ADMINISTRATION & FINANCE COMMITTEE
Meeting Minutes

Thursday, September 27, 2012
IRMA Office
9:30 a.m.

PRESENT:	David Clark, Chair	Scott Anderson
	Dan Nisavic	Janet Gorman
	Andriana Peterson	Kelly Amidei
ALSO PRESENT:	Laura Vesecky	Larry Bush
	Mary Henzler	Brian Goding, Fiduciary Consultants
	Doug Nishimura, Milliman	Richard Frese, Milliman
ABSENT:	David Danielson	George Schafer
	John Prejzner	

I. CALL TO ORDER

Chair Clark called the meeting to order. Roll was taken and a quorum declared.

II. APPROVAL OF MINUTES – June 5, 2012

A motion was made by Gorman and seconded by Nisavic to approve the Administration and Finance Committee Meeting Minutes of June 5, 2012. A voice vote was called and the motion carried.

III. FINANCIAL REPORTS

A. IRMA Financial Statements as of July 31, 2012
B. IRMA Investment Portfolio as of July 31, 2012
C. IRMA Payables for the period 5/18/12 – 9/13/12

Clark asked if there were any questions on any of the reports. Hearing none, a motion was made by Nisavic and seconded by Anderson to approve the Financial Reports. A voice vote was taken and the motion carried.

IV. 2ND QUARTER INVESTMENT PERFORMANCE REPORT

Goding gave a brief overview of the 2nd Quarter Investment Report. Goding reported that the Russell 3000 was up YTD by 9.32%. Goding stated that the 2nd quarter was a negative quarter. The US markets were down by 3.15%, but bottom line is that we had a very good 1st quarter. April started off with a little bit of negative performance in the equity markets and then May was really a bad month. In June it started back up and the downtrend wasn't as bad as it could have been. It was down a little over 3% and it has been up pretty much since then. International was down more than twice the US market. Bonds continue to do well as interest rates came down again in the 2nd quarter.

Goding stated that both growth and value were down for the quarter. Large cap, mid cap, small cap, and micro cap stocks were down by varying degrees during the 2nd quarter. Being a negative quarter, the only sectors that were positive were Consumer Staples, Telecommunication and Utilities. Everything else was down for the quarter.

Goding reviewed IRMA's total composite and reported that as of June 30th, we were a little bit light in equities; with a downturn in the market, we were at 45.59%. This has changed with the market coming up. We are a little heavy in fixed income and a little light on alternatives; however, we are funding those over time.

Goding reported that from a return standpoint, the fund continues to do very well on a relative basis. For the quarter we are down a little less than 1%. Year to date, the fund is up 6.31%.

Goding referred to page 52 in the report that contained the numbers behind the return through June, and page 53 that updates the performance summary for July and August. Goding reported that the Equity Index fund continues to perform in line with the Index. Chicago Equity Partners continues to out perform. Goding stated that the two managers that he wanted to talk about were Denver Investment and Legg Mason International Equity. Denver Investment continues to struggle during July and August and continues to struggle through September. Legg-Mason is doing a little better, as they out performed in July; however, under performed a little in August. Year-to-date, they are behind a little bit. Goding noted that although we talked about giving these two managers until the end of the year, he did perform a manager search to talk about today. It's a question of how long we want to give them.

Goding reported that a representative from Fiduciary Consultants met with Denver Investment this morning and they continue to tell us that they have had no personnel changes and they have had no major changes in their methodology; however, due to their under performance they are going to tweak their process and be more cognizant of shorter term risk in the portfolio.

Legg Mason is similar; however, Legg Mason is more of a quantitative process driven manager and they really haven't changed much in the way of their process. They have had some personnel changes and management changes over time.

Goding reviewed the rest of the managers and reported that the total portfolio had a beginning market value of $133,006,070 and the fund ended at $134,307,851.

Vesecky noted that Denver Investment has been under performing for several years. Goding passed around a performance analysis that he had prepared showing that under performance.

