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December 1, 2011 299091

City of San Leandro
Civic Center
835 East 14th Street
San Leandro, California 94577

Attn: Ms. Mary Ann Perini
Budget & Compliance Manager/Risk Management

RE: Retention Analysis and Financial Benchmark For the General Liability Program Using Data Valued as of June 30, 2011

The City of San Leandro (the City) currently maintains a $1 million per occurrence self-insured retention (SIR) and participates in the CJPRMA pool above the $1 million limit.

The City has asked us to (1) evaluate if there is a benefit in lowering the SIR limit, and (2) provide some financial benchmarks to evaluate its fund balance.

(1) Evaluation of the Alternative SIRs

We have estimated the projected losses for 2012/13 at the $1 million SIR limit in our actuarial report dated August 24, 2011. We have projected the 2012/13 losses at various alternative SIRs and confidence levels as shown in Table 1.

Table 1
Projected Ultimate Limited Losses
at Various SIRs and Confidence Levels
2012/13

SIR (1)	Expected (2)	70% (3)	80% (4)	90% (5)
(A) $500,000	$992,800	$1,231,072	$1,499,128	$1,985,600
(B) $750,000	1,086,240	1,346,938	1,640,222	2,172,480
(C) $1,000,000	1,168,000	1,448,320	1,763,680	2,336,000
(D) $1,500,000	1,284,800	1,593,152	1,940,048	2,569,600
(E) $2,000,000	1,366,560	1,694,534	2,063,506	2,733,120

Note: (C) is from the actuarial report as of 6/30/11 dated August 24, 2011
(A), (B), (D), (E) are based on (C) and actuarial judgment.

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In Table 2 we display the additional projected losses to go to a different limit from the current $1 million SIR to the various alternative SIRs in Table I.

Table 2
Additional Projected Ultimate Limited Losses
at Various SIRs and Confidence Levels
2012/13

SIR (1)	Expected (2)	70% (3)	80% (4)	90% (5)
(A) $500,000	($175,200)	($217,248)	($264,552)	($350,400)
(B) $750,000	(81,760)	(101,382)	(123,458)	(163,520)
(C) $1,000,000	0	0	0	0
(D) $1,500,000	116,800	144,832	176,368	233,600
(E) $2,000,000	198,560	246,214	299,826	397,120

Note: (A) to (E) are from Table 1 minus (C).

Table 2 can be interpreted as follows:

To go from $1 million SIR to $500,000 SIR, the City would not bear the "expected" losses in the layer from $500,000 to $1 million. These costs would be shifted to the excess pool, in exchange for a premium contribution. Assuming that this premium is about $30,000 (the premium for the upcoming year 2012/13 was not available, but the premium quoted for 2011/12 by CJPRMA was $29,815.), the City would pay $30,000 to cover the "expected" losses of $175,200 from Table 2, for a net savings of $145,200. However it is very important to bear in mind that the "expected" losses are an estimate based on long-term averages of other similar entities, and do not solely reflect San Leandro's loss experience in this layer. San Leandro's loss experience is reflected in Table 3A and 3B. Moreover, the "expected" losses are subject to great variation due to the sparsity of claims in higher layers.

We have also reviewed the size of loss distribution as shown in Table 3A and Table 3B. These represent 30 years of claims from July 1, 1981 to June 30, 2011.

Table 3A
Size of Loss Distribution: Total Reported Claims

Layer	Prior	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	Total	% Total
$0	549	32	47	31	50	45	88	60	17	15	34	968	
$0 to $5,000	1,134	42	52	38	52	34	29	49	61	32	27	1,550	80.9%
$5,000 to $10,000	91	7	10	2	5	4	1	2	7	3	5	137	88.1%
$10,000 to $25,000	68	0	6	0	4	1	5	2	2	3	3	94	93.0%
$25,000 to $50,000	31	1	5	1	0	3	2	1	0	1	1	46	95.4%
$50,000 to $100,000	19	2	4	2	2	0	0	3	6	0	8	46	97.8%
$100,000 to $250,000	14	0	6	1	2	0	3	2	1	0	0	29	99.3%
$250,000 to $500,000	5	0	0	0	0	1	2	0	2	0	0	10	99.8%
$500,000 to $750,000	1	0	0	0	0	0	0	0	0	0	0	1	99.9%
$750,000 to $1M	1	0	0	0	0	0	0	0	0	0	0	1	99.9%
Over $1M	0	0	0	0	0	0	0	☆ 1	0	0	0	1	100.0%
Total	1,913	84	130	75	115	88	130	120	96	54	78	2,883	

Note: Data is provided by the City.
Total non-zero claims = 1,915 (2,883 – 968)
* One claim in 2007/08 in "Over $1M" layer is not covered by CJPRMA.

