

Commission for a New Georgia Risk Management Task Force

**Final Report
July 2007**

Task Force Members

Dr. Larry D. Gaunt
Professor Emeritus-Risk Management
Georgia State University

Mr. David A. Paulk
Director of Risk Management
Association of County Commissioners of Georgia

Mr. J. Gary Meggs
Director Risk Management
Southern Company Services, Inc.

Mr. Art Kirchoffer
Executive Director-Risk Management
AT&T (Bell South)

Table of Contents

	<u>Page</u>
1. Executive Summary	3
2. Introduction	5
3. Findings	7
4. Recommendations and Implementation Actions	9
1) Organizational Structure and Personnel	9
2) Cost Allocation	12
3) Performance Measurement	13
4) Loss Control	15
5) Actuarial	17
6) Claim Litigation Management	18

Executive Summary

The task force was charged by the Governor's Commission for a New Georgia with reviewing the operations of the Risk Management Services (RMS) Division of the Department of Administrative Services (DOAS), report our findings and make recommendations.

Objective

The State of Georgia, Risk Management Services Division was compared to public and private organizations of similar size and scope of operations. What is considered "best practices" today by professional risk managers was the basis for comparison and the task force's recommendations.

Activities

The task force reviewed internal documents prepared by RMS, reviewed budget documents and actuarial reports, submitted questions to RMS, held meetings with RMS and DOAS staff and interviewed personnel at state agencies. The task force also met frequently with the staff of the Commission receiving considerable support and direction.

Recommendations

Six major recommendations are presented to the Commission for implementation.

- Reorganize the RMS Division with fewer, higher level, professional managers supported by technically qualified staff.
- Revise the cost allocation system to create a more responsive, equitable and incentive based method of funding.
- Create a comprehensive set of performance measures that are meaningful and accurate as a management tool.
- Create the position of loss control manager within the RMS Division.

- Expand the understanding and use of actuarial analysis by RMS.
- Examine the inter-agency process of managing claims in litigation.

Introduction

Task Force Charge

The task force was charged by the Governor's Commission with reviewing the operations of the Risk Management Services (RMS) Division of the Department of Administrative Services (DOAS), reporting our findings and making recommendations. The objective of the Commission of promoting efficiency, reducing costs, and providing superior service was the focus of the task force in reviewing the RMS Division.

Size and Scope of Risk Management Services

Programs

With a budget of \$138 million (FY 07), RMS is responsible for managing the following programs.

1. A Workers' Compensation program covering state employees,
2. A liability program covering the states obligations under the Georgia Tort Claims Act, as well as general liability, automobile and professional liability,
3. A property insurance program covering buildings, contents, vehicles, equipment, aircraft and watercraft,
4. An indemnity program providing a financial benefit to certain classes of employees disabled or killed in the line of duty and
5. An unemployment compensation program for claims of terminated state employees.

Exposures to Loss

Workers' Compensation	129,000 Covered Workers
General Liability	129,000 Workers, plus many volunteers
Auto Liability	22,000 Vehicles
Property	\$ 20 Billion in property values

Number of Claims per Year (average)

Workers' Compensation	9400
General Liability	1600
Auto Liability	1700
Property	<u>400</u>
Total	13,100

Budgetary Requirements

Claim Payments During Fiscal Year (estimated)	\$105 million
RMS Budget-Fiscal Year	\$138 million

The RMS Division is responsible for managing five programs as outlined above, with the three largest programs resulting in over 13,000 claims per year. The size of the State's exposure to loss, number of claims and budgetary demands are indicative of the magnitude and importance of the responsibilities placed on RMS. The size and scope of this program is comparable to the risk management and insurance programs of the very largest corporations in the U.S.

Guiding Principles

The State of Georgia Risk Management Services Division was compared to public and private organizations of similar size and scope of operations. What is considered "best practices" today by professional risk managers was the basis for comparison.

The goal is a Division that is professionally managed and efficient in providing risk management services to the agencies of state government it serves, at the lowest reasonable cost and aligned with "best practices" in the public and private sectors.

Task Force Activities

The task force reviewed internal documents prepared by RMS, reviewed budget documents, reviewed actuarial reports, submitted questions to RMS, held meetings with RMS and DOAS staff, and interviewed personnel at state agencies. The task force also met frequently with the staff of the Commission, receiving considerable and welcome support and direction.

Findings

The findings are, of necessity, somewhat general in nature as the task force did not engage in an in-depth review of the Division. Also, the task force did not specifically address the two smaller indemnity and unemployment programs of the Division.

