

## **Self Insurance Group Board of Trustees Duties and Responsibilities**

As a member of the board of trustees of a Self Insurance Group in California, there are certain legal responsibilities and best practices to be aware of in the performance of your duties as a board member.

It is important to recognize that the group administrator works for and is a service provider to the group. The group is a legal entity that has elected you to represent the best interests of the owners, which are the members of the group. Part of this representation that you provide is looking out for the best interests of the members, not the administrator, or other service providers to the group. You represent the group and members best interests. In turn, a well-run, financially solvent group is also in the public's best interest.

It is critical to always keep in mind that each member is jointly and severally liable for the compensation liabilities of all other members for the years in which the member was in the group. That liability does not exist where members purchase insurance in the private market. As a result, the decision to join a group, and to serve on the board of directors of a group, is a very serious and important one.

The first fundamental principle is that all actions and decisions of the board must be made from the perspective of the best interest of the members. That includes decisions on setting rates, admitting new members, making assessments, and making disclosures to the members. It also applies to the fundamental decision whether to continue to operate as a self insured group at all, or simply return the membership to the private insurance market.

The second fundamental principle is that the interest of the members is in an adequately funded, financially sound, group, not in obtaining short term premium discounts that will result in future deficits, assessments to members, and possible conservation of the group, with the inevitable assignment of blame that accompanies those events. In that regard, you need to be aware of the fact that group administrators are paid on a commission and only make money if the group continues to exist. They make more money if the group grows. There is nothing improper about that structure, but one side effect can be that even an honest and well-intentioned group administrator may naturally be biased in favor of keeping a group in operation, or growing the membership, by charging low rates, giving discounts, and letting in members who are a poor risk. Bear in mind, however, that it is the members, not the administrator, who are "on the hook" if the rates collected are inadequate or the group fails for any reason.

Do not rely on representations by anyone that the safety and soundness of the group is assured because it is subject to state regulation. You, as board members, have the best and most current information regarding the condition of the group. Be proactive to ensure rates are adequate and that the group is operated in a sound manner. Do not wait for regulators to catch a problem after the fact. By then serious liabilities may already have been incurred harming all group members.

Other representations that have been made in the past to lull SIG boards into complacency include the representation

that the group is protected from extreme liability by excess insurance, that group liabilities are overstated because they are calculated at an 80% confidence level, or that reserves are overstated because of regulation. Such comments should be a warning sign to you that the group may be at risk. You need to take action to find out the true story. Get a second opinion.

Remember, there is no requirement that you continue as a self insured group forever, or that the group always has to beat the rate for insurance in the private market to retain membership. The decision to continue as a group or to charge a given rate is just that – a decision – that the board should make each year after careful analysis of all the evidence and the pros and cons, viewed from the perspective of the members in light of their joint and several liability for any underfunding.

### **SPECIFIC REQUIREMENTS AND RECOMMENDATIONS**

Below are some requirements and recommendations that at a minimum should be a standard practice that you include in your activities as a board member. This is NOT all inclusive and does not cover all areas. These are some of the basics and most commonly overlooked duties.

Groups are governed by Title 8 of the California Code of Regulations (CCR) Subchapter 2, Articles 1 and 13. The Board of Trustees' duties and responsibilities are primarily identified in CCR §15475, 15476, 15477, and 15481. The California Department of Industrial Relations, Office of Self Insurance Plans (DIR OSIP), is the state agency which has regulatory oversight responsibility and authority over group self-insurers (groups) operating in California. Because groups must be formed as corporations pursuant to the California Corporations Code (Corporations Code), the Board must also ensure that the group adheres to statutory provisions contained within the Corporations Code. However, it is fundamentally the board's responsibility to ensure the safety and soundness of the group.

CCR §15475 addresses the Board of Trustees' duties and responsibilities. Its purpose is to maximize the Board's accountability for the group's financial condition and for ensuring that the group operates legally. Specifically, CCR Section 15475 (a) holds the Board of Trustees responsible for all operations of the group self insurer. The following lists the other specific responsibilities required by the regulations.

#### **A. Board Composition pursuant to CCR §15475 (b)**

The Board composition requirements must be defined in the group's bylaws, which in turn should contain the provisions mandated by CCR §15475 (b):

1. The Board of Trustees must be elected by the group members; except in the case where every group member has a seat on the Board;
2. At least two-thirds of the Board must be comprised of the group members;
3. Service providers are not allowed to serve on the Board as voting members; and
4. The group administrator may serve on the Board but only as a non-voting member.

Also, review your bylaws to see if there are additional provisions relating to board membership such as a limitation on the number of years a member may serve on the board, or a prohibition on consecutive terms. If you do not have such

provisions in your bylaws, you may want to consider adding them, to ensure that the board is continually exposed to new points of view. Do not allow the group administrator to dominate and control the process of selecting board members.

You should use the annual election of board members as an opportunity to communicate with members regarding the financial results of the group, the overall condition of the group, and plans for the future.

In addition, make sure that the board has independent counsel which was not selected by and has no other affiliation with the group administrator. It is important for the board to be exposed to legal advice that is completely unbiased and not subject to any conflict of interest.