Table 3B
Size of Loss Distribution: Total Reported Incurred Losses
($000)

Layer	Prior	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	Total	% Total
$0	0	0	0	0	0	0	0	0	0	0	0	0	
$0 to $5,000	1,084	59	67	46	61	54	32	45	44	26	43	1,562	7.7%
$5,000 to $10,000	658	49	66	15	34	25	9	14	46	22	39	976	12.6%
$10,000 to $25,000	1,065	0	92	0	57	12	67	26	27	53	42	1,441	19.7%
$25,000 to $50,000	1,152	35	208	36	0	100	68	43	0	33	47	1,723	28.2%
$50,000 to $100,000	1,287	141	300	171	146	0	0	204	452	0	420	3,122	43.7%
$100,000 to $250,000	2,010	0	965	105	384	0	380	263	152	0	0	4,259	64.8%
$250,000 to $500,000	1,849	0	0	0	0	426	667	0	739	0	0	3,681	83.0%
$500,000 to $750,000	640	0	0	0	0	0	0	0	0	0	0	640	86.2%
$750,000 to $1M	833	0	0	0	0	0	0	0	0	0	0	833	90.3%
Over $1M	0	0	0	0	0	0	0	☆ 1,950	0	0	0	1,950	100.0%
Total	10,578	284	1,698	373	682	617	1,224	2,546	1,460	134	590	20,187	

Note: Data is provided by the City.
* One claim in 2007/08 in "Over $1M" layer ($1.95 million) is not covered by CJPRMA.

Table 3A and 3B show that the City has experienced 3 claims above $500,000 from July 1, 1981 to June 30, 2011. Two of these claims for $640,000 (1999/00) and $833,000 (1994/95) would have been eligible to be covered by CJPRMA. Thus, had the City had $500,000 SIR instead of $1 million SIR, it would have recovered $473,000 ($140,000 + $333,000, coming from $640,000 - $500,000 and $833,000 - $500,000, respectively) from the excess insurance. However, they City would have paid over all these years from 1981/82 to 2010/11, a total premium contribution of about $1.5 million (an approximation based on 30 years multiplied by an average annual premium of about $50,000).

It is also important to keep in mind that this is a retrospective look. It does not in any way imply that the City is not exposed to one or more claims above $500,000 in the coming year, even though the City's loss experience in this layer is very favorable.

The City expects about 90 claims per year (both claims with zero dollars and payments); and the average annual cost per claim is about $13,000.

About 98% of the claims are below $100,000 (i.e. about 10 x average cost). Based on the City's loss experience, the possibility of a claim exceeding $500,000 is remote (3 out of 1,915 non-zero claims over 30 years, one recent claim of $1.95 million in 2007/08).

While the loss experience to date indicates that the City has achieved savings by maintaining the $1 million SIR (since joining CJPRMA in 1986) instead of electing the $500,000 SIR, the decision whether to lower or maintain the current $1 million SIR depends on factors beyond the quantitative historical review. Qualitative factors should be considered such as risk capacity, as guided by the financial benchmarks discussed in (2) below, to withstand future claims (even though the City has remote possibilities of such claim), as well as its philosophy of risk aversion and potential exposure due to changing conditions or risk environment.

(2) Financial Benchmark for Fund Balance

In determining the adequacy of the financial position, several financial measures exist. Most of these are used by state insurance regulators to monitor solvency of insurance enterprises. Three key measures are (1) net contribution (net of reinsurance cost)-to-surplus, (2) reserves-to-surplus and (3) surplus-to-SIR. Reserves are the estimated outstanding losses, undiscounted and at the expected (55%) confidence level. Surplus is defined as the excess of assets over liabilities. It broadly relates to net assets or, in the case of the City, the projected financial position.

Net contribution-to-surplus ratio of 1:1 (judgmentally selected based on industry experience) is considered reasonable. The net contribution can be derived as the expected 2012/13 limited projected losses of about $1.2 million plus expenses (excluding reinsurance costs). We estimate the expenses at 20% (judgmentally selected based on industry experience) of the projected losses at about $0.24 million, for a total net contribution of about $1.44 million. For a 1:1 ratio, this implies a fund balance of $1.44 million.

A reserve-to-surplus ratio of 2:1 is also considered reasonable. Using this target ratio and given the City's estimated outstanding losses for the general liability program of $4.5 million (see Table III – 1A of the actuarial report date August 24, 2011), then the required surplus (financial position) would be about $2.25 million.

A reasonable target for the surplus-to SIR ratio is 10:1, implying that the available funds are sufficient to absorb 10 large claims that reach the self-insured limit. For general liability, the required fund balance would be $10 million (i.e. the SIR of $1 million x 10). The City's loss experience as shown in Table II indicates that claims exceeding $500,000 are rare, and we select a lower level of 5:1 ratio. This implies a fund balance of $5 million ($1 million x 5).

The three measures above indicate a fund balance ranging from a low of $1.44 million to a high of $5 million. For a conservative position, we recommend the maximum indicated in the range.

While these measures are guidelines, the financial solidity of the self-insured program depends on many factors, e.g. ability to levy assessments to pay for catastrophic losses, etc.

We appreciate the opportunity to serve the City of San Leandro and are available to answer any questions you may have.

Respectfully submitted,

Aon Risk Consultants, Inc.

By Mujtaba Datoo

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