



City of Seattle
Department of Finance and Administrative Services

September 1, 2010

The Honorable Bruce Harrell, Chair
Energy, Technology and Civil Rights Committee
Seattle City Council
P.O. Box 34025
Seattle, WA 98124-40251

Dear Councilmember Harrell,

I am pleased to transmit the attached Risk Management Best Practices briefing paper and Loss Control Procedures from Bruce Hori and his staff, which will create a more formal risk reduction framework by implementing specific policies and procedures intended to reduce both the frequency and severity of claims and lawsuits against the City of Seattle.

We appreciate the opportunity to provide this information and hope you find it helpful. If you have any questions, or would like an in-depth briefing on this matter, please don't hesitate to call me at 684-5212 or Bruce Hori at 386-0073.

Sincerely,

A handwritten signature in cursive script that reads "Fred Podesta".

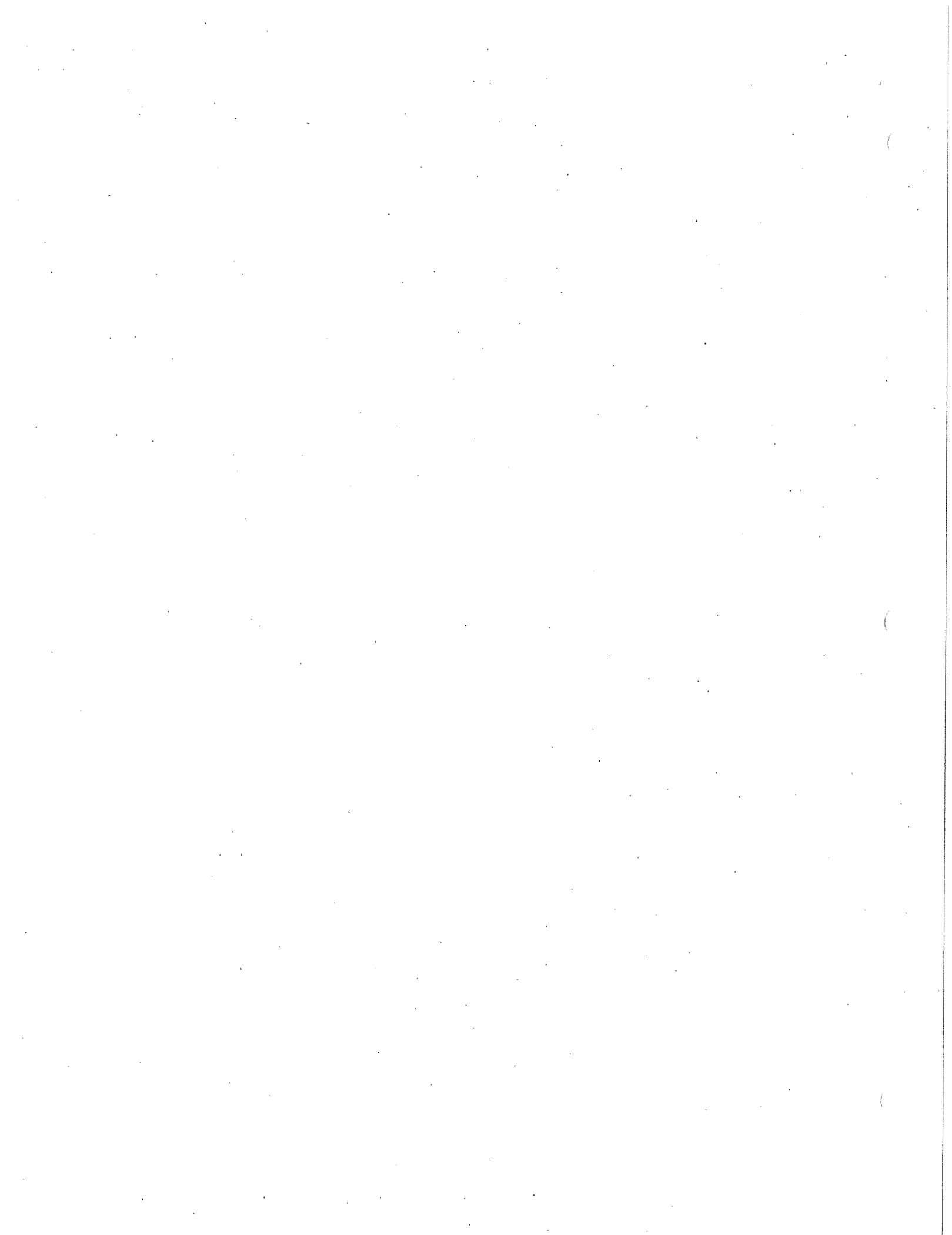
Fred Podesta
Acting Director

Attachment: Risk Management Loss Control Procedures

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City of Seattle
Department of Finance and Administrative Services

