Gateway Pricing Proposal

Gateway Processing:

Payeezy Onetime setup fee	$299.00
Payeezy monthly fee	$9.95
Payeezy transaction fee	$.05

MEMORANDUM

TO: Training and Education Committee
Coverage Claims and Litigation Committee
Member Relations Committee
Administration and Finance Committee
Executive Board

FROM: Margo Ely, Executive Director
Dan LeTourneau, Director of Risk Management
Rita Boserup, Finance Director
Susan Garvey, Legal Director

DATE: August 30, 2017

RE: Revenue vs. Expenditures – Exposure Base

ACTION REQUESTED: Concur with staff's recommendation to appoint an Ad Hoc Committee to draft an amended Bylaw to provide a new definition of expenditure/expense in order to switch from revenue base to expenditures/expenses as the "denominator" in the IRMA contribution formula.

BACKGROUND: Currently, the IRMA member financial process starts with the revenue base worksheet. Each member fills out a worksheet reporting their audited revenues based on criteria in the Bylaws. The worksheet is reviewed, any adjustments made, and an agreed upon number is determined for each member. These revenue base numbers are used in determining the annual contribution paid by each member.

The process to determine each member's annual contribution uses an average of the last five years of revenue bases and 5 years of member losses. The losses use a sliding scale that limits the impact on a member's contribution for unusually large claims.

Historical Studies of the Revenue Base:
IRMA has used a revenue exposure base since its inception in 1979, but not without issue. Over the past thirty plus years, IRMA has considered whether to rely on an alternative exposure base multiple times. Each time, however, the membership has chosen the status quo. It is undisputed that revenue is closely correlated with risk; we have multiple actuarial studies that support this conclusion. While the IRMA membership has chosen to remain with the revenue base, the studies over the years have resulted in several deductions to the revenue calculation in the Bylaws. Ultimately, each study came back to the same conclusion that revenue correlated well with member risk and was easily and accurately verifiable via each member's financial audit.

The Insurance Marketplace:
Along with the results of the studies, there are other pertinent factors that have supported the continued use of revenue base exposure throughout the history of IRMA. For example, IRMA has historically had a growth strategy of limited, selective growth without an active marketing program. During this time, IRMA's pricing was always well below any commercial insurance program and the experience modifier was not even applied until after a new member had three years of IRMA specific claim experience. There were also cyclical "hard" insurance markets where commercial insurance was either not readily available at all to municipal entities or was available at a very high cost. Public entities were the first to feel such "hard" markets as

commercial insurers did not understand nor value the municipal risk. Members joined IRMA with little competition from commercial insurance.

Times have changed. We are in the longest “soft” insurance market cycle in history, represented by low premium costs and extensive capacity for new business, including public entities. Commercial insurers have abundant capacity to write new business and can “buy” the business at a premium rate below expected losses with the ability to increase future premiums at will.

Challenges in Member Recruitment and Retention:
The Board has directed staff to recruit members in a more assertive fashion than in IRMA’s history. Changing insurance programs is a project that rarely makes the top 10 list of priorities for any municipality for several reasons. First, insurance matters are usually outside of the comfort zone of staff and elected officials. Second, insurance is not a “core” government function and as long as there are no problems or impetus for the project, it tends to be passed over. Third, insurance matters/claims are primarily confidential and difficult to discuss at a public meeting.

With the expiration of the HELP contract in May of 2018, we have an excellent opportunity for growth. HELP is a high level excess pool consisting of 13 municipalities. The pool provides GL coverage above a self-insured retention of $2 million. Arlington Heights, our most recent new member, is a member of the HELP pool. The expiration of the current 10 year HELP contract is a challenge for continued HELP membership since the statutory provision requiring only 120 days notice to withdraw from an intergovernmental risk pool is now in place. This situation presents IRMA with the reality that members of the HELP pool are likely to “shop” the marketplace. We are eager to be considered.

As staff has pursued conversations with potential members, the Revenue Base has been a constant obstacle to discussions. This challenge is also present for member retention; the Revenue Base was given as a primary factor in the decision of the Village of Buffalo Grove to withdraw from IRMA. Municipal entities are consistently looking to increase revenues and the correlation with risk is difficult to quantify from a layman’s perspective. It is extremely difficult to market a program that is perceived to “penalize” a municipality for increasing revenues, by an increase in insurance costs. For all of these reasons, staff recommends that we change from Revenue Base to Expenditures.

The Switch From Revenues to Expenditures:
Our actuaries have opined that expenditures are sufficiently correlated with risk and are an appropriate replacement for revenue as the exposure base in the contribution formula. Expenditures/expenses correlate well with risk and are commonly an indicator of increased activities and assets associated with risk. The majority of a municipality’s expenditures is personnel costs; the majority of IRMA loss fund costs are in worker’s compensation claims. In the long run, revenue and spending for a non-profit organization are about equal. IRMA’s actuary, Milliman, has not run a correlation analysis between expenditures/expenses and revenue because we need to define “expenditures/expenses” first. This project will be focused on defining “expenditure/expense” as closely to our current definition of “revenue” as possible in order to maintain as much consistency among member contributions as possible.