Goding distributed a Small Cap Core Manager Search that he had prepared, comparing Denver Investment with Kayne, Anderson Small Cap Core, Kennedy Capital Management Small Cap Core and Vanguard Small Cap Index I and the Russell 2000 Index. Goding reviewed the report with the committee.

Goding reported that he was asked to put an index fund into the report, and he chose Vanguard Small Cap Index. Goding noted that Vanguard manages to an FMCI small cap index and that is why the index return isn't the same as the Russell 2000.

Goding reported that Kayne, Anderson is a small cap core manager out of Los Angeles, California. They have been in business since 1984 and manage small cap, mid cap and some hedge fund portfolios. They run a concentrated portfolio with about 25-30 stocks. They perform very well; however, they didn't do well in July and sold off quite a bit. For August, they were about even with the index.

Kennedy Capital Management is a firm out of St. Louis, Missouri and they are also a specialty manager. They have more of a typical small cap portfolio with 80-100 positions.

Goding noted that both of these managers are fundamental managers and actually do a lot of analysis on the firms that they buy. Kayne Anderson's fees start at 1% and based on the size of the portfolio that is where we would be. Kennedy Capital Management's fees start at 1%, too. Goding noted that he can try and negotiate the fees down.

After several minutes of discussion, a motion was made by Gorman and seconded by Anderson to recommend approval of replacing Denver Investment with Kayne, Anderson Small Cap Core Manager. A voice vote was called and the motion carried. Vesecky noted that this item would go to the Executive Board for their approval.

The committee decided to give Legg Mason to the end of the year before making the decision to replace them.

V. CASH FLOW UPDATE

Vesecky stated that it looked like she would be short by the end of the year, but she didn't want to withdraw now because it is all based on claim payments. Vesecky asked for the committee to give her authority to withdraw $3 million for the balance of the year, if it was needed. A motion was made by Anderson and seconded by Amidei to approve $3 million being withdrawn by the end of the year, if needed for claim payments. A voice vote was called and the motion carried.

Vesecky indicated that it would take the actuaries a few minutes to set up, so suggested to skip ahead on the agenda.

VIII. EXCESS SURPLUS FUND DISTRIBUTIONS

Clark reported that at the Organizational Planning Workshop there was a discussion about the frequency of the Excess Fund distributions to IRMA members. Staff is recommending that beginning in 2013, a report of Excess Surplus Fund balances will be issued on the 1st of January, April, July and October and members will have the opportunity to receive a check on the 1st of the following month. With this change, the Members' Reserve Fund Policy and Procedure needs to be revised. A motion was made by Amidei and seconded by Anderson to approve the revision to the Members' Reserve Fund Policy and Procedures. A voice vote was taken and the motion carried.

VI. PLANNING WORKSHOP – ACTUARIAL REPORT ON UNDERWRITING AND POLICY IMPLICATIONS – NISHIMURA

Doug Nishimura introduced himself and Richard Frese from Milliman. Nishimura stated that the purpose of their visit was to go over some of the underwriting policies and discuss the rate for 2013.

Vesecky noted that during the Planning Workshop there was a focus on underwriting and policy implications and we asked the actuaries to take a look at this.

Nishimura explained that the members are changing their exposures and operations and they were asked to look at three situations in particular.

A. Members form a new entity to provide a basic function
B. Members outsource major functions to non-IRMA entities
C. Prospective members with large deductibles

A. Members form a new entity to provide a basic function

Nishimura stated that the first thing they looked at was the data by process, such as police, fire and administration. They were able to look at those rates and were able to see what the relative rate was of each process/department to the rest of the pool. Frese added that there were some limitations on the data, especially exposure information and revenue for each of these groups, so they used payroll.

Nishimura reviewed, answered and summarized several questions posed by IRMA's Executive Board.