August 31, 2010

To: Councilmember Bruce Harrell, Chair
Law and Risk Management Committee

From: Bruce Hori, Director
Risk Management Division
Department of Finance and Administrative Services

Re: FAS Risk Management Best Practices

This briefing paper sets forth the Department of Finance and Administrative Services (FAS) Risk Management Division's current risk management best practices and specific plans for improvements to enhance effectiveness and citywide financial loss control.

EXECUTIVE SUMMARY

The FAS Risk Management Division (RMD) provides the following services:

- Investigates and adjusts claims filed by people who allege they have been damaged by the negligent act of the City or its employees.
- Advises City departments on ways to reduce or avoid losses.
- Reviews City department contract work scopes to specify appropriate insurance and indemnification language.
- Administers all of the City's liability, property insurance policies and its self-insurance program.

RMD consists of in-house claims adjusters and a claims manager who directly handle 1,500 to 2,000 claims each year. RMD also has operational staff who work with the Law Department and City operating departments to:

- 1) Identify loss exposures,
- 2) Eliminate exposures that cannot be justified,
- 3) Reduce frequency and severity of remaining exposures,
- 4) Contractually transfer risk where and to the extent possible, and then
- 5) Arrange risk financing for the residual risk portfolio via insurance and self-insurance programs.

All five steps are critical in reducing the City's total cost of risk.

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SUMMARY OF ESTABLISHED RISK MANAGEMENT BEST PRACTICES

Two principal professional risk management associations, the Risk and Insurance Management Society (RIMS) and the Public Risk Management Association (PRIMA), are considered authoritative sources of risk management best practices in the United States. Best practices are dependent on many variables, such as the size of the organization, whether it is public or private, owns or operates a transit system or airport, and the extent of its legal immunities and statutory tort liability caps.

Public entity risk management practices are generally aligned with those in the private sector, though there are differences that make public entities, and the risks they encounter, unique from private profit-seeking businesses. These risks can include essential governmental functions, such as public safety, utility service, traffic management and transit operations that must continue in an orderly and reasonably safe society. These daily activities present a unique scope of exposures that are typically subject to tort liability.

Another difference is that a public entity strives to achieve specified public interest or governmental objectives within budget constraints in a political environment. A public entity's selection of risk management techniques is likely to be influenced by public interest goals, statutory requirements, charter provisions, budgeting processes, tax laws, insurance market conditions and political considerations that are not applicable in the private sector. Public interest organizational objectives are given high priority and must be balanced against controlling the public entity's activities in order to reduce the incidence and costs of losses.

Because a public entity's losses can compromise its ability to carry out organizational purposes, risk management professionals must identify and analyze loss exposures, examine alternative risk management techniques, select appropriate loss mitigation techniques, implement the techniques and monitor the results.

RMD'S ADHERENCE TO BEST PRACTICES

To establish a baseline for reference, the City of Seattle is a mid-sized municipality with a population of approximately 600,000, owning a potentially expanding transit system (the South Lake Union Streetcar) and operating within an uncapped tort environment with certain statutory protections, such as the Recreational Land Use Statute (RCW 4.24.200) which limits the liability of owners of land open to the public for recreational purposes.

We have used RIMS and PRIMA models to assess our operations, as detailed below.

Organizational Placement

The current Risk Management organizational placement, as a Division in FAS, is consistent with best practices for public entities, which places risk management functions within administrative or budgetary/finance departments.

Until January 2002, core risk management functions were divided among several departments – undesirable from a “best practices” perspective of most effective coordination. The City's Claims Management unit was in the City Attorney's Office, the City's Risk Manager and an Administrative Specialist were in the Department of Finance, and a Risk Management Contract Analyst was in the Executive Services Department.

In 2002, as part of a reorganization which created the Department of Executive Administration, the functions were brought together as the Risk Management Division with a City Director of Risk Management. The RMD is currently part of the newly created Department of Finance and Administrative Services.