The task force study found the following conditions and needs around which recommendations are framed.

Organizational Structure and Personnel

Overall, the RMS Division needs professionally educated, trained, and experienced personnel to manage the large, complex, changing, and increasingly technical risk management and insurance programs of state government.

DOAS needs to begin immediately the process of succession planning for a Director of the RMS Division.

The Division needs an experienced claim manager to oversee all claim operations, with a small number of specialists (e.g. workers' compensation and liability) reporting to the claim manager.

The Division needs a professionally qualified, experienced loss control manager to provide leadership for the state agencies in their loss control activities.

The Division needs a technically trained person in the Division to assume the role of risk financing manager. This person would coordinate insurance purchasing, manage cost allocation methods, work with the actuarial reports which estimate claim liabilities, as well as other risk financing activities.

The Division needs an information technology staff person to oversee the increasing information technology needs of the Division.

Cost Allocation

RMS lacks an equitable, responsive, and incentive-based cost allocation system for distributing the cost of claims arising from state operations, insurance costs, and administrative overhead to the state agencies.

Performance Measurement

The Division lacks performance measures that are accurate, consistent, and meaningful. Many of the metrics in the Division's scorecard are not meaningful and do not give an accurate picture of results. Overall, there is a need to make loss data and statistics routinely available to the state's agencies for management purposes.

Loss Control

There is no centralized, state-wide coordination and support of loss control activities of the state agencies. An experienced, professionally qualified staff person located in RMS is needed to provide leadership, direction, and a source of expertise in loss control.

There is no or little use of the extensive claim data base to support loss control efforts by the agencies of state government.

There is no meaningful use of the cost allocation system to encourage loss control activities.

Actuarial Analysis

The state obtains actuarial evaluations of its workers' compensation and liability programs from outside actuarial consultants. It is not apparent that the actuarial analysis in these reports is being used by RMS to the extent desirable. The Division needs to obtain training for a staff person in the understanding and use of actuarial reports.

Recommendations and Implementation Actions

The following recommendations and implementation actions are offered with the objective of promoting efficiency, reducing costs, and providing superior service in the management of risk for the State of Georgia. The observations are offered in the spirit of the mission of the Commission for a New Georgia. All of the recommendations are aligned with “best practices” in risk management in the public and private sectors. The implementation actions are steps in carrying out the recommendations.

Organizational Structure and Personnel

We were asked by the Commission to specifically consider the reporting relationship of RMS within the DOAS. We found that it is common in other states for risk management to be located in a department such as DOAS. A small number of states have risk management reporting to the finance or treasury function. In contrast, in the private sector, the most common reporting relationship is to the chief financial officer. This relationship is very desirable because of the importance of risk financing in risk management and the authority and influence of the CFO in the organization. We also believe that RMS would be more successful in fulfilling its goals if it were elevated to a position that would be more visible to agency heads and had more influence over risk financing cost allocation. However, it appears that the management of DOAS is very supportive of a new direction for a RMS Division with enhanced capabilities.

If the RMS Division within DOAS is to change significantly it will require an assessment of the organizational structure and personnel of the Division. The risk management organizational model that has proven to be successful in both the public and private sectors is one with professional personnel and support staff, while outsourcing a number of staff functions in order to achieve efficiency, productivity and economy. The result should be a smaller, more professional, higher level, management oriented division supported by capable technical personnel.

To achieve this model it will be necessary to redefine several positions and to add at least two new positions, including a claim manager and a loss control manager, while reducing the overall size of the Division.

As outlined above, the State has over 13,000 claims and pays out on average \$100 million dollars per year on claims. The latest actuarial evaluation estimates the state has outstanding claim liabilities on claims incurred but not yet paid of \$ 476 million dollars. An organization with that volume of claims and payments should have a senior level claims manager on staff. This position would oversee all aspects of claim management.

There is a need for a senior level loss control manager located within RMS. The potential benefits of this new position to the State are very significant and will be discussed in more detail below.

A technically skilled, risk financing manager is needed to manage the insurance and self-insurance programs, cost allocation, performance measurement and actuarial evaluations. If a current employee assumes this position additional training will be necessary.

The positions identified above require capable people who will be in demand and have other employment opportunities. If the RMS Division is to achieve its potential, it must be able to offer competitive salaries to attract and retain key professional employees. The qualifications of the top level management employees of the Division should be comparable to the qualifications of the risk management employees found in a Fortune 100 company. The task force believes this investment will result in savings for the state.