1. How does IRMA price other stand-alone functions such as dispatch and fire, etc.? **Answer: It is our conclusion that the current pricing is based on the revenue formula.**

2. Do IRMA's formulas work for special districts? 3. Should the formula change for new special districts? 5. Should separate rates be developed for these districts? 8. If the district/cooperative is a new entity, what is the revenue or other exposure base? **Answer: Police and Fire exposures are significantly different that a village's overall exposures. The rating for this type of entity must be based on the appropriate rate for the exposure.**

   Nishimura stated that they actually looked at payroll for police and fire workers' compensation and based on IRMA's history, the rate for police and fire is 4.22 and the rate for fire is based on 4.84 and the combined rate is 4.43. IRMA's rate is only 3.31. So the overall combined rate for police and fire is 1.34 higher than IRMA's average rate. Nishimura stated that they also looked at a bigger industry base, NCCI, which they may use. This would be based on industry exposures rather than IRMA exposures. In this case, we think that IRMA's data is significant enough to use, so we don't have to use the NCCI data.

   Vesecky asked Nishimura how they would get the GL and Auto data. Nishimura stated that they would try to look at the types of losses and go from there. Frese stated that they may have to try and look at what the revenue is for police and fire and use that.

   Nishimura noted that initially each member would have the same rate for police and fire.

6. Should the $50,000 minimum change for new districts/cooperatives.
   Answer: The $50,000 minimum contribution is not unreasonable, but may be adjusted slightly downward depending on revenue size and loss history.

7. Should the sponsoring member be part of the rate? **Answer: Yes, the sponsoring member should be part of the combined rate.**

9. What are alternative non-revenue rating systems? **Answer: Alternative rating systems use more direct exposure such as payroll for workers' compensation, autos for auto liability and revenue for general liability.**

Vesecky asked whether in the event that this is approved, would it entail the actuary doing separate pricing for these members every year or would they eventually roll into our normal formula. Nishimura stated that he didn't know whether they would roll into the normal formula, it would depend on how the loss experience goes.

Vesecky stated that they talked about a new entity joining that spun off from existing members, but what if several members and non-members join together to form let's say a dispatching entity that wants to join IRMA -- how would we price them? Nishimura stated that they would price them on the rated basis of the police and fire adjusted for dispatch only. Nishimura stated that he wasn't quite sure how to do the dispatch only yet, but it's someplace between the police, the fire and the administration. Vesecky noted that right now we have some fire protection districts and we rate them just like IRMA. Nishimura stated that they wouldn't recommend that. Vesecky asked – what about the existing members. Nishimura stated that with the existing members, we would probably want to change them, but do them slowly overtime.

Vesecky commented on the question on the $50,000 minimum deductible stating that this issue came up at the Executive Board meeting that there are members that want to form cooperatives, but they don't want to have to pay more for insurance and won't be anywhere near the $50,000 level. Nishimura stated that you don't want to have itty bitty thing break off – that is too much of a hassle. There is no credibility in the data and you don't know how to rate them. There has to be some kind of minimum threshold.

B. Members outsource major functions to non-IRMA entities

Nishimura stated that part B of this project was to see what to do about outsourced functions. Right now, an IRMA member left because they were outsourcing a lot of functions and they weren't getting credit for that. Another one is that for other members who are currently outsourcing functions, they are not getting an offset for that.

Nishimura reviewed, answered and summarized the questions posed by the Executive Board.

1. Should IRMA provide a deduction for out-sourced major functions? **Answer: Yes, there should be an adjustment for the exposure to match the risk that the exposure is measuring.**

2. Should the deduction be preapproved? **Answer: Yes, it should definitely be preapproved. You need to make sure that you are transferring risk there, that IRMA should see that the policies that are being implemented and there should be an exclusion in your agreement with IRMA saying that this is not being covered. Even with all that being said, there is still a gray "deep pocket" area where IRMA may have some liability.**

3. How does IRMA define major function? **Answer: The definition of a major function should be determined by IRMA, but may subject to a minimum % of the revenue.**

4. Should there be a minimum dollar amount? **Answer: Yes, there should be some kind of a minimum based on revenue. It could be a dollar amount, but IRMA needs to decide on what that should be. Nishimura stated that they could give some guidelines, but it is really up to IRMA.**

5. Could the functions be services provided to residents? **Answer: It is not unreasonable for the function to be services provided to members' residents.**

6. What is the deduction? **Answer: The deduction should be quantified as a portion of the total revenue and then determined as percentage of the revenue reduction.**