The group administrator answers to the Board of Trustees and it is the Board's responsibility to ensure that the administrator operates in the manner prescribed by the regulations.

#### **B. Approval of New Members pursuant to CCR §15475 (c)**

CCR §15475 (c) holds the Board responsible for approving or denying the applications of new members into the group. If this responsibility is delegated to the group administrator via the group bylaws, the Board should maintain oversight and ensure the group's underwriting criteria are met.

#### **C. Board Duties and Responsibilities pursuant to CCR §15475 (d)**

The Board of Trustees is charged with ensuring that the group's workers compensation program as a whole is properly funded and financially and operationally maintained at the levels mandated by the regulations. The Board is accountable for all program year budgets, actual expenditures, service provider contacts, actuarial studies pursuant to CCR § 15481, rates, investment policies and investment portfolio, return of surplus (dividends) to members, assessments to members, underwriting guidelines, and for instituting accounting procedures that fairly and accurately depict income, expenses, and the reserves for future loss costs for each program year until all claims in a given year are closed. CCR §15475 (d) requires the Board to "take all necessary precautions" to protect the group's assets. Collecting sufficient contributions and obtaining proper estimates of group's claims liabilities are the regulations most key directives to the Board. CCR §15475 (d) (7) and (8) mandate that the Board:

- Contract with an actuary to conduct an annual actuarial review of the group self insurer's claims and produce a 'Written actuarial study that projects ultimate liabilities of the group self insurer by program year at the undiscounted expected actuarial confidence level also commonly known as the undiscounted 'actuarial central estimate', inclusive of incurred but not reported (IBNR) liabilities, Allocated loss adjustment expense (ALAE), and unallocated loss adjustment expense (ULAE) to ensure that all claims and associated costs are recognized;
- Ensure that sufficient income from annual member contributions and/or assessments are collected.

CCR §15476 prohibits the Board from authorizing discounts to any member.

Note also that any actuarial report used in setting rates may include the assumption that discretionary underwriting discounts will not be given and may include assumptions about the treatment of ex-mods for members in underwriting their specific level of contribution. It may also include assumptions about the makeup of the group. Make sure you understand those assumptions. Granting discounts on top of rates recommended in the actuary's report, using more generous ex-mods than the actuary assumed would be used, or letting in group members whose profile differs from what the actuary assumed would be the case, will foreseeably result in the collection of inadequate contributions to cover future claim liabilities.

CCR §15475 (d) also describes the following administrative and operational matters for which the Board has full responsibility:

1. Designating a group administrator to manage the financial affairs and day to day operations.
2. Ensuring there are no conflicts of interest involving the Board, group administrator, or other key service providers; CCR §15475.1 addresses separation of duties and conflicts of interests among the group's service providers.
3. Contracting with a third-party claims administrator (TPA);
4. Obtaining fidelity coverage in an amount sufficient to cover the group funds handled by the Board and/or any employees of the group;
5. Obtaining Directors and Officers insurance in an amount sufficient to protect the group's interest;
6. Ensuring that the group administrator and TPA obtains fidelity coverage and errors and omissions coverage in an amount sufficient to cover the group funds handled for the group;
7. Ensuring that the TPA's fidelity coverage names the group as a beneficiary (additional insured);
8. Managing disbursements for the payment of all operating expenses of the group, including the security deposit;
9. Establishing all necessary bank accounts within California and adopting a Board Resolution for signature authority for each account;
10. Obtaining an independent financial audit immediately after the December 31 close of each year;
11. Ensuring that contributions from members are used only for the payment of claims, posting of the security deposit, and reasonable expenses for operation of the group;
12. Meeting at least one time per year to adopt an operating budget, approve contribution rates, and

review the investment portfolio of the group; and

13. Reporting if the SIG is not in compliance with OSIP requirements or if a membership is terminated for cause.

The Board may delegate some of these duties to the group administrator, however those delegated duties should be stated in the group's Bylaws. Any changes to those duties will require a Bylaw change that must be submitted to the DIR OSIP.

#### **D. Other Assigned Responsibilities**

The following Board responsibilities and accountability are specifically stated in other sections of the regulations.

1. Ensuring that the group does not lend money, issue any debt instruments, incur other encumbrances or obligations or extend credit to group members (CCR §15475.2);
2. Ensuring that the group funds are not comingled with the funds or assets of any group member or group self-insurer (CCR §15475.2);
3. Oversight of the group self-insurer's investments (CCR §15475.3);
4. Proper declaration of surplus (CCR §15477);
5. If necessary, submitting a corrective action plan to DIR OSIP and execution of the plan, including issuing assessments to members (CCR §15477);
6. Ensuring that the group obtains specific excess workers compensation insurance (CCR §15478);
7. Direct the group administrator to ensure ongoing safety and risk control services for the group members. The risk control must be directed by a California Professional Engineer, Certified Safety Professional, or Certified Industrial Hygienist. These certified individuals must report the results of the safety and risk control activities to the Board at least annually (CCR §15486.1);

For additional information on regulations, please visit the OSIP website at <http://www.dir.ca.gov/sip/sip.html>.