Functional Responsibilities

Risk Financing – A core risk management responsibility of a mid-sized public entity, such as the municipality of Seattle, is to administrate the risk financing function against accidental loss exposures. Best practices dictate that larger public entities establish an appropriate self-insured retention and purchase appropriate limits of Excess Liability insurance over the self-insured retention for catastrophic circumstances that exceed the entity's prudent risk-bearing capacity. These loss exposures are generally composed of third-party bodily injury and property-damage claims/lawsuits, i.e., claims against the City, and first-party property losses to City-owned real and personal property, i.e., the City's losses due to damage to its facilities, property or equipment.

The RMD's current risk financing practices, described below, fall within generally accepted risk management best practices for public entities. The Director of Risk Management and operational risk management staff are all involved in the strategic and day-to-day management of the risk financing function.

The smallest public entities purchase "first dollar" (no deductible) commercial insurance policies to fund their accidental loss exposures. Smaller cities and counties, as well as school, water and similar districts, typically participate in pooled self-insurance and excess liability insurance arrangements.¹¹ Larger cities in the Pacific Northwest region (notably Seattle, Portland and Spokane) administer self-insurance programs with substantial self-insured retentions (similar to a deductible).

Each year the Risk Management Division works with the City's insurance broker, actuaries at PricewaterhouseCoopers and FAS Finance to determine the appropriate level of a self-insured retention given the loss developments, insurance market conditions and premium costs. The City of Seattle's self-insured retention is presently \$6.5 million for each occurrence for accidental losses, paid out of the Judgment/Claims Subfund. (Self-insured Workers Compensation losses, managed by the Personnel Department, have a \$15 million self-insured retention).

The rationale for self-insured programs for larger entities with the financial capacity to absorb a self-insured retention, such as the City of Seattle, is that, over time, those entities will pay the entire cost of their losses whether those losses are self-insured or insured. Buying insurance typically costs more than self-insurance because, in addition to the pure cost of defense and indemnity, the entity also pays the insurer's overhead, risk charges, taxes and commissions, which can inflate costs by 30% to 40%.

Consistent with best practices, the City of Seattle maintains a \$6.5 million self-insured retention. Above this, the City has a \$5 million First Excess layer of insurance and a \$25 million Second Excess layer, for total program limits of \$36.5 million for each third-party loss occurrence. Essentially this means the City covers the first \$6.5 million in losses, and has two insurance policies to cover the next \$5 million and \$25 million in losses. Any third-party losses above \$36.5 million are the City's responsibility. The City also maintains first-party insurance coverage for its property inventory of buildings and other lesser limit policies for many specialized exposures, such as builders risk insurance for capital projects.

A significant ancillary duty of managing a self-insured retention is maintaining loss portfolio databases with total incurred losses (both paid and reserved indemnity and expenses) that are funded by the Judgment/Claims ("J/C") Subfund. RMD contracts for actuarial services with PricewaterhouseCoopers and coordinates management of the J/C Subfund with FAS Finance and the Law Department.

It should be noted that from time to time City operations present new and sometimes significant exposures that necessitate a formal review to determine the need to increase insurance limits. For example, at the present time the City's ownership of the South Lake Union Streetcar System presents a distinct and limited transit loss exposure. However, as the streetcar system expands, the cost of risk associated with owning an expanded system must be factored into the cost of owning such a system. This may call for increasing the City's excess liability limits to cover the expanded transit exposure. The yearly premium for this expanded insurance coverage could be significant and should be factored into the costs of owning an expanded streetcar system.

Claims Management – Another core risk management responsibility of a larger public entity with a self-insured retention is to adjust claims and defend lawsuits within its retention. RMD's current claims management practices fall within generally accepted risk management best practices for public entities.

Consistent with best practices, the City of Seattle maintains an in-house staff of claims adjusters. The City has three in-house adjusters and a claims manager who handle 1,500 to 2,000 claims per year. When a catastrophic event occurs, such as the December 2006 and December 2007 rainstorms, the volume of claims increases substantially. To supplement existing staff resources, RMD contracts with outside third-party administrators for claim management services. Because contracting out claims adjustment responsibilities removes the element of direct interaction with claimants, City adjusters remain involved to manage sensitive claim situations and to prevent socially inequitable claim adjustments. For these reasons, RMD manages most claims in-house to the maximum extent possible and carefully coordinates the work of outside claims adjusters.

