Manager/Supervisor Risk Management
#86– 9/4/12
A twice weekly e-mail training for YCPARMIA members

TOPIC: LIABILITY COVERAGE

The next series of topics will explore the YCPARMIA Coverage Agreement, the mechanism that transfers most of the liability risk from the member entity to the self-insurance pool. As previously discussed, assuming that the entity does not want to eliminate their risk by closing their doors, there are three broad options available for managing risk:

- The entity can take steps to <u>reduce</u> the risk – loss prevention
- The entity can <u>retain</u> their risk – in essence self- insure
- The entity can take steps to <u>transfer</u> the risk – by contract

The transfer can be to a contractor for a specified activity through an indemnification clause in a contract, or the transfer can be general through the purchase of insurance or participation in a risk sharing pool (i.e. YCPARMIA).

Historically California public entities, like any other business, purchased commercial insurance. However, in the late 1970's the insurance industry collectively decided that public entities were bad risks (i.e. law enforcement activity), and chose to either stop underwriting the public sector, or to raise premiums to a level where coverage was unaffordable. Confronted with the reality that they could not buy insurance coverage, the entities were essentially self-insured for their various liability exposures; their general funds were exposed to largely unpredictable claims and lawsuits. The crisis led to the formation of California public entity risk sharing pools as an alternative to entities going bare.

Insurance companies (and pools) spread risk among the various individuals and business that purchase their policies. The insureds know what the cost of their risk will be –their premium cost. The insurance companies, through their underwriting analysis, determine how much premium they will need to collect to pay the anticipated costs of defending and indemnifying their insureds. Their profit comes from lower than anticipated loss ratio, and investment returns on the collected premiums.

The relationship between the insurance company and their insured is defined and controlled by the <u>insurance policy</u>. It is a contract where the carrier agrees to defend and indemnify the insured in exchange for the payment of an insurance premium. The insurance contract contains various clauses that define the various rights and obligations of the parties. Different insurance policies – auto, general liability, workers compensation – cover different types of risks.

A public entity <u>risk sharing pool</u>, formed under a <u>joint powers agreement</u>, in many ways functions like a traditional insurance company with its <u>coverage agreement</u> looking like a typical commercial insurance policy. The agreement defines the coverage obligations between the JPA and its members. The important distinction is that it "does not provide insurance, but instead provides for pooled self-insurance." The member entity shares their individual and collective risk with the other pool members.

Next topic: Anatomy of an Insurance Policy