7. Should IRMA include a portion as if IRMA was a fronting company? **Answer: IRMA should include some kind of a fee since there may still be risk to IRMA. Additional fees should be charged for administering the claims.**

8. How does IRMA verify the risk transfer? **Answer: IRMA should review contracts of the entities to verify risk transfer and should clearly define exclusion from IRMA coverage.**

9. Would the deduction be pre-approved prior to the preparation of the revenue base? **Answer: Yes, the deduction should be pre-approved before the revenue base, and the revenue base should not include any services that are excluded from IRMA coverage.**

10. What is the timing for implementation? **Answer: The implementation period can be at any time.**

11. After defining major functions, IRMA needs to determine the number of outsourced functions. **Answer: IRMA should understand how many of its members may consider outsourcing functions to determine if it applies to a few members or the majority of members.**

Vesecky asked Nishimura if IRMA wanted to do a survey of our members and ask what they are outsourcing, what would be a minimum percentage, so they don't send us every little thing. Nishimura answered somewhere between 5% and 10%. Nishimura stated that he would like to see a list of the outsourcing and then you can get an idea of where a break point would be. Gorman stated that we would have to define what is considered outsourcing. Vesecky commented that maybe for the survey we should be looking at a certain dollar amount. Nishimura stated that since there are a lot of unique situations out there, we need to research this.

C. Prospective members with large deductibles

Nishimura noted that prospective members may be interested joining IRMA at a higher deductible and the $250,000 deductible credit currently offered may not be adequate or correct for that prospective member. Why can't we just put them in the formula? The problem is that you may not be competitive. Secondly, that entity may be big enough to stand on its own if they have enough data. So, you may want that entity if they are good risk, or you may not want them. Because that entity has enough data, you could probably rate them yourself. Some of the questions were can you rate individual members, what criteria to use to individual rate an entity, how frequent an analysis would need to be completed, will individual rating a member hurt the pool, and what methodology do you use to individually rate a member.

Nishimura stated that individual members can be rated providing they meet certain criteria: size, credible data, financial strength, methodology and consideration of advantages/disadvantages.

One advantage is that if you rate an individual member, they are not going to hurt the pool. The disadvantage is that there is no risk sharing in those small layers. If we rate them correctly it should not hurt or help the pool – it will be a zero sum game. Bush stated that it would help with the administrative costs. Bush stated that one of the criteria is that a member would have to come in at $250,000 and be committed to always remain at that $250,000 and not change.

The committee discussed where they wanted to go with this. Clark stated that he felt it was worth exploring the issue of outsourcing major functions. Clark recommended that for Part A, we put together some illustration that shows here is entity A and B before and here's entity A and B and this new entity C the first year and here's what happens in a couple of subsequent years.

Vesecky asked if we were ready to go forward with Part C – prospective members with large deductibles – coming in at $250,000 deductible. Bush stated that this is something we may want to vote on before the end of the year, as we have some potential members out there. And a current member could choose to go that way as well. Currently, members who go up to a higher deductible can choose to go down again in another year. However, to be individually rated members would be forced to stay at the $250,000 deductible.

Bush stated that he would want to bring the membership along on the whole concept, but a lot more work needs to be done on Part A and Part B. We could take a vote on Part C.

Vesecky noted that some of the larger members that have left may have stayed if we could have offered the higher deductible.

Nishimura stated that the IRMA pool has been very stable. When you get the bigger members leaving the pool, it creates a cycle. By providing this to those members, they are still going to get excess coverage through the pool. Pooling in the long run is always better than commercial insurance because the commercial insurance company makes a profit, and the pool doesn't – the pool keeps the money. You have to get the message across to your members that in the long run it is always better to pool. By offering this to someone who may be leaving, you get their administrative expenses still. Even if their losses are a little worse, you are getting their administrative cost and that is good.

Bush was looking for consensus from the committee as to what the next steps should be. Clark stated that he thought the consensus would be that Part A and Part B needed further exploration and consensus on Part C – the higher deductible would be whether or not we feel comfortable going to the Board with the higher deductible for new members and existing members could go up to $250,000 and could go back down if they wanted to, but would not be individually rated. The committee concurred with this strategy.