Generally, 65 days after filing a claim a third-party claimant may file suit against the City. If this occurs, the RMD "zeroes out" any outstanding defense and indemnity reserves and transfers the file to the City Attorney's Office. However, RMD continues to track the defense and indemnity reserves and payments as RMD is responsible for compiling loss data for periodic financial reports to the City Council, for our actuaries, and for our Excess Liability insurance underwriters.

Loss Control Enhancements – Third-party legal liability claims and lawsuits are managed through RMD, working with the Law Department and City operating departments. Earlier this year, RMD drafted specific procedures to enhance loss control measures and recommended strategies to reduce the City's exposure to liability. The enhanced measures have been reviewed and are supported by Council Central Staff. RMD and the Law Department are in the process of fine-tuning the enhanced procedures and plan to begin implementation early next year. Generally, the procedures outline a joint effort between Risk Management and the Law Department to form a Citywide Risk Management Advisory Group and to require each operating department to designate a Risk Management Coordinator to assist with implementing specific mitigative measures and/or changes to operating protocol when appropriate. The new procedures may also involve workplace training and education. Additionally, as a result of the recent FAS organization, additional resources are available to perform enhanced data analysis to identify more specific loss trends. The draft enhanced Loss Control Procedures are attached.

CONCLUSION

The City's current risk management program covers third-party liability exposures arising from the City's own operations, as well as "vicarious" (assuming liability for the acts of others) and contributory liability for the acts of contractors, vendors, consultants and others within a \$6.5 million self-insured retention. The City's risk management program also covers catastrophic risks for the City's first-party loss exposures (property insurance for the City \$4.3 billion property inventory and unlimited Excess Workers Compensation insurance). Principal exceptions to this are:

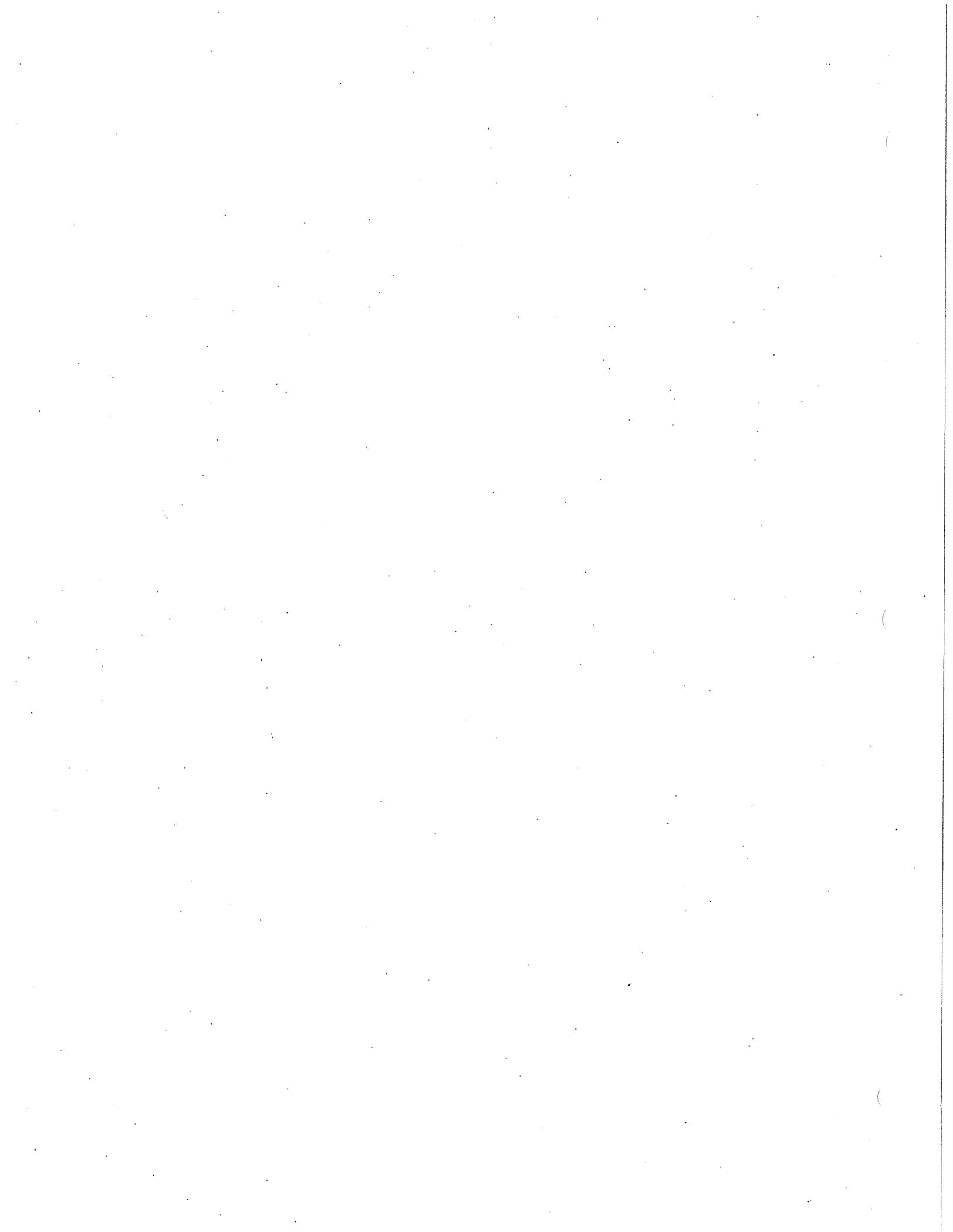
- Safety/Loss Control (resides in Personnel and within operating departments)
- Self-Insured Workers Compensation (resides in Personnel)
- Regulatory Management (resides within Departments)
- Crisis Management Planning and Execution (resides in Emergency Management)
- Control of Disposition of Lawsuits (resides in City Attorney's Office)