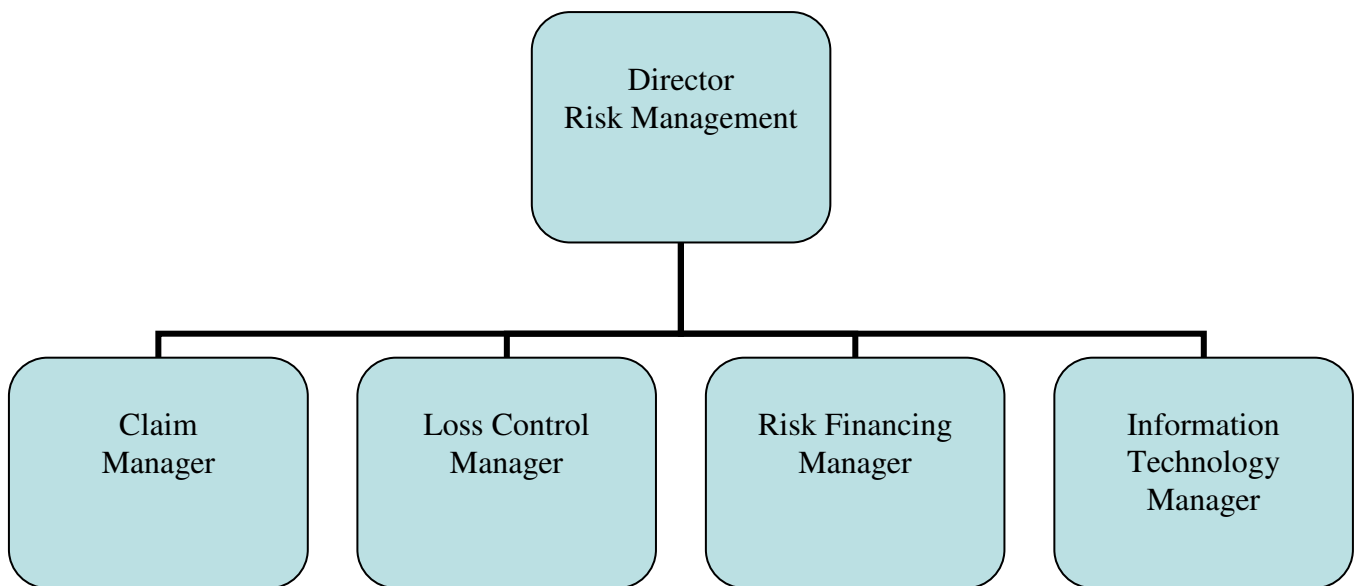
Implementation

- DOAS should begin now the search process for a risk manager to head the RMS Division. The candidates should have educational and experience credentials commensurate with the significant responsibilities of this position. A college degree in business administration with a major in risk management or finance is preferable. An MBA degree and professional risk management designations would be a plus. Risk management experience in the private or public sector should be a requirement.
- RMS and DOAS should begin the search for a senior level claim manager with significant experience managing a large workers' compensation and liability claim operation.

- RMS and DOAS should begin the search for a senior level loss control manager. This individual should have professional loss control credentials, work injury and liability control experience, and be capable of working closely with loss control personnel in the state agencies.
- RMS and DOAS should begin the search internally or externally for a technically trained person to assume the role of risk financing manager. This person would coordinate insurance purchasing, administer cost allocation methods, work with the actuaries estimates of claim liabilities, and develop performance metrics among other duties.
- RMS and DOAS should begin to evaluate the future information technology needs of the Division to support the new direction for the Division. Once the needs are understood, a search should be initiated, internally or externally, for a risk management information technology manager. The individual needs to be experienced with risk management and claim information systems and know how to use data bases to meet the information needs of the state agencies.

The resulting organization chart for the Division would look like this at the management level.

Risk Management Services Division



Cost Allocation

Allocating the cost of risk to operating units is always a challenge. The goal of an allocation system is to equitably and fairly distribute loss costs to the units from which the costs arise. More importantly, accountability creates a strong incentive for those units to control loss costs.

The method used now to distribute loss costs and expenses to state agencies does not create strong incentives, nor does it distribute those costs equitably among state agencies. The current cost allocation formulas are dated and in need of substantial revision.

The costs charged to operating units should be based on the risk of loss (e.g. police officers and prison guards are at higher risk of work injury than clerical workers) and the amount of exposure (e.g. the number of workers or payrolls). The resulting costs should then be adjusted up or down based on the credibility-weighted loss experience record of the individual agency. Further incentives can be built in through the use of deductibles and credits for meeting loss control performance standards.