To conclude, Clark stated that the committee agrees that more exploration needs to be done on Part A and Part B, and the committee is comfortable with going forward with C. Bush suggested that a motion be made to recommend that we offer prospective members a deductible of $250,000, individually rated with no opportunity to change in the future. A suggestion was made that we have more narrative on what this means to IRMA given to the Board of Directors before we try and vote on this. Nishimura stated that they could try and put something together.

Clark stated that it could move to the Executive Board and then on to the full Board, and it doesn't need to come back to the Administration and Finance Committee. It was decided that a motion was not needed. Consensus of the committee was that they were recommending this be considered further by the Executive Board and then moved on to the full Board for discussion.

VII. ACTUARIAL REPORT

Nishimura reported that in looking at all the numbers adjusted to 2013, IRMA's rate was coming down about 7%. Nishimura noted that if IRMA's loss experience continues to be favorable, the rate will come down more for 2014.

Vesecky stated that what the actuaries do is give us the selected rate which is $2.10 per $100 dollars of revenue for the loss fund. They also give us a range. Given the fact that it is down 7%, Vesecky stated that she would recommend that we stay with the selected rate.

A motion was made by Anderson and seconded by Amidei to accept the selected rate of $2.10 for 2013. A voice vote was taken and the motion carried.

IX. IRMA'S SALARY COMPENSATION PROGRAM

Bush reported that staff is in the process of updating our Personnel Manual, but since the preliminary budget needs to be handled at this meeting, there is one item that we want to bring forth from the Personnel Manual now. Bush commented that every year there is great confusion on the salary increases because our increases are based on the midpoint of the salary range. Staff is recommending that we base future merit increases on an employee's actual salary, which will be less confusing for employees and delegates, and the impact on the 2013 budget will be about 1/10 of one percent of the budget for salaries.

After a brief discussion, a motion was made by Nisavic and seconded by Anderson to approve future merit increases being based upon each employee's actual salary. A voice vote was called and the motion carried.

X. 2013 PERSONNEL REPORT

Bush reported that the number of full-time equivalent employees will remain at 18.7 in the 2013 budget. The 2013 budget also includes an overlap of two months in the Director, Financial Services position to train a new employee upon the current director's retirement. The budget also includes a promotion for a Claims Representative II to Claims Representative III.

Bush reported that staff is recommending a 2% increase to the salary ranges for 2013, based on reports from the Hay Group, and a 3% budget for merit increases in 2013.

After a brief discussion, a motion was made by Amidei and seconded by Anderson to approve the Personnel Report recommendations:

- Approve two month overlap for Director, Financial Services
- Approve promotion for a Claims Representative II to Claims Representative III
- Approve 2013 staffing levels
- Approve 2013 Salary Ranges
- Budget for a 3.0% salary adjustment factor

A voice vote was called and the motion carried.

XI. 2013 PRELIMINARY BUDGET

Vesecky referred to the Budget Summary that was handed out, that made a change to the loss fund with the number provided by the actuaries. Everything else stayed the same as what was in the meeting packet.

Vesecky noted that the budget had a 6% increase for health insurance; however, we are waiting for final numbers from our broker who is doing a full marketing effort for us. We will have those numbers for the final budget.

A motion was made by Nisavic and seconded by Amidei to approve the 2013 preliminary budget. A voice vote was taken and the motion carried.

XII. INVESTMENT NEWSLETTERS

Vesecky reminded everyone that the investment newsletters are available on the IRMA website.

XIII. ADDITIONS TO AGENDA

There were no additions to the agenda.

XIV. CONFIRMATION OF NEXT MEETING

Clark announced that the next meeting is scheduled for Thursday, November 15, 2012 at 9:30 a.m. at the IRMA office.

XV. ADJOURNMENT

A motion was made by Nisavic and seconded by Anderson to adjourn the meeting. A voice vote was taken and the motion carried.

Submitted by:	Approved by:
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Laura Vesecky	David Clark, Chair
Director, Financial Services & Administration	Administration & Finance Committee

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