The City's current approach to allocating risk management roles is consistent with generally accepted risk management best practices among similarly situated public entities. In addition, the planned loss control improvements will further enhance the City's best practices.

Attachments: Draft Loss Control Procedures

¹ Head, George L. and Wong, Kwok-Sze Richard, *Risk Management for Public Entities*, First Edition, (Center for the Advancement of Risk Management Education, Malvern, PA, 1999), pp. 3-4.

ⁱⁱ Pooled public entity risk services in Washington State are furnished by Association of Washington Cities Risk Management Service Agency, Enduris, Public Utility Risk Management Services, Southwest Washington Risk Management Insurance Cooperative, Washington Cities Insurance Authority, Washington Counties Risk Pool, Washington Schools Risk Management Pool, Washington State Transit Insurance Pool and Water and Sewer Risk Management Pool





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INTRODUCTION:

- Claims and lawsuits paid out of the City's Judgment Claims Subfund (J/C) Subfund primarily involve liability for bodily injury and property damage to third party claimants. Expenses to defend the City are also funded out of the J/C Subfund.
- In order to minimize payments out of the J/C Subfund, the FAS Risk Management Division (RMD) will partner with the City Attorney's Office (CAO) to implement the following loss control measures.
- The measures cited below do not address expenses for the City's self-insured Workers Compensation (WC) program for industrial injury benefits payable to City employees. The WC program is administered by the Personnel Department and WC costs are not paid out of the J/C Subfund. The WC safety function resides in the Personnel Department and with departmental safety officers.

FRAMEWORK:

- The overall strategy is to create a more formal risk reduction framework with specific policies and procedures to reduce both the frequency and severity of claims and lawsuits. Essentially, the objective is to identify and reduce recurring claims, thereby reducing payments for claims, lawsuits and associated costs.

Risk Management Manual

- Risk Management will take the lead in collaborating with the CAO to prepare a formal Risk Management Manual outlining the roles and responsibility of the Risk Management Division, the CAO and City departments.
- The manual will set forth procedures, protocol and expectations for departments working with Risk Management and the CAO, and will specify more detailed loss control reporting in the Annual Report of the J/C Subfund to the City Council.



City of Seattle:
Department of Finance and Administrative Services
Risk Management Division

Document:
Risk Management Loss Control
Procedures

Contact: Bruce Hori (206-386-0073)

Last Update: September 1, 2010

Risk Management Advisory Group (RMAG)

- Risk Management will form a citywide Risk Management Advisory Group (RMAG) to provide executive loss control oversight of potential citywide loss exposures and possible mitigation measures.
- RMAG members will include the City's Risk Management Director, the Risk Management Division's Operational Risk Manager, attorneys from the CAO and senior managers from certain City Departments as determined by Risk Management.
- RMAG meetings will convene two to four times a year and will be a forum to discuss legal advice regarding specific losses and the departments' operational challenges with implementing cost effective mitigative measures given funding, feasibility, timing, and prioritization of any suggested measures or changes.