To the extent that the current allocations are not risk and exposure based, cross subsidization of state agencies creates the unintended consequences of providing disincentives to control costs, as well as hiding a segment of the real cost of operating the agency.

In measuring loss costs, having the right cost figures is very important. For example, in tracking loss costs, if amounts paid during an accounting period are used rather than the total anticipated cost of losses incurred (e.g. including reserves for unpaid obligations on those losses) during that accounting period, significant distortions in the cost of losses occur. These cost estimates are contained in the actuarial report.

From the perspective of state government, it is only necessary to fund in any accounting period the amount of obligation estimated to be paid during that period plus a safety margin for errors in the estimates. However, in determining the fair share proportion of that amount to allocate to individual units of state government, it is desirable to recognize the anticipated full cost of those losses incurred in a specific accounting period.

Our recommendation is that an actuarial and financial analysis of the current cost allocation formula be conducted in an effort to create a more equitable and responsive cost allocation system. Once a new formula is adopted, a technically trained person to administer the system would be very useful.

Implementation

- RMS and DOAS, with the help and cooperation of other state agencies sharing responsibility for budget allocations, should create a small task force of outside actuarial and insurance experts to advise the state in developing a new and meaningful cost allocation system. The Division's current plans to adjust the current cost allocation system will not solve the problems of equity and incentives outlined above.

Performance Measurement

While the risk management division has developed some performance measures, additional emphasis needs to be placed in this area.

The claim data base provides or can provide detail on the nature of losses occurring in state agencies. Our research indicates that few metrics or benchmarks regarding losses based on claim data are being provided to the agencies from RMS.

Performance measurements should be the backbone of an efficient and effective management system. Performance metrics focus on important statistics that measure program results. They should be accurate, consistent, and meaningful. The goal is for RMS and state agencies to be able to evaluate important characteristics of their risk management programs. The resulting statistics should encompass all risk management areas including exposure analysis, loss frequency and severity, insurance costs, loss control, cost allocations, and others. Achieving this goal requires a robust information system, selection of appropriate metrics, and the ability to generate timely reports.

These measures have the potential to become one of RMS's most effective communication tools by creating greater understanding and involvement in risk management by the various state agencies.

Below is a simple example for workers' compensation:

For each fiscal year:

1. Number of claims incurred (including an estimate of those incurred but not reported)
2. Claim frequency per 100 employees
3. Dollar amount of losses incurred (amounts paid plus case reserves and actuarial reserves)
4. Average claim severity (3/1)

Item one shows the number of claims occurring by year and the trend. Item two indicates whether the number has actually increased relative to the amount of exposure (number of employees). Item three shows, for the claims that have occurred that year, the total estimated cost of those claims. Item four shows the estimated average cost of each claim, which indicates cost trends. When comparing these items across fiscal years trends can be examined. All of the above information should be available from the actuarial report.

These statistics could be shown for each of the state agencies and for the state in the aggregate. Unfavorable changes in these numbers will focus attention on the reasons for the change and possible solutions. It will also alert the agency that if their losses have increased it is likely that their risk financing costs will also increase. If they have a favorable trend, their costs should be lower. Trends may indicate the need for loss control initiatives, or show the favorable result of these activities.

We recommend that series of performance measures be developed that are accurate, consistent, and meaningful. Many of the metrics in the Division's scorecard are not meaningful and do not give an accurate picture of results. The Division needs to place more emphasis on making data and statistics available to the state agencies.

Implementation

- Form a small group of outside actuarial and insurance experts to advise the Division in creating a set of performance measures that will be used to evaluate program results and trends.

Loss Control

A key objective of a successful risk management program is loss prevention and loss reduction. The greatest cost reductions for the State are possible, as in the private sector, by controlling losses through effective loss control programs.

Each state agency manages loss control independently. The operating units of state government have the primary responsibility for preventing and controlling losses. In that the operating units have different levels of exposure and in many cases unique loss control needs, it is appropriate that they provide the first line of responsibility for loss control. This however, leads to no coordination or cooperation in sharing information among state agencies or their subdivisions (e.g. units of the University System), except on an add hoc basis. The claim data base provides, or can provide, detail on the nature of losses occurring in state agencies. Our interviews with several state agencies indicate that basic data on losses is generally not available from RMS. This means that few metrics or benchmarks based on claim data are being provided to the agencies.

While loss control is primarily the responsibility of the individual operating units, important efficiencies can be achieved if this activity is provided direction, leadership and coordination at the state level. It is also likely that certain loss control services may be provided at a lower cost on a centralized basis. Significant opportunities exist for the risk management division in coordinating this critical function.

We view the role of RMS in loss control as follows:

- Serve as an educational resource to state agencies,

- Create a scorecard that would effectively communicate to the agencies important metrics regarding their exposures and loss experience,
- Create benchmarks for the agencies and divisions within agencies to compare their loss control programs results with other similar programs,
- Create awareness by communicating best practices and
- Provide loss control services, primarily through outsourcing, where it is more efficient to do this on a coordinated, centralized basis, such as the recently initiated property inspection and driver safety awareness programs.

A program, as outlined above, requires a high level, experienced, management oriented loss control professional to direct the program. An organization the size of the state government of Georgia has a great opportunity through loss control for cost savings, governmental efficiency, and a highly visible demonstration of professionalism by state government.

The key, however, to loss control success is integrating loss control more fully into the risk financing program. The current risk financing and budget allocation system is not designed to promote and create responsive incentives for preventing and reducing losses, as discussed previously. Operating units with higher risk and loss producing activities should bear a more equitable proportion of loss costs, and those units with lower risk and loss costs should have lower risk financing allocations. When an incentive-based cost allocation system is implemented, loss control becomes even more important as operating units will now be more highly motivated to control losses. In turn, RMS can be responsive to the operating units' desire to control losses through the variety of services identified above.

One model of the above approach is the successful effort by the Association of County Commissioners of Georgia in providing loss control leadership and services to county governments.

Implementation

- Hire an experienced, professionally qualified loss control person to manage the loss control activities in RMS. This person would report to the Director of the RMS Division.
- Charge this person with the responsibility to carry out the recommendations outlined above.

Actuarial

The state obtains actuarial evaluations of its workers' compensation and liability programs from outside actuarial consultants. Actuarial reports serve several purposes. One use is to project for the Office of Planning and Budget the resources that will be needed in the aggregate in order to make estimated claim payments during the upcoming fiscal year. Additionally, the report estimates the total unfunded liability of the workers' compensation and liability programs.

RMS also has an important need for the actuarial analysis in these reports, as indicated above, in developing input to cost allocation formulas. This need is similar to the actuarial needs of an insurer in establishing rates or self-insurers in funding losses. Furthermore, the report is necessary in developing meaningful performance measures as previously described. Other uses of these reports include analysis of claim payments, reserving, and claim management trends.

It is not apparent that the report is being used by RMS to the extent desirable. This is partially due to the confusing nature and complexity of the reports and also due to the lack of expertise in the Division in this area.

We recommend that RMS develop the expertise to not only use the reports as indicated above, but to also have greater involvement in making sure the reports are designed to serve the specific analytical needs of the Division. Additionally, a technically trained RMS staff person is needed to enhance the Division's use of these reports.

Implementation

- Secure training for a RMS staff person in the construction and use of actuarial reports.
- Meet with the actuaries and require that their reports focus on the needs of the RMS Division and that each report delivered is followed with an explanatory meeting with the staff of RMS.

Claim Litigation Management

The Director of RMS provided the task force with the Division's view of the present process of managing litigated claims and the Division's concerns about the efficiency and cost of this process. The Director provided the following information.

“In Georgia, the Attorney General's Office (AG) is responsible for handling the lawsuits for the agencies. RMS manages the claims, through an outsourced vendor, and works with the agencies and the AG's attorneys on the liability cases. Although RMS is responsible for paying all settlements/jury awards and expenses associated with a litigated claim, RMS generally has limited control over the assignment and management of an attorney on a litigated claim, and the legal expenses associated with it, due to the constitutional duty and authority of the State's Attorney General to represent the State of Georgia and its agencies in courts of law. Georgia has one of the highest, if not the highest, Tort limits in the country. . This is different from private industry and is different among states in the public sector. In regards to litigation, in the insurance industry an insurance company's Claims Department directs, manages and controls the attorney's assigned to claims in litigation.”

The management of litigated claims is essential in controlling the cost of these more severe claims. While we did not specifically study this issue, when we compared, in general, the litigation costs of RMS claims with those of a private organization, the State's costs seemed high.

While there may be no easy solution to this inter-agency situation, it appears that this is an issue that should be addressed at the appropriate level of state government. We certainly endorse the private sector approach of

having more control in risk management over claim litigation and settlement management, as this is a significant source of cost.

Implementation

- The Commissioner of DOAS should meet with the Attorney General and the Governor's representative to discuss possible adjustments to the present litigation management process in an effort to reduce litigation costs.