With regard to member stability in contributions, which is certainly a priority, our actuaries have also opined that they expect expenditures/expenses to be closely aligned with revenues. However, without seeing the final expenditures/expenses by member, Milliman cannot estimate the actual impact on member contributions due to a change in exposure base. Milliman states that the actuarial expectation, consistent with the bell curve, is that this type of revision can have an impact on 20% of the membership with 10% on the positive side and 10% on the negative side. However, to the extent that the analysis results in significant changes to certain member contributions, there are options such as blending or possibly a 5 year phasing that can mitigate the impact.

The migration from revenues to expenditures/expenses requires thoughtful consideration to an appropriate "Expenditure/Expense" definition. Without a consistent definition and understanding of what "expenditure" is, we cannot run an analysis. It is for this reason that staff recommends the creation of a Ad Hoc Committee with the direction to draft the Definition of Expenditures/Expenses, with appropriate deductions, to be presented no later than the first Administration and Finance Committee meeting in 2018. The goal is to be ready with a contribution model that relies on expenditures/expenses for the 2019 fiscal year.

<u>What Does it Mean to You?</u>
The decision to move away from a revenue base contribution formula should be based on considerations common to all pool members, the forward thinking goals of the organization and the importance of maintaining stability in the financial structure for all members. This decision should not be based on a certain member's contribution in a given year. In order for staff to present a specific analysis of the impact to individual members for this transition, the Ad Hoc Committee project must be finished so that we have a definition of Expenditure/Expense and a list of potential deductions. An important direction for the Ad Hoc Committee is to develop definitions, deductions, and a transition plan that avoids large swings in member contributions. With this direction, the Ad Hoc Committee will provide a stable and equitable definition and implementation plan for all IRMA members. Moving to an expenditure/expense based formula does not change the overall annual contribution that IRMA needs to operate.

<u>RECOMMENDATION</u>: Concur with Staff's recommendation to base contributions on expenditures/expenses rather than revenues, and form an Ad Hoc Committee to draft the definitions and deductions.

<u>Training and Education Committee 9/6/17</u>: The TEC discussed this agenda item and expressed concern that they did not have enough information to vote on this change without seeing the new definition of expenditure. In addition, most of the members felt they did not have the finance background to make this decision. As such, the TEC voted unanimously to appoint an Ad Hoc Committee to draft the Expenditure definition, but did not feel comfortable voting to revise the exposure base from revenues to expenditures.

<u>Coverage Claims and Litigation Committee 9/7/17</u>: The CCLC discussed this agenda item and also expressed concern that they did not want to vote to move to expenditures without additional information. The members felt that the wording in the "Action Requested" was too strong, appearing to be a decision to move from revenues to expenditures, even though the final action would be the approval of a Bylaw Amendment, which requires 2/3 vote of the full Board. Some additional comments/thoughts: relying on revenue base is not intuitive; this is the first time IRMA has looked at moving to expenditures so it is a new idea; contrary to the suggestion that we have looked at this issue multiple times; on prior occasions, it has been primarily in defense of the revenue base and has resulted in multiple deductions to the revenue base; if this change will have minimal impact to members and will be positive for recruitment and retention, then it should be approved; we need to emphasize that the primary driver of member contributions is their losses, not the revenue base – if a member wants a lower contribution, then reduce losses; this memorandum seems like the move is being offered only for sales/recruitment – we need to emphasize the importance of member retention as well; if for some reason, we don't make this change, then we need to make sure we are able to explain the use of the revenue base with more clarity and also be able to quantify revenue increases as they impact contributions since most of the time the impact is minimal; the motion should include words like goal, preliminary, general; since revenues work and we believe expenditures will work as well, we need to make sure we are explaining why we need the change for the future – it's for both recruitment and retention; who is going to appoint members to the Ad Hoc Committee? Who will they be? How many members will there be? Discussion that the decision should be the Executive Director's decision and she should be charged with leading this project. We should engage in outreach to all members, survey all members on what should be included in expenditures before the ad hoc committee drafts the definition.

In the end, the motion was "In an effort to promote member retention and recruitment, we concur with staff's recommendation to appoint an Ad Hoc Committee to draft an amended Bylaw to provide a new definition of expenditure/expense in order to switch from revenue base to expenditures/expenses as the 'denominator' in the IRMA contribution formula." This motion was unanimously approved.

Member Relations Committee 9/13/17: The MRC discussed this agenda item and also expressed concern that they did not want to vote without specific information as to the impact the change would have for individual municipalities. Like the TEC and the CCLC, the MRC revised the motion after discussion, which included the following comments/thoughts: this is not going to happen fast and won't be done in time to recruit the municipalities in HELP; maybe we should have a workshop on the issue with the entire membership; rather than a discussion with the whole membership, we would be better off with a task force and then a presentation to the whole membership; this is important for recruitment, but it is also important for retention; it would be nice for the actuaries to do a sensitivity analysis, but we need an expenditure definition in order to do this; really don't see the value in working on this right now, open to it, but it's not a necessary task right now.

In the end, the motion was "to create an Ad Hoc Committee to explore changing from a revenue base to an expenditure base and the Ad-Hoc Committee should draft a definition of expenditures and review the impacts on membership." There was one dissenting vote, based on belief that this is not a necessary task right now.

Administration and Finance Committee 9/14/17: The AFC discussed this agenda item and ultimately revised the motion in a similar fashion to TEC, CCLC and MRC. The discussion included the following comments/thoughts: this issue should go back to the committee that looked at the question of whether the revenue formula results in large members subsidizing small members a couple years ago and we should bring back consultant Peter Wright to assist; this issue is an ongoing issue and keeps coming up – we need to address it; this is too much work and it's not necessary – it's really just semantics – just refer to "revenue" as "financing for expenditures"; the change to expenditures would be a monumental change for IRMA staff and overly burdensome; we're going to have to defend whatever model we have, if we are going to look at this issue, it should not be narrowed to just expenditures – consider all potential exposure bases; not convinced that this change will retain existing members or attract new members; IRMA has invested a lot of time and resources to support the revenue model – don't change it; maybe we should just improve our marketing/education on our current formula rather than undertaking this major project; if we move in this direction, we need to make sure that it is cost neutral for 2/3 of the members; changing to expenditures will result in too many deductions and be too controversial; the only question for members is going to be whether they will pay more or they will pay less. maybe we should survey the entire membership; revenue works and the membership understands it, this is just too much work.

In the end, the motion was to "concur with staff's recommendation to appoint an Ad Hoc Committee to evaluate a new definition of expenditure/expense in order to consider a potential switch from revenue base to expenditures/expenses as the "denominator" in the IRMA contribution formula." There were 2 dissenting votes, who both feel that we should stay with revenue.

G:\Committees\Training & Education Committee\2017\9-6-17\Revenue Vs Expenditures - Exposure Base Final.Doc

INTERGOVERNMENTAL RISK MANAGEMENT AGENCY

The Risk Management Solution for Local Government

M E M O R A N D U M

TO: Executive Board

FROM: Rita Boserup, Director Finance & Administration

DATE: September 20, 2017

RE: New Investment Manager-Parametric

Action Requested: Approve Parametric's Defensive Equity as an additional investment manager.

Background: Our investment manager, Marquette's Brian Goding, would like IRMA to diversify the portfolio with hedge fund products. Parametric's Defensive Equity is a defensively structured portfolio which can capture the Volatility Risk Premium by selling fully-collateralized options without introducing leverage and is expected to deliver the best relative performance in down and sideways markets. Our investment advisor, Brian Goding from Marquette Associates, is recommending an initial $5 million investment in this fund, which would be set aside from the members' contributions that are received in January/February 2018.

Discussion: Marquette provided the Administration and Finance Committee with two choices of puts and calls hedge fund managers. After in-person presentations and some discussion, the AFC selected both Neuberger Berman and Parametric as investment managers, with a $5 million future investment in each fund. Parametric meets the criteria in IRMA's Cash and Investment Policy. Pursuant to the Cash and Investment Policy, the Executive Board must approve the selection of money managers.

Recommendation: Approve investment in Parametric's Defensive Equity.

G:\Committees\Executive Board\2017\9-27-17 Meeting\Parametric investment manager.doc

IRMA's 4th Annual Education Summit
NIU—Naperville

FACING THE CHALLENGES TOGETHER: LESSONS LEARNED

At IRMA, our main objective is to make sure that each member is equipped with the knowledge, training and tools to prevent losses from occurring and to mitigate costs when they do.

Although we are sharing our risk within the pool we rarely have the opportunity to discuss the challenges we face and the lessons we learn.

This year, we are going back to basics with workshop-style break-out sessions focused on sharing our lessons learned and plan for the future.

Not only will Delegates, Alternates and City Managers benefit from this workshop, all upper management including Department Heads and Supervisors, will find solutions to risk management issues within your organization.

By the end, you should gain further insight and understanding on:

8:00 a.m.—9:00 a.m.

- IRMA SERVICES

9:15 a.m.—10:30 a.m.

- ZONING ISSUES
- FITNESS FOR DUTY

10:45 a.m.—12:00 p.m.

- IRMA FINANCIAL EQUATIONS
- POLICE EXPOSURES
- IMPACT OF CAREER ENDING INJURIES

- OCTOBER 16, 2017
- REGISTRATION 7:30 AM—8:00 AM
- PROGRAM 8:00 AM—12:00 PM
- NO COST

NIU—NAPERVILLE
1120 E Diehl Rd.,
Naperville, IL

12:00PM—2PM

BOARD MEETING LUNCHEON

REGISTER NOW

When registering, please select only one morning and one late morning concurrent session

IRMA

The Risk Management Solution for Local Government