Risk Management Coordinators

- The Risk Management Division shall ask each departmental to designate a Risk Management Coordinator (RMC) of sufficient experience and authority to accomplish the goals listed below as approved by Risk Management and the CAO.
- Risk Management and the CAO will meet with the RMC of each operating department at least once per year. The Risk Management Coordinators shall also interact with the CAO and the City's Risk Management Division on an as needed basis to: (1) discuss major losses and loss trends, (2) assist in designing effective remedial training of appropriate Departmental line employees, (3) follow up on the Department's implementation of loss control measures, and (4) monitor past loss control measures to assess effectiveness in reducing incidents/accidents and claims/lawsuits against the City.
- The four City departments with the highest numbers of claims will each meet with Risk Management and the CAO approximately three times a year to review loss trends, to follow up on the department's implementation of loss control measures and to determine whether past loss control measures have been effective in reducing claims and lawsuit payments.



Claim Loss Prevention

- The Closing Report for each Claim for Damages filed with the City will continue to report of the loss prevention measures taken by the operating department. In addition, prior to closing the file on paid claims, the claims adjuster shall verify with the operating department that appropriate loss prevention measures were in place at the time of the claim, or that specific loss prevention measures have been or will be implemented to reduce similar losses to the extent possible.
- On paid claims where the operating department has not identified or implemented loss prevention measures to reduce similar losses to the extent possible, the file will be forwarded to the Risk Management's Operational Risk Manager who will contact the operating department's RMC who will work with Risk Management, the CAO and the operating department's staff to identify and implement appropriate loss prevention measures. The CAO, Risk Management, the Budget Office and the operating department will meet to discuss any issues that arise regarding the ability of the Department to follow legal advice concerning suggested loss control measures. The Operational Risk Manager shall track the department's implementation of the loss control measures.

Loss Trend Analysis

- Risk Management will develop periodic reports analyzing citywide loss trends and analyze data by department to identify more specific loss trends. Based on the information gathered in the reports, Risk Management and the CAO will meet with the department's RMC, who shall work to identify reasonable and cost effective loss control measures (taking into account funding, feasibility and timing) and to prioritize any suggested mitigative measures. City Risk Management and the operating department will consult with the CAO concerning the implementation of the loss control measures. The CAO, Risk Management, the Budget Office and the department will meet to discuss any issues that arise regarding legal advice surrounding suggested loss control measures.



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Claim Review and Loss Analysis

- For incurred claims greater than \$100,000 and incurred lawsuit losses greater than \$500,000, Risk Management, with input from the operating department, will seek advice from the CAO as to the implementation of mitigative measures and/or changes to operating protocol, where appropriate. Where mitigative measures and/or changes to operating protocol are indicated, the CAO, Risk Management, the Budget Office and the operating department will meet to discuss issues that may arise regarding the funding, feasibility, timing, and prioritization of any suggested measures or changes.
- Where claims or lawsuits arise out of identifiable and correctible department action or conduct, each operating department's RMC will evaluate the identified claim or lawsuit and recommend measures to be incorporated in remedial training for relevant employees. Risk Management will establish an on-line toolbox for use in this procedure; Risk Management and the CAO will work with the operating department to support the process.
- With respect to incurred claims greater than \$100,000 where no mitigative measures and/or changes to operating protocol are indicated, Risk Management will document its analysis. With respect to incurred lawsuit losses greater than \$500,000, the CAO will communicate its analysis in writing to Risk Management.

Risk Management Annual Report

- In the Annual Report of the J/C Subfund to the City Council, Risk Management and the CAO will report on mitigative measures taken to reduce the occurrence of similar preventable losses for claim payments greater than \$100,000 and lawsuit payments greater than \$500,000.
- RMD will also work with the City Council to more clearly define the roles, responsibility and authority of the City's Risk Management Director to enhance his or her ability to control the cost of claims by effective loss control techniques, and to require operating departments to designate a RMC who will be responsible for



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working with the Risk Management Division and the CAO to reduce preventable losses.

