended by the Finance Committee in 2003, this report summarizes the levels of self-insurance versus the projected insurance premium expense in 2004-05. The City of Palo Alto transfers risk by purchasing various insurance policies as outlined in the Comprehensive Annual Financial Report (Attachment 1). The Finance Committee directed staff to report on the City’s purchase of insurance and how self-insured retentions (SIR) are determined.

The SIR level functions similar to a deductible for a personal consumer product such as an automobile liability insurance policy or a homeowners policy. The City pays for any claim losses incurred below the SIR level and the insurance carrier or risk pool pays losses over the SIR amount. Moving to a higher SIR level allows the City to realize premium savings but at the same time increases the City’s exposure to claim costs if the City experiences a high number of claims or an increase in the severity of the claims. There are three areas of coverage where greater risk assumption through higher retentions or deductibles can potentially reduce the City’s cost of insurance: liability, workers’ compensation, and property.

DISCUSSION

At the beginning of each calendar year, the Risk and Benefits Manager begins reviewing changes in City operations, programs and City property and gathers data that is provided to the City’s risk pool administrator and broker in order to obtain price quotations.
Liability Insurance
The City is a member of the Authority for California Cities Excess Liability (ACCEL), a joint powers authority (see Attachment 2). Palo Alto is one of ACCEL’s founding members. ACCEL was formed in 1986 during a hard market when insurance was not only costly but difficult to obtain. Participating municipalities pool their resources and share risk. A $1 million SIR is required for each member and is typical for a medium sized city like Palo Alto with similar operations and services. This self-funded program was designed to pool catastrophic losses as a viable alternative to high cost insurance. ACCEL is one of the most successful accredited JPA’s in the state and has provided an excellent return to Palo Alto each year.

Between July 1999 and June 2003, ACCEL took advantage of the soft liability insurance marketplace and purchased a three -year liability insurance policy at a lower premium. In 2002, the insurance market hardened; in 2003, the pool experienced a slight increase in premium above the previous year’s rate. This year it may not be cost effective to purchase insurance and ACCEL may be risk-sharing again.

Property Insurance Coverage
The commercial property insurance market stabilized in 2003 and Palo Alto’s premium decreased compared to 2002. It is expected that there may be a nominal increase in 2004-05 but it will be within budget. Currently the City’s property program deductible for property loss is $25,000, and for fine arts $2500. In the past 10 years, Palo Alto has only experienced one minor property claim. This year the Risk and Benefits Manager will be reviewing premium cost quotes for coverage with a higher deductible to analyze the cost/benefit of assuming additional risk.

Excess Workers’ Compensation Insurance
Recent changes in the insurance marketplace have resulted in much higher workers’ compensation premiums for many employers. In 1998, the City’s workers’ compensation SIR was changed from $500,000 to $250,000 due to increasing claim costs associated with severe injuries. By reducing the SIR, Palo Alto improved the mix of risk the City was retaining and risk that could be transferred. However, the SIR slowly increased to $500,000 in fiscal 2002-03 due to the unavailability of insurance at a lower retention level. In 2003, the cost for the same coverage at a $500,000 SIR increased by 69%. To lessen the budget impact, the SIR was increased to $750,000. The cost for this coverage was $226,610 or 24% above the premium paid in fiscal 2002-03. In 2004-05, the premium is expected to increase by 54% or $120,936. The Risk Manager will analyze losses and determine the cost/benefit of increasing the SIR to $1 million to partially offset these premium increases. As previously stated, increasing the SIR level will allow the City to realize premium savings but at the same time increase the City’s exposure to claim costs if the City experiences a high number of claims or an increase in the severity of the claims. It is not expected that the City will experience a high number of claims but many of the Fire and Police claims tend to be severe, require surgery and are costly. The Human Resources department is working with City departments to reduce the number of work-related injuries, recognizing that prevention is the best method for reducing claim costs.

RESOURCE IMPACT
The increase in insurance premiums costs will be partially contained by assuming higher risk and focusing on reducing the number of work-related injuries. Funds for insurance premiums are provided in the 2004-05 proposed budget.

**POLICY IMPLICATIONS**

This report does not represent any change to existing policies

**ENVIRONMENTAL REVIEW**

This program is not a subject as defined by the California Environmental Quality Act (CEQA) and is not subject to CEQA requirements.

**ATTACHMENTS**

Attachment 1: Comprehensive Annual Financial Report, Insurance Coverage Summary
Attachment 2: Description of ACCEL